



City of Palo Alto City Council Staff Report

(ID # 5006)

Report Type: Consent Calendar

Meeting Date: 9/15/2014

Summary Title: MuniGas Natural Gas Purchase Agreement

Title: Finance Committee Recommendation that the City Council Adopt a Resolution Authorizing the City's Participation in a Natural Gas Purchase from Municipal Gas Acquisition and Supply Corporation for the City's Entire Retail Load, an Amount Estimated to be Approximately \$150 Million over Ten Years, Waiving the City's Choice of Law and Venue Requirements, and Authorizing the City Manager to Execute all Associated Agreements Required to Effect the Natural Gas Purchase

From: City Manager

Lead Department: Utilities

Recommendation

Staff, the Utilities Advisory Commission (UAC), and the Finance Committee recommend that the City Council adopt a resolution:

1. Authorizing the City's participation in a natural gas purchase from Municipal Gas Acquisition and Supply Corporation (MuniGas) for the City's entire load, an amount estimated to be approximately \$150 million over ten years;
2. Waiving the choice of law and venue requirements of Section 2.30.340(c) of Palo Alto's Municipal Code, to permit the City to enter into the purchase transaction with MuniGas under Texas law; and
3. Authorizing the City Manager to execute all associated agreements required to affect the natural gas purchase.

Executive Summary

Gas prepay transactions are a mechanism for municipal utilities to utilize their tax-exempt status to achieve a discount on the market price of gas. Staff has evaluated many options for prepay participation over the years and has concluded that the MuniGas transaction is the best fit for the organization. If approved, the City would participate in a gas prepay transaction by purchasing gas from MuniGas at a discounted price, and taking delivery of the gas from one of the City's existing suppliers that also participates in the MuniGas program. Taking advantage of this low-risk opportunity will reduce the City's gas commodity cost by about \$1 million per year and save retail gas customers about 7.5% on their monthly gas commodity bill.

Background

The most recent Gas Utility Long-term Plan (GULP) was approved by City Council in April 2012 (Staff Report 2552, Resolution 9244). The plan covers a wide-range of areas, including the change from purchasing gas up to three years in advance, to purchasing gas on the market and passing those costs directly to customers via a rate based on the monthly market index price. GULP's "Supply Cost Management" objective is to "lower delivered gas cost over the long term". The associated GULP strategy is to "take advantage of the City's low cost of capital to acquire gas supply and assets".

Discussion

Gas prepay transactions offer the only opportunity for CPAU to reduce gas commodity costs significantly below market. This is an opportunity that is not available to PG&E. The MuniGas program is a very low risk way to take advantage of the City's tax-exempt status to achieve a discount on the commodity cost for all CPAU gas rate payers and meet the Council-approved GULP objectives. Staff feels that the significant economic and commercial advantages of entering into a MuniGas purchase outweigh the relatively low risks associated with accepting most of MuniGas' contractual provisions. The 'index less discount' price structure is well matched with CPAU's market index-based pass-through gas commodity rate.

The discount for participating in the MuniGas transaction is estimated to be 30 cents per million British thermal units (MMBtu). Table 1 shows the impact of a 30 cents per MMBtu (equivalent to 3 cents per therm) discount on residential customer bills.

Table 1: Residential Natural Gas Bill Impact with Estimated MuniGas Discount

Gas Usage (therms/month)	Current Monthly bill *	Monthly bill with a discount of 3¢/therm	Decreased monthly bill with a discount of 3¢/therm	
			\$/month	%
10	\$18.27	\$17.97	\$0.30	1.6%
18 (summer median)	\$24.99	\$24.45	\$0.54	2.2%
25	\$33.44	\$32.69	\$0.75	2.2%
30	\$35.06	\$34.16	\$0.90	2.6%
54 (winter median)	\$55.20	\$53.58	\$1.62	2.9%
100	\$114.42	\$111.42	\$3.00	2.6%

* Assumes gas commodity cost of 40 ¢/therm

Because this opportunity is only available to tax-exempt entities, investor-owned utilities like PG&E are unable to participate. The discount on natural gas commodity helps to narrow the gap between PG&E's rates and Palo Alto's rates. For example, Palo Alto's current residential rates are approximately 9 percent higher than PG&E's, and participation in the MuniGas transaction will reduce that difference by approximately 2 percent.

Details of the proposed MuniGas transaction, including a discussion of the risks of the transaction, can be found in the report presented to the Finance Committee (Staff Report 4832), which is also provided as Attachment G to this report.

Commission Review and Recommendation

The UAC reviewed the recommended action at its June 4, 2014 meeting. The UAC discussed the merits of reducing the cost of gas compared to that of PG&E. Staff clarified that, in the worst-case scenario of the prepay deal terminating, Palo Alto would be back to the status quo of purchasing gas on the market without the MuniGas discount.

After discussion, the UAC voted unanimously (4-0, with Commissioners Chang, Foster and Hall absent) to recommend that Council approve the recommended action. The draft minutes from the UAC's June 4, 2014 meeting are provided as Attachment H.

The Finance Committee considered the recommended action at its August 5, 2014 meeting and voted unanimously (4-0) to recommend that Council approve the recommended action. The draft minutes from the Finance Committee's August 5, 2014 meeting are provided as Attachment I.

Resource Impact

The total gas commodity budget is approximately \$15 million per year (based on a gas price of \$4.50 per MMBtu), and staff anticipates a discount of \$0.30 per MMBtu resulting in a savings of approximately \$1 million per year. The discount will be passed through to retail gas customers. Staff time to administer the contract is anticipated to be negligible.

Policy Implications

Adoption of the proposed resolution supports the objectives and strategies identified in the Council-approved GULP and the Council-approved Utilities Strategic Plan's strategic objective to reduce the cost of delivering service.

Environmental Review

Execution of the attached contracts does not require review under the California Environmental Quality Act (CEQA) since the proposed action does not meet the definition of a project under Public Resources Code Section 21065. In the alternative, execution of the attached contracts is exempt from CEQA pursuant to Section 15061(b)(3) of the CEQA Guidelines because it can be seen with certainty that there is no possibility of significant environmental effects occurring as a result.

Attachments:

- Attachment A: Resolution - MuniGas Prepay Transaction 5-19-14 (PDF)
- Attachment B: Secretarial Certificate MuniGas Prepay Transaction(PDF)
- Attachment C: Joint Gas Purchase Contract (PDF)
- Attachment D: Purchase Contract (PDF)
- Attachment E: Supplier Addendum (Non-Texas Non-BPEC) Clean (PDF)
- Attachment F: Participant Addendum (PDF)
- Attachment G: Final Staff Report ID 4832_MuniGas Natural Gas Purchase Agreement without attachments (PDF)
- Attachment H: Excerpted Final UAC Minutes of June 4, 2014 meeting (PDF)
- Attachment I: Excerpted Draft FC Minutes of August 5, 2014 (PDF)

ATTACHMENT A

Not Yet Approved

Resolution No. _____

Resolution of the Council of the City of Palo Alto Authorizing the City's Participation in a Future Natural Gas Purchase from Municipal Gas Acquisition and Supply Corporation for the City's Entire Retail Load, an Amount Estimated to be Approximately \$150 Million over Ten Years, Waiving the City's Choice of Law and Venue Requirements, and Authorizing the City Manager to Execute all Associated Agreements Required to Effect the Natural Gas Purchase

RECITALS

A. The City of La Grange (the "*Sponsor*") and its instrumentality, the Municipal Gas Acquisition and Supply Corporation ("*MuniGas*"), have offered to sell natural gas to one or more municipalities pursuant to a joint purchasing program at prices substantially below prevailing market prices.

B. Joint gas purchasing programs, or gas prepay transactions, are a mechanism for municipal utilities to utilize their tax-exempt status to achieve a discount on the market price of gas. Staff recommends that the City participate in a gas prepay transaction by purchasing gas from MuniGas at a discounted price, and taking delivery of the gas from one of the City's existing suppliers that also participates in the MuniGas program.

C. The City of Palo Alto (the "*City*") desires to purchase gas via the gas prepay transaction on such terms to reduce the cost of gas commodity supplies, for the benefit of Palo Alto Gas Utility customers.

D. The City currently purchases its gas requirements from JP Morgan Ventures Energy Corporation, Shell Energy North America, L.P., ConocoPhillips Company, BP Energy Company, and Powerex Corporation (the "*Suppliers*") and desires to amend three to five of those agreements to enable the City to purchase gas pursuant to such program.

E. On June 4, 2014, the Utilities Advisory Commission voted _____ to recommend that City Council approve the City's participation in a natural gas purchase from Municipal Gas Acquisition and Supply Corporation for the City's entire retail load, an amount estimated to be approximately \$150 million over ten years, waive the City's choice of law and venue requirements, and authorize the City Manager to execute all associated agreements required to effect the natural gas purchase.

F. On June 17, 2014, the Finance Committee voted _____ to recommend that City Council approve the City's participation in a natural gas purchase from Municipal Gas Acquisition and Supply Corporation for the City's entire retail load, an amount estimated to be approximately \$150 million over ten years, waive the City's choice of law and venue requirements, and authorize the City Manager to execute all associated agreements required to effect the natural gas purchase.

The Council of the City of Palo Alto RESOLVES as follows:

Not Yet Approved

SECTION 1. The Council authorizes the City's participation in a natural gas purchase from Municipal Gas Acquisition and Supply Corporation for the City's entire load, amount estimated to be approximately \$150 million over ten years.

SECTION 2. The terms of the Purchase Contract with the Sponsor and MuniGas, a Participant Addendum with MuniGas and BP Energy Company, and a Supplier Addendum with the Supplier and BP Energy Company, each attached to this Resolution as Exhibits A, B and C, are hereby approved as presented.

SECTION 3. The City Manager of Palo Alto is authorized to execute and deliver such Purchase Contract and Supplier Addendum, making any such changes not affecting the essential terms of the Purchase Contract and Supplier Addendum as the Council may approve, on behalf of the City.

SECTION 4. The Sponsor is authorized to purchase gas on behalf of the City solely in accordance with the terms of such Purchase Contract and Supplier Addendum, as required to deliver gas in the amounts and on the terms to be purchased by the City under such Purchase Contract from and after its execution.

SECTION 5. The Council hereby waives the choice of law and venue requirements of Section 2.30.340(c) of Palo Alto's Municipal Code, to permit the City to purchase gas via the terms of the Purchase Contract with the Sponsor and MuniGas, and the Supplier Addendum with the Supplier and BP Energy Company, under Texas law.

SECTION 6. The City Manager of the City is authorized to take any and all action required to observe and perform the obligations of the City under such Purchase Contract and Supplier Addendum from and after its execution.

SECTION 7. The Council's approval of a gas purchase from MuniGas, including Council's approval of all related documents required to affect the Gas Prepay Transaction, does not meet the definition of a project, pursuant to section 21065 of the California Environmental

Not Yet Approved

Quality Act (CEQA). In the alternative, Council's authorization of a gas purchase from MuniGas is exempt from CEQA pursuant to Section 15061(b)(3) of the CEQA Guidelines because it can be seen with certainty that there is no possibility of significant environmental effects occurring as a result.

INTRODUCED AND PASSED:

AYES:

NOES:

ABSENT:

ABSTENTIONS:

ATTEST:

City Clerk

Mayor

APPROVED AS TO FORM:

APPROVED:

Senior Deputy City Attorney

City Manager

Director of Utilities

Director of Administrative Services

Attachments:

- A. Purchase Contract
- B. Participant Addendum
- C. Supplier Addendum

ATTACHMENT B

CERTIFICATE OF BUYER

I, the undersigned City Manager of the City of Palo Alto, California (the "City"), acting in my official capacity, do hereby certify as follows:

1. This Certificate is given in connection with the execution and delivery by the City of a Purchase Contract (the "*Purchase Contract*") with the Municipal Gas Acquisition and Supply Corporation ("*MuniGas*") and the City of La Grange, Texas (the "*Sponsor*"), by which the City became a party to the Joint Gas Purchase Contract, dated as of _____ among MuniGas, the Sponsor, and other local governments that become parties thereto.

2. Execution and delivery of the Purchase Contract by the City has been duly authorized by resolution (the "*Resolution*") adopted at a meeting of the City Council of the City held on September 15, 2014 (Staff Report _____). A true and correct copy of the Resolution is attached hereto. The Resolution was duly introduced and adopted at such meeting, such meeting was duly called and held, and notice of such meeting and of the proposed action on the Resolution was duly given, in accordance with applicable law; and such action has been recorded in the minutes of such meeting.

3. The Purchase Contract has been authorized, executed, and delivered in accordance with all legal requirements established by any charter or ordinance of the City.

4. The Purchase Contract was duly executed on behalf of the City by the following person, who at the time of such execution held the office within the City specified opposite such person's name below, and the signature appearing opposite such person's name below is the true and genuine signature of such person:

<u>Name</u>	<u>Signature</u>	<u>Office</u>
James Keene	_____	City Manager

5. The Resolutions has not been repealed or amended.

SIGNED and SEALED this ____ day of _____, 20__

.....
James Keene, City Manager

The person whose name is subscribed to the foregoing Certificate is the duly appointed and incumbent City Manager of the City, and the signature subscribed above is such person's true and genuine signature.

.....
Donna Grider, City Clerk

APPROVED AS TO FORM

.....
Amy Bartell, Sr. Deputy City Attorney

ATTACHMENT C

**TEXAS MUNICIPAL GAS CORPORATION II
“TMGC II”**

and

**CITY OF LA GRANGE, TEXAS
as “Agent”**

and

**TEXAS LOCAL GOVERNMENTS DESCRIBED HEREIN,
as “Buyers”**

JOINT GAS PURCHASE CONTRACT

Dated as of January 1, 2006

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JOINT GAS PURCHASE CONTRACT

THIS JOINT GAS PURCHASE CONTRACT (herein referred to as this "**Agreement**"), dated as of January 1, 2006, among Texas Municipal Gas Corporation II (herein, together with successors and assigns permitted hereby, referred to as "**TMGC II**"), a public facility corporation created with the approval of the City of La Grange, Texas, under the Texas Public Facility Corporation Act, chapter 303, Texas Local Government Code, as amended (herein referred to as the "**Enabling Act**"), the City of La Grange, Texas (herein, together with assigns permitted hereby, referred to as the "**Agent**"), and each "local government", as defined in the Texas Interlocal Cooperation Act, chapter 791, Texas Government Code, as amended (herein referred to as the "**Interlocal Act**"), and state "agency", as defined in Section 771.002, Texas Government Code, which has hereafter assumed the rights and obligations of a Buyer hereunder and whose rights and obligations hereunder have not terminated as herein provided (each herein referred to as a "**Buyer**"), including Texas Municipal Gas Corporation (herein referred to as "**TMGC I**"),

WITNESSETH:

WHEREAS, the Agent and one or more Buyers have previously contracted with TMGC I to purchase gas for the purposes described herein; TMGC I has not acquired sufficient production interests to supply the Buyers' gas requirements in full; and the Agent approved the incorporation of TMGC II to carry on the municipal joint gas purchasing program initiated by TMGC I on more efficient and flexible terms;

WHEREAS, TMGC II plans to acquire interests in certain mineral leases, overriding royalties, and/or production payments covering proved developed producing gas reserves or enter into gas supply contracts and desires to sell to the Agent all gas produced or saved from wells drilled on the property subject and attributable to such interests or acquired under such contracts, so that such gas may be devoted to public use in the gas or electric utility enterprises of (or otherwise consumed, used, or exchanged for the benefit of) the Buyers, and TMGC II is authorized to do so by the Enabling Act; and

WHEREAS, the Agent desires to purchase such gas on behalf of the Buyers and to resell such gas to the Buyers, and the Buyers desire to purchase such gas, on the terms described herein for such uses, which they consider to be necessary, useful, or appropriate for such purposes, in order to realize savings in the cost of gas and/or electric energy, and the Agent and the Buyers are authorized to do so by the Interlocal Act, the Texas Public Property Finance Act, chapter 271, subchapter A, Texas Local Government Code, as amended, section 271.102, Texas Local Government Code, as amended, and, in the case of Buyers which are home-rule municipalities, section 402.002(c), Texas Local Government Code, as amended;

NOW, THEREFORE, for and in consideration of the premises and the mutual covenants hereinafter contained, and subject to the conditions herein set forth, the parties hereto covenant, agree, and bind themselves as follows:

ARTICLE ONE

DEFINITIONS AND OTHER PROVISIONS OF GENERAL APPLICATION

SECTION 1.01. *Definitions.*

For all purposes of this Agreement, *except* as otherwise expressly provided and *unless* the context otherwise requires:

A. The terms defined in this Article have the meanings assigned to them in this Article, the terms defined in the Base Provisions have the meanings assigned to them in the Base Provisions (unless inconsistent with this Article), and all terms include the plural as well as the singular.

B. All references in this instrument to designated “*Articles*”, “*Sections*”, “*Exhibits*”, and other provisions are to the designated Articles, Sections, Exhibits, and other provisions of this instrument as originally executed.

C. The words “*herein*”, “*hereof*”, and “*hereunder*” and other words of similar import refer to this Agreement as a whole and not any particular Article, Section, Exhibit, or other subdivision.

D. Unless otherwise provided herein, all accounting terms have the meanings assigned to them, and all computations herein provided for shall be made, in accordance with generally accepted accounting principles.

E. References herein to “*generally accepted accounting principles*” refer to such principles as they exist on the date of applicability thereof.

“*Agent*” has the meaning stated in the first paragraph of this Agreement.

“*Agreement*” means this Joint Gas Purchase Contract (including the exhibits hereto) together with all Buyer Purchase Contracts, as originally executed or as they may from time to time be amended, supplemented, or modified by one or more instruments supplemental thereto entered into pursuant to the applicable provisions thereof.

“*Available for delivery*” has the meaning stated in *Section 6.03*.

“*Balancer*” means a party to a Balancing Agreement other than TMGC II or a Buyer.

“*Balancing Agreement*” means an agreement between TMGC II and any other Person pursuant to which such Person has agreed to accept Gas from TMGC II at a Displacement Point in each month in quantities available for delivery by TMGC II at such Displacement Point and to deliver Gas to TMGC II at the Buyer’s Delivery Point in each Month in quantities equal to such Buyer’s confirmed nominations for delivery in such Month, all on terms and conditions and subject to limitations therein provided, as originally executed or as amended, supplemented, or modified from time to time. A Balancing Agreement is in effect in respect of a Buyer if it provides for delivery of Gas to TMGC II at such Buyer’s Delivery Point.

“*Base Provisions*” means the General Terms and Conditions attached hereto as *Exhibit A*.

“*Bonds*” means all bonds or other obligations of TMGC II or any Related Supplier authenticated and delivered under or secured by an Indenture to finance the acquisition of Production Rights or the development or rehabilitation of properties subject or facilities related thereto or related costs (or to refinance Bonds or finance or refinance other obligations associated with or arising out of Production Rights or Bonds), *provided* that, in the case of obligations of a Related Supplier, TMGC has contracted to purchase all Gas attributable to such Related Supplier’s interest in such Production Rights.

“*Buyer*” has the meaning stated in the first paragraph of this Agreement, including TMGC I after it has assumed the rights and obligations of a Buyer hereunder and before such rights and obligations have terminated as herein provided.

“*Charter Buyer*” means each of the following which has executed a Purchase Contract with a term of 15 years or more within 180 days after the date of this Agreement, but only for so long as such Buyer remains a Requirements Buyer:

City of Brady
City of Brenham
City of Carrizo Springs
City of Columbus
City of Del Rio
City of Denver City
City of Dumas
City of Lubbock

City of Pearsall
City of Perryton
City of Robstown
City of Spearman
City of Sunray
City of Tomball
City of Woodville

“**Code**” when used with respect to any issue of Bonds means the Internal Revenue Code of 1986, as amended and in force and effect on the date of issue thereof.

“**Conditional Buyer**” means a Buyer specified as such in its Purchase Contract. (A Conditional Buyer is not a Requirements Buyer and is obligated to buy Gas from TMGC II only on the conditions described in *Clause (3) of Section 6.01B*.)

“**Contract Year**” means each 12-Month period beginning with the first Day to begin in January.

“**Day**” means a period of 24 consecutive hours beginning at 9:00 a.m., Central Time.

“**Delivery Point**” for the Gas to be sold and delivered to any Buyer means each place where such Gas is to be sold and delivered by TMGC II to the Agent and again by the Agent to such Buyer hereunder. Each Buyer’s Delivery Points shall be as specified in its Purchase Contract or determined pursuant to *Section 5.02*.

“**Discount**” means the percentage of each Buyer’s Gross Price or the absolute amount, in either case determined by TMGC II from time to time pursuant to *Section 5.04*, to be subtracted from each Buyer’s Gross Price to determine the price to be paid by such Buyer for Gas sold and delivered to it hereunder. Each change in the Discount shall become effective on the first Day of the Month following the Month in which it is determined and announced, unless otherwise determined by TMGC II.

“**Displacement Point**” means a location where Gas is required to be transferred and delivered by TMGC II to a Balancer pursuant to a Balancing Agreement, to an Exchanger pursuant to an Exchange Agreement, or to the Agent pursuant hereto for resale to a Buyer in respect of which no Balancing Agreement or Exchange Agreement is in effect.

“**Effective Date**” of any Buyer’s Purchase Contract and rights and obligations hereunder means the date specified as such in its Purchase Contract.

“**Enabling Act**” has the meaning stated in the first paragraph of this Agreement.

“**Exchanger**” means a party to an Exchange Agreement other than TMGC II.

“**Exchange Agreement**” means an agreement (other than a Balancing Agreement) between TMGC II and any other Person pursuant to which such Person has agreed to accept Gas from TMGC II at a Displacement Point in each Month and to deliver Gas with equivalent value to TMGC II at a Buyer’s Delivery Point in such Month, all on terms and conditions and subject to limitations therein provided, as originally executed or as amended, supplemented, or modified from time to time. An Exchange Agreement is in effect in respect of a Buyer if it provides for delivery of Gas to TMGC II at such Buyer’s Delivery Point.

“**Exempt Bonds**” means Bonds the interest on which was stated to be exempt from gross income for federal income tax purposes when such Bonds were issued.

“**Exempt Gas**” means Gas derived (directly or by exchange) from Production Rights the acquisition, exploration, development, or improvement of which was financed or refinanced by outstanding Exempt Bonds.

“**Exempt Gas Buyer**” means a Buyer specified as such in its Purchase Contract or that has otherwise agreed to accept Exempt Gas and to observe the obligations of Exempt Gas Buyers under *Article Ten* (to the extent of Exempt Gas accepted by such Buyer).

“**Expenses**” means all amounts paid by or for the account of TMGC II in respect of its financing, acquisition, ownership, development, operation, maintenance, sale, or delivery of Production Rights or Gas or other minerals attributable to TMGC II’s interest therein, whether or not current expenses under generally accepted accounting principles, *except* amounts paid from proceeds of borrowings, *but including* without limitation (1) principal of (and premium, if any) and interest on obligations issued or incurred to finance any such amount or to acquire Production Rights, including the Bonds, or to refund any other such obligation, (2) labor, material, and other costs of developing, rehabilitating, reworking, or replacing wells, gathering lines, separators, processing plants, storage facilities, and other property used in the production, storage, processing, and transportation of minerals produced or saved from wells drilled on property subject to Production Rights, and premiums for and other costs of policies of casualty, hazard, and liability insurance elected to be maintained by TMGC II in respect of such property, (3) storage, processing, exchange, balancing, and transportation expense, including costs incurred to purchase Gas, (4) amounts paid by TMGC II pursuant to any commodity price or interest rate exchange agreement, or any other hedging agreement, entered into by TMGC II in order to provide assurance that proceeds from the sale of Gas, separated liquids, and extracted components hereunder will be sufficient to pay when due the principal of (and premium, if any) and interest on the Bonds and other obligations of TMGC II incurred under or secured by an Indenture, including costs of terminating any such agreement, (5) financing costs such as fees and expenses of any trustee, paying agent, registrar, tender agent, authenticating agent, credit enhancer, liquidity provider, rate-setting agent, or remarketing agent with respect to the Bonds, (6) allocable general and direct administrative costs, including legal and accounting fees, taxes, costs of program management, marketing, Gas dispatching and trading, billing, and collecting, and premiums for and other costs of policies of general liability, business interruption, or other insurance elected to be maintained by TMGC II, and (7) payments to TMGC I, any Related Supplier, or any other corporation created for substantially the same purposes as one or more of the purposes of TMGC II and sponsored and controlled by the Agent or TMGC II, *provided* that such payments do not exceed amounts contributed to TMGC II by the payee or have been found by the board of directors of TMGC II to be in the best interests of the Buyers.

“**Gas**” means the effluent vapor stream, in its natural state, produced from wells, including all hydrocarbon and non-hydrocarbon constituents and casinghead gas produced with crude oil and residue gas resulting from the processing of gas well gas or casinghead gas.

“**Gas Supply Contract**” means a written agreement entered into by TMGC II to purchase Gas for the purpose of satisfying its obligations hereunder and identified as such by written notice to the applicable Trustee.

“**Gross Price**” for any Buyer has the meaning specified in such Buyer’s Purchase Contract.

“**Historical Service Area**” has the meaning stated in *Section 10.03*.

“**Indenture**” means any indenture and deed of trust and/or security agreement entered into between TMGC II or a Related Supplier and a Trustee to provide for the issuance of Bonds to finance the purchase of Production Rights or the development or rehabilitation of the property subject thereto or to refinance Bonds or other obligations associated with or arising out of Bonds or Production Rights, as such instrument is originally executed or as it may from time to time be amended, supplemented, or modified by one or more supplemental indentures or other instruments supplemental thereto entered into pursuant to the applicable provisions thereof.

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“Interlocal Act” has the meaning stated in the first paragraph of this Agreement.

“Lease” means any written instrument conveying to TMGC II or a Related Supplier an undivided or divided right to drill for, produce, and dispose of one or more minerals (including Gas) in, under, and from specified lands, acquired (or the rights to Gas produced therefrom has been acquired) by TMGC II for the purpose of obtaining Gas with which to satisfy its obligations hereunder, and identified as such by written notice to the applicable Trustee.

“Local Government” has the meaning assigned to such term in the Interlocal Act.

“Long-Term Buyer” means a Buyer which has a Maximum Annual Quantity (or, if none, estimated annual Requirements) of at least the amount specified below for at least the number of Contract years specified opposite such Maximum Annual Quantity below, beginning with the current Contract Year:

<u>Maximum Annual Quantity/ Requirements</u>	<u>Minimum Contract Years</u>
20,000,000 MMBtus and above	2 yrs
10,000,000-19,999,999 MMBtus	4 yrs
3,000,000-9,999,999 MMBtus	5 yrs
Less than 2,999,999 MMBtus	10 yrs

“Maximum Annual Quantity” for any Buyer means the amount of Gas, including Transporter’s Fuel, if any, which such Buyer shall nominate for purchase hereunder in any Contract Year (up to its Requirements) in accordance with and subject to the conditions of *Section 6.01B*. Each Buyer’s Maximum Annual Quantity shall be as specified in its Purchase Contract or adjusted pursuant to *Section 5.06* or *11.03* for each Contract Year that does not end in a leap year and shall be 366/365ths of such specified or adjusted quantity for each Contract Year that ends in a leap year. If the Effective Date of any Buyer’s Purchase Contract occurs, or such Purchase Contract is terminated, during a Contract Year, then such Buyer’s Maximum Annual Quantity for such Contract Year shall be as specified in such Purchase Contract or, if not specified therein, shall be reduced to the same proportion of the stated Maximum Annual Quantity as the number of days of such Purchase Contract’s term in such Contract Year bears to the number of days in such Contract Year.

“Nominated Quantity” of any Buyer for any Day means the amount of Gas which TMGC II schedules for sale and delivery to such Buyer at such Buyer’s Delivery Points on such Day pursuant to *Article Six*.

“Operator” means any Person engaged by TMGC II or a Related Supplier to operate facilities used to produce Gas under a Lease.

“Operations Agreement” means an agreement between an Operator and TMGC II or a Related Supplier providing for operation by such Operator of the facilities used to produce Gas under a Lease.

“Opinion of Counsel” means a written opinion of counsel who may (*except* as otherwise expressly provided in this Agreement) be counsel for TMGC II, a Related Supplier, the Agent, or any Buyer and, when given with respect to the status of interest on any Bond under federal income tax law, shall mean counsel of nationally recognized standing in the field of municipal bond law acceptable to TMGC II.

“Person” means any individual, corporation, partnership, joint venture, association, joint-stock company, trust, limited liability company, unincorporated organization, or government or any agency or political subdivision thereof.

“Prior Agreement” means the Joint Gas Purchase Contract dated as of April 1, 1998, among TMGC I, the Agent, and the Local Governments described therein, together with all “Purchase Contracts,” as

therein defined, as originally executed or as they may from time to time be amended, supplemented, or modified pursuant to the applicable provisions thereof.

“Production Right” means a Lease, a Royalty, or a Gas Supply Contract.

“Purchase Contract” of a Buyer means a written agreement, substantially in the form set forth in *Exhibit B*, duly completed, executed, and delivered among such Buyer, TMGC II, and the Agent, by which such Buyer assumes the obligations and becomes entitled to the rights and privileges of a Buyer hereunder, as originally executed or as amended, supplemented, or modified from time to time in accordance with this Agreement.

“Regulations” when used with respect to the Exempt Bonds of any series means the temporary or final Income Tax Regulations applicable to the Bonds of such series issued pursuant to Sections 141 through 150 of the Code or section 103 of the Internal Revenue Code of 1954. Any reference to a Section of the Regulations shall also refer to any successor provision to such Section hereafter promulgated by the Internal Revenue Service pursuant to Sections 141 through 150 of the Code and applicable to the Exempt Bonds of the related series.

“Related Supplier” means any corporation (other than TMGC II) that is a party to a Gas Supply Contract and a majority of the directors of which may be appointed or removed by the Agent or the board of directors of TMGC II.

“Requirements” for Gas by any Buyer during any period means the excess, if any, of (1) the total of all Gas consumed, exchanged, or otherwise used by such Buyer in generating or acquiring electricity distributed or used by such Buyer or other Local Governments, or sold by such Buyer in its gas utility system or enterprise, or (if specified in such Buyer’s Purchase Contract) consumed by such Buyer in its public facilities, during such period within the areas permitted by *Section 10.03*, if applicable, whether greater than, equal to, or less than such Buyer’s Maximum Annual Quantity, over (2) the total of all Gas, if any, sold by the Agent to such Buyer in such period pursuant to the Prior Agreement.

“Requirements Buyer” means a Buyer specified as such in its Purchase Contract. (A Requirements Buyer is obligated to purchase its Gas Requirements from TMGC II, up to the Maximum Annual Quantity, if any, specified in such Buyer’s Purchase Contract, to the extent of Gas available for delivery by TMGC II but without further condition.)

“Revenues” means all amounts received by or for the account of TMGC II in respect of its financing, acquisition, ownership, operation, maintenance, sale, or delivery of Production Rights, the property subject thereto, minerals produced or saved from wells drilled on such property and attributable to TMGC II’s interest therein, or other Gas delivered to TMGC II thereunder, *except* proceeds of borrowings, *but including* without limitation (1) all amounts received from or for the account of the Agent for Gas, separated liquids, and extracted components sold and delivered hereunder (including Gas sold and delivered to Buyers, hydrocarbons separated and sold and components extracted and sold pursuant to *Section 2.05*, and Gas sold pursuant to *Section 3.03* or *3.05*), (2) all amounts received by or for the account of TMGC II pursuant to any commodity price or interest rate exchange agreement, or any other hedging agreement, entered into by TMGC II in order to provide assurance that proceeds from the sale of Gas, separated liquids, and extracted components hereunder will be sufficient to pay when due the principal of (and premium, if any) and interest on the Bonds and other obligations of TMGC II or a Related Supplier incurred under or secured by an Indenture, and (3) income from the investment of such amounts or of amounts held under any Indenture.

“Royalty” means any written instrument (other than a Lease) conveying or assigning to TMGC II an undivided or divided right to one or more minerals (including Gas or one or more component parts thereof including methane) produced or saved from wells now or hereafter drilled on specified lands, acquired (or the rights to Gas produced therefrom has been acquired) by TMGC II for the purpose of acquiring Gas with which to satisfy

its obligations hereunder, and identified as such by written notice to the applicable Trustee, including overriding royalties and production payments.

"Second Priority Buyer" means each of the following which has executed a Purchase Contract with a term of 15 years or more within 180 days after the date of this Agreement, but only for so long as such Buyer remains a Requirements Buyer:

City of Boerne	City of Navasota
City of Dilley	City of Plains
City of Fort Stockton	City of Sundown
City of Greenville	West Texas Municipal Power Agency
City of Gruver	

"Short-Term Buyer" means a Buyer other than a Long-Term Buyer.

"State Agency" means any "agency," as defined in Section 771.002, Texas Government Code, as amended, and any similar agency of a state other than the State of Texas.

"Supplier" means a party to a Supply Contract other than a Buyer.

"Supplier-Exchanger Agreement" means an agreement under which a Buyer's Supplier sells Gas to a Balancer or Exchanger at such Buyer's Delivery Points to enable such Balancer or Exchanger to perform its obligations under the Balancing Agreement or Exchange Agreement in respect of such Buyer.

"Supply Contract" means an agreement between a Buyer and another Person pursuant to which such Person may or shall sell and deliver to such Buyer in each Month at one or more of its Delivery Points all or a portion of such Buyer's nominated requirements of Gas less the quantities of Gas sold and delivered to the Buyer at such Delivery Points pursuant to this Agreement, all on terms and conditions and subject to limitations therein provided.

"TMGC I" has the meaning stated in the recitals to this Agreement.

"TMGC II" has the meaning stated in the first paragraph of this Agreement.

"Transporter's Fuel" means the volume of Gas retained by a Buyer's Transporter, if any, as fuel (for compressor fuel and line loss make-up) for transportation of Gas sold hereunder.

"Trustee" means each commercial bank or trust company appointed by TMGC II or a Related Supplier to act as trustee under an Indenture, until a successor shall have become trustee under such Indenture pursuant to the applicable provisions thereof, and thereafter **"Trustee"** shall mean such successor trustee.

"Withdrawing Buyer" means a Buyer which has elected to phase out its obligation to purchase and receive Gas hereunder pursuant to *Section 11.03*.

SECTION 1.02. Notices, etc.

Any request, authorization, direction, notice, consent, waiver, or other document provided or permitted by this Agreement to be made upon, given or furnished to, or filed with,

A. **TMGC II:** TMGC II by the Agent or any Buyer shall be sufficient for every purpose hereunder if in writing and mailed, first-class postage prepaid, to TMGC II addressed to it in care of

Municipal Energy Resources Corporation, Three Riverway, Suite 1375, Houston, Texas 77056, Attention: Executive Director, or at any other address previously furnished in writing to such Person by TMGC II, or

B. Agent: the Agent by TMGC II or any Buyer shall be sufficient for every purpose hereunder if in writing and mailed, first-class postage prepaid, to the Agent addressed to it at 155 E. Colorado Street, La Grange, Texas 78945, Attention: City Manager, or at any other address previously furnished in writing to such Person by the Agent, or

C. Buyer: any Buyer by TMGC II or the Agent shall be sufficient for every purpose hereunder if in writing and mailed, first-class postage prepaid, to such Buyer addressed to it at the address specified in its Purchase Contract or at any other address previously furnished in writing to such Person by such Buyer,

all subject to *Section 6.06*.

Where this Agreement provides for notice in any manner, such notice may be waived in writing by the Person entitled to receive such notice, either before or after the event, and such waiver shall be the equivalent of such notice.

SECTION 1.03. *Benefits of Agreement; Assignment.*

Nothing in this Agreement, expressed or implied, shall give any benefit or any legal or equitable right, remedy, or claim under this Agreement to any Person, other than the parties hereto and their successors hereunder and, as third party beneficiaries, the Trustees for the benefit of the owners of the obligations secured by the Indentures.

All right, title, and interest of TMGC II in and to this Agreement, including the present and continuing right to bring actions and proceedings hereunder or for the enforcement hereof and to do any and all things which TMGC II is or may become entitled to do hereunder, (1) in respect of Production Rights or Gas Supply Contracts financed by Bonds issued by TMGC II and secured by an Indenture or in respect of Gas derived therefrom may and are intended to be collaterally assigned to the applicable Trustee pursuant to such Indenture and (2) in respect of Gas purchased under any other Gas Supply Contract may and are intended to be collaterally assigned to the Related Supplier counter-party to such Gas Supply Contract. Notwithstanding the foregoing, all rights of TMGC II to enforce, or for damages on account of any breach of, a Buyer's obligations pursuant to *Article Seven* may be assigned to or for the benefit of any Person acting as Balancer or Exchanger under any Balancing Agreement or Exchange Agreement, or any party to a Supplier-Exchanger Agreement, in effect in respect of such Buyer. The Agent and the Buyers hereby consent to such assignments.

SECTION 1.04. *Term.*

This Agreement shall become effective when the Agent, TMGC II, and a Buyer have first executed and delivered a Purchase Contract.

As between TMGC II and the Agent, the term of this Agreement shall extend for a term beginning on the date it becomes effective and ending 40 years from the date hereof. As between TMGC II and the Agent, the term of this Agreement shall be automatically extended by one year on each anniversary of the date hereof unless either such Person has given notice to the other such Person of its election not to extend the term hereof at least 30 days prior to such anniversary date. Notwithstanding the foregoing, this Agreement may be terminated at the option of TMGC II or the Agent upon the later of (1) expiration (without extension) of the term of all Production Rights of TMGC II or (2) if all Production Rights of TMGC II are Leases, the later of (a) the date as of which TMGC II has abandoned all wells drilled on the property subject to the Leases or surrendered, released, or terminated all Leases

pursuant to *Section 2.02* or (b) the date as of which no Gas produced or saved pursuant to the Leases remains in storage available for delivery hereunder.

This Agreement shall terminate and be discharged on the condition described in *Section 2.01*.

The term of each Buyer's Purchase Contract and rights, privileges, and obligations hereunder shall be as specified in *Article Eleven*.

SECTION 1.05. *Amendment of Agreement*

This Agreement may be amended only (1) by written agreement of all affected parties hereto, including the Buyers, or (2) by written agreement of TMGC II and the Agent if such agreement is either (a) applicable only in respect of Production Rights acquired or entered into and Gas produced and saved therefrom or purchased thereunder or exchanged for such Gas, if TMGC II has given notice of such amendment to each Buyer that has not consented to such amendment at least 75 days before the beginning of the Contract Year in which such Production Rights are purchased or entered into or (b) consented to in writing by Buyers of each class described in *Section 6.03A* affected by such amendment aggregating a majority of Maximum Annual Quantities (or, for Buyers with none, Requirements) of such class. If so provided in an Indenture or Gas Supply Contract, this Agreement may not be amended without the consent of the Trustee thereunder.

Any Purchase Contract may be amended by written agreement executed by TMGC II, the Agent, and the applicable Buyer, *provided* that such Purchase Contract, as amended, is consistent with the provisions of this Agreement.

ARTICLE TWO

PRODUCTION OF GAS

SECTION 2.01. *Acquisition of Production Rights.*

TMGC II will use reasonable efforts to acquire Production Rights from time to time which will enable TMGC II to produce or otherwise acquire the Gas scheduled for sale and delivery hereunder on the terms and conditions described herein (provided that such Production Rights may be acquired and financed on terms and at locations expected to enable TMGC II to maintain a positive Discount in respect of all Gas produced or otherwise resulting therefrom and to be sold and delivered by it hereunder), to sell and issue Bonds as and if required to finance such acquisition, and to secure any governmental authorization which may be necessary to commence the receipt and sale of Gas from any well drilled on property subject to the Leases. If no Production Right is acquired within three years after the date of issuance of the initial series of Bonds, then this Agreement will terminate and be of no further force or effect.

SECTION 2.02. *Development of Leased Property.*

It is anticipated that the Leases, if any, will convey to TMGC II rights to produce proved developed producing reserves of Gas (among other possible minerals or hydrocarbons), *i.e.*, reserves recoverable from completion intervals open and producing to market at the time of acquisition, and an interest in the facilities used for such purpose. If, at any time, it is necessary or advisable to improve, repair, or otherwise rework such facilities, to develop such reserves further, to extend any Lease, or to construct or improve facilities for processing or transporting Gas produced under such Lease, TMGC II may, at its election, but shall not be required to, make expenditures for such purposes, and TMGC II or any Related Supplier may issue Bonds or apply funds held under any Indenture to fund such expenditures.

SECTION 2.03. *Pooling.*

TMGC II may pool, combine, or unitize any Lease with other properties and may alter any such pooling, combination, or unit at its election. If it does so, or if the property from which any Royalty is assigned is so pooled, combined, or unitized, then this Agreement shall apply to the Gas resulting from TMGC II's allocated interest in such pool, combination, or unit attributable to such Lease or Royalty rather than to the Gas produced by wells pursuant to such Lease or Royalty.

SECTION 2.04. *Operation of Leased Property.*

TMGC II shall contract with an Operator for operation pursuant to an Operations Agreement of the facilities acquired or developed pursuant to each Lease acquired by TMGC II. If any such Operator resigns or is removed as Operator or becomes insolvent or otherwise incapable of managing such operations, TMGC II will use reasonable efforts to engage a substitute Operator to the extent permitted by the applicable Operations Agreement. Subject to *Section 2.02*, TMGC II shall use reasonable efforts to enforce its rights, and to make elections and give consents, under each such Operations Agreement so as to enable it to offer, in the judgment of its board of directors, the largest aggregate Discount in the sale of Gas to the Buyers hereunder.

SECTION 2.05. *Processing.*

TMGC II shall remove (or cause to be removed) liquid hydrocarbons, including oil and condensate, from the Gas produced pursuant to the Leases or delivered to TMGC II pursuant to the Royalties by means of drips or conventional gas-liquid separators. TMGC II may, in its discretion, process (or cause to be processed) any or all Gas produced under any or all Leases or delivered to TMGC II pursuant to the Royalties and extract or cause to be extracted therefrom ethane, propane, butanes, pentanes, and heavier hydrocarbons (together with so much methane as is necessarily removed or lost in the employment of customary processes for the extraction of all such components). TMGC II shall sell such separated liquid hydrocarbons and extracted components as agent for and for the account and benefit of the Agent in consideration for TMGC II's right to receive the proceeds of such sales pursuant to *Section 4.03B*. TMGC II will not process (or permit to be processed) any such Gas in a manner that would render it incapable of meeting the quality specifications set forth in the Base Provisions.

SECTION 2.06. *Production Projections.*

Upon request of any Buyer made not more than once each Contract Year, TMGC II shall give notice to such Buyer of the amount of Gas reasonably expected by TMGC II to be available for delivery to such Buyer at such Buyer's Delivery Points hereunder in each Month of the ensuing 12-Month period.

SECTION 2.07. *Disposition of Production Rights.*

TMGC II may abandon any well or surrender, release, terminate, or assign any Lease which TMGC II does not deem capable of producing Gas in commercial quantities, *subject* to the provisions of any Indenture. TMGC II may also sell, assign, convey, exchange, or otherwise dispose of Production Rights at any time and from time to time, *subject* to the provisions of any Indenture, *provided* that the board of directors of TMGC II determines, in its sole discretion, that such disposition and the terms thereof are in the best interests of the Buyers.

SECTION 2.08. *Release of TMGC I.*

Each Buyer and Agent releases TMGC I from any and all obligations on its part to comply with Section 2.01 of the Prior Agreement. Upon execution of a Purchase Contract by a Buyer, the Agent, and TMGC II, such Buyer shall give prompt notice to TMGC I of its election to phase out pursuant to Section 16.03 of the Prior Agreement, which election may be revoked only with the written consent of TMGC II.

ARTICLE THREE

RESERVATION AND STORAGE OF PRODUCTION

SECTION 3.01. *Reservation of Production.*

TMGC II will reserve for and sell to the Agent all Gas produced or saved by or for the account of TMGC II from wells now or hereafter drilled on the property subject to the Leases and the Royalties and attributable to TMGC II's interest therein, or purchased and received by TMGC II pursuant to Gas Supply Contracts, *subject* to the terms hereof and *except* as herein otherwise provided.

SECTION 3.02. *Permitted Uses of Gas.*

TMGC II may consume, sell, or otherwise use the following amounts of Gas or portions thereof or extracts therefrom for the following purposes for the account and benefit of the Agent in furtherance of its obligation to deliver Gas hereunder:

A. *Royalties:* all Gas which is contractually required to be delivered to or reserved in favor of Persons other than the Agent and the Buyers under the terms of any Lease or Royalty at the time such Production Right is acquired by TMGC II;

B. *Prior Contracts:* all Gas produced pursuant to any Production Right which is required to be sold or delivered to Persons other than the Agent and the Buyers pursuant to contracts executed prior to the date of acquisition of such Production Right by TMGC II, *provided* that the remaining term of such contract at the time of such acquisition does not exceed one year and TMGC II shall not extend the term of such contract or increase the amount of Gas committed thereunder;

C. *Fuel:* all Gas which TMGC II may require as fuel to further develop the property subject to any Lease or in operation of the facilities used to produce Gas under any Lease or as shall be required as fuel or shall otherwise be lost in any processing of Gas pursuant to *Section 2.05*;

D. *Recycled Gas:* any Gas used, at the election of TMGC II, for cycling, repressuring, and pressure maintenance in connection with the production of Gas pursuant to any Lease, which shall be excluded from the terms hereof until such Gas becomes available for delivery by TMGC II at a Displacement Point hereunder; and

E. *Oil Production:* Gas reasonably necessary for gas-lifting of oil produced from the property subject to any Lease, if used for such purpose at the election of TMGC II, which shall be excluded from the terms hereof until such Gas becomes available for delivery by TMGC II at a Displacement Point hereunder.

SECTION 3.03. *Spot and Other Sales.*

Whenever TMGC II determines that the amount of Gas produced or saved pursuant to the Leases and Royalties and attributable to TMGC II's interest therein or purchased and received by TMGC II pursuant to the Gas Supply Contracts, together with the Gas stored pursuant to *Section 3.04*, is expected to exceed the amount of Gas required to deliver the Requirements (or, if less, Maximum Annual Quantities, if any) of all Buyers hereunder and to honor any prior contractual commitments, TMGC II may sell and deliver such excess Gas for the account and benefit of the Agent to one or more other Local Governments and State Agencies of the State of Texas at prices and on other terms and conditions determined by TMGC II, including (in the case of Exempt Gas) the terms and conditions applicable to Buyers pursuant to *Article Ten*. If TMGC II is unable to sell and deliver any such excess Gas to such Local Governments and State Agencies on such terms after reasonable efforts to do so, TMGC II may

sell and deliver such excess to any other Person or on any other terms for the account and benefit of the Agent, subject to the provisions of any Indenture.

SECTION 3.04. *Storage.*

Whenever the aggregate amount of Gas produced or saved pursuant to the Leases and Royalties and attributable to TMGC II's interest therein, net of liquid hydrocarbons separated and components extracted therefrom pursuant to *Section 2.05*, and purchased and received by TMGC II pursuant to the Gas Supply Contracts exceeds the aggregate Nominated Quantities to be delivered to Buyers hereunder and the Gas sold pursuant to *Section 3.03*, TMGC II may arrange for the storage of such excess Gas pending its delivery through the Agent to Buyers hereunder or sale pursuant to *Section 3.03*.

SECTION 3.05. *Exchange and Balancing Agreements.*

To deliver Gas to any Delivery Point, TMGC II may from time to time enter into one or more agreements with other producers of or dealers in Gas, including Balancing Agreements and Exchange Agreements, under which TMGC II shall transfer and deliver all or any portion of the Gas produced or saved pursuant to a Lease or Royalty (and attributable to TMGC II's interest therein), or purchased and received by TMGC II pursuant to a Gas Supply Contract, to any Person at one or more agreed locations in exchange for such Person's transfer and delivery to TMGC II of Gas of like aggregate value at or near such Delivery Point.

To deliver Gas in desired quantities at various times during each Contract Year, TMGC II may from time to time enter into one or more agreements with other producers of or dealers in Gas, including Balancing Agreements, under which TMGC II shall transfer and deliver all or any portion of the Gas produced or saved pursuant to a Lease or Royalty (and attributable to TMGC II's interest therein), or purchased and received by TMGC II pursuant to a Gas Supply Contract, to any Person in certain quantities and at certain times in such Contract Year in exchange for such Person's transfer and delivery to TMGC II of Gas of like aggregate value, adjusted for applicable carrying charges, if any, at one or more other times during such Contract Year.

If TMGC II enters into any such agreement of either type described in the two preceding paragraphs of this Section, then while such agreement remains in effect the provisions of this Agreement relating to the sale and delivery of Gas to and by the Agent shall apply to the Gas so transferred and delivered to TMGC II under such agreement rather than to the Gas delivered or required to be delivered by TMGC II thereunder.

If a Buyer elects to contract with one or more new Persons for the purchase of its Requirements for Gas in excess of the quantities of Gas sold and delivered to it pursuant to this Agreement, TMGC II and such Buyer shall cooperate with each other to keep the then existing Balancing Agreement or Exchange Agreement in effect for such Buyer on substantially the same terms or such other terms as are acceptable to TMGC II and such Buyer.

SECTION 3.06. *Subordination.*

The Agent and the Buyers hereby acknowledge and agree that they shall have no legal or equitable right, title, or interest in or to any Production Right (or in or to any Gas produced, sold, or delivered thereunder prior to the time such Gas is sold and delivered to such Person hereunder) pursuant to this Agreement or on account of any breach hereof or otherwise, and in order to secure financing of the acquisition of the Production Rights on favorable terms the Agent and the Buyers do hereby release all such right, title, and interest.

All rights, titles, and interests of the Agent and the Buyers hereunder, including, without limitation, all rights, titles, and interests of such Persons in and to the Gas produced or saved pursuant to the Leases and the Royalties and attributable to TMGC II's interest therein, or purchased and received by TMGC II pursuant to the Gas Supply Contracts, are subject and subordinate (and in order to secure financing of the acquisition of the

Production Rights on favorable terms the Agent and each Buyer do hereby subordinate such rights, titles, and interests) to the liens and security interests now or hereafter granted by TMGC II under the Indentures to secure the Bonds and other obligations of TMGC II secured thereby. The Agent and each Buyer shall execute and deliver such instruments as TMGC II may reasonably request from time to time, in recordable form, to evidence such subordination.

ARTICLE FOUR

PURCHASE OF GAS BY AGENT

SECTION 4.01. *Purchase and Sale of Gas Produced.*

TMGC II shall sell to the Agent, and the Agent shall purchase from TMGC II, (1) all Gas produced or saved by or for the account of TMGC II from wells now or hereafter drilled on the property subject to the Leases and the Royalties and attributable to TMGC II's interest therein, and all Gas purchased and received by TMGC II pursuant to the Gas Supply Contracts, *save and except* the Gas excluded pursuant to *Section 3.02* and Gas transferred and delivered by TMGC II pursuant to a Balancing Agreement, an Exchange Agreement, or another agreement described in *Section 3.05*, and (2) all Gas transferred and delivered to TMGC II pursuant to Balancing Agreements, Exchange Agreements, and other agreements described in *Section 3.05*, in each case at the times and respective Delivery Points specified in *Section 4.02*, for the price specified in *Section 4.03*, and upon and subject to the further terms and conditions hereof.

SECTION 4.02. *Delivery.*

All Gas to be sold by the Agent to the Buyers shall be sold and delivered by TMGC II to the Agent at the respective times and Delivery Points at which such Gas is sold and delivered by the Agent to the Buyers. All liquid hydrocarbons separated and components extracted from Gas pursuant to *Section 2.05* and sold for the account and benefit of the Agent, and all Gas sold pursuant to *Section 3.03* for the account and benefit of the Agent, shall be deemed to be sold and delivered by TMGC II to the Agent and resold and delivered by the Agent to the purchasers at the times and places at which such Gas, hydrocarbons, and components are sold and delivered by TMGC II pursuant to such Sections. TMGC II shall use reasonable efforts to arrange for transportation to, or an exchange for Gas at, the respective Delivery Points of all Gas to be sold and delivered by TMGC II to or for the account and benefit of the Agent hereunder.

SECTION 4.03. *Price.*

In consideration for the Gas sold and delivered by TMGC II to or for the account and benefit of the Agent hereunder, the Agent shall pay to TMGC II:

A. *Gas Sold to Buyers:* for all Gas resold and delivered by the Agent to the Buyers, the aggregate prices due and owing from the Buyers to the Agent in consideration for such resales, and

B. *Sold Liquids, Extracts, and Excess:* for all liquid hydrocarbons separated and components extracted from Gas, and sold, pursuant to *Section 2.05*, and all excess Gas sold pursuant to *Section 3.03*, an amount equal to the aggregate consideration for which such hydrocarbons, components, and excess Gas are sold by TMGC II for the account and benefit of the Agent,

in each case as and when such consideration is received by or for the account of the Agent.

In consideration for the services provided by the Agent in approving creation of TMGC II and purchasing, selling, and delivering Gas hereunder, TMGC II shall (1) rebate to the Agent at the end of each Month

during the term of this Agreement, from the aggregate purchase price paid to TMGC II by or for the account of the Agent hereunder, an amount agreed to by TMGC II and the Agent, not to exceed 2¢ per MMBtu of Gas delivered by TMGC II pursuant to Balancing Agreements and Exchange Agreements in respect of each Buyer (or, absent such an agreement in respect of any Buyer, delivered by the Agent to such Buyer hereunder) in the immediately preceding Month, and (2) pay, or cause to be paid, to the Agent from proceeds of each issuance of Bonds an amount agreed to by TMGC II and the Agent, not to exceed 0.1% of the principal amount of such Bonds.

ARTICLE FIVE

SALE OF GAS TO BUYERS

SECTION 5.01. *Purchase and Sale of Gas.*

On each Day during the term of this Agreement, each Buyer shall purchase and receive from the Agent, and the Agent shall sell and deliver to such Buyer, at the place specified in *Section 5.02* and for the price specified in *Section 5.03*, an amount of Gas equal to such Buyer's Nominated Quantity for such Day, as determined pursuant to *Article Six*, upon and subject to the further terms and conditions hereof, including *Article Ten* to the extent applicable. The Agent shall be obligated to sell and deliver Gas to each Buyer solely from and to the extent of Gas sold and delivered by TMGC II to the Agent at the Buyer's Delivery Point.

SECTION 5.02. *Delivery.*

All Gas sold by the Agent to any Buyer hereunder shall be delivered by the Agent to such Buyer at such Buyer's respective Delivery Points.

TMGC II shall employ reasonable efforts to maintain a Balancing Agreement (and, if unable to do so, an Exchange Agreement) in effect for each Buyer, unless otherwise agreed by such Buyer, while such Buyer remains obligated to receive and purchase Gas hereunder. If a Balancing Agreement or Exchange Agreement entered into in respect of a Buyer becomes ineffective for such Buyer (whether because the counterparties to such Buyer's Supply Contracts cease to sell Gas to the applicable Balancer or Exchanger at such Buyer's Delivery Points or for any other reason), then (1) such Buyer's Delivery Points and Gross Price shall cease to be the Delivery Points and Gross Price specified in its Purchase Contract, (2) such Buyer's Delivery Points shall thereafter be the point or points designated by TMGC II at which it may deliver Gas under the last Balancing Agreement or Exchange Agreement in effect for such Buyer, and (3) such Buyer's Gross Price shall thereafter be the price at which Gas delivered by TMGC II at such Delivery Point was valued from time to time for exchanges under such Balancing Agreement or Exchange Agreement.

If TMGC II for any reason shall desire that Gas be sold and delivered to any Buyer at a Delivery Point in addition to or different from the Delivery Point specified in such Buyer's Purchase Contract or previously agreed to pursuant to this Section, TMGC II may propose that such additional or different Delivery Point be added to or substituted for such Buyer's previous Delivery Point by written request to such Buyer. If any Buyer for any reason shall desire that Gas be sold and delivered to such Buyer hereunder at a Delivery Point in addition to or different from the Delivery Point specified in its Purchase Contract or previously agreed to pursuant to this Section, such Buyer may propose that such additional or different Delivery Point be added to or substituted for such Buyer's previous Delivery Point by written request to TMGC II. If the Person receiving any such request agrees to the proposed addition or substitution specified therein, it shall accept such proposal by written notice to the Person making such request, whereupon the proposed new Delivery Point shall be added to or substituted for the respective Buyer's Delivery Point hereunder, as applicable. Neither TMGC II nor any Buyer shall unreasonably withhold its agreement to any request for an additional or substitute Delivery Point hereunder.

SECTION 5.03. *Price.*

In consideration for the Gas sold and delivered by the Agent to each Buyer hereunder during any calendar Month, such Buyer shall pay to or for the account of the Agent, as provided in the Base Provisions, (1) the product of (a) the quantity of Gas sold and delivered by the Agent to such Buyer in such period, measured in MMBtus, and (b) the price per MMBtu determined by (i) if the Discount is expressed as a percentage, multiplying such Buyer's Gross Price for such period by 100% less the Discount in effect for such period, or (ii) if the Discount is expressed as an absolute amount, subtracting the Discount in effect during such period from the Buyer's Gross Price for such period, plus (2) if so required by any Purchase Contract, the amount specified therein to compensate the Agent and TMGC II for transporting such Gas, or Gas exchanged for such Gas, to such Buyer's Delivery Point or for storing the same pending such transportation.

SECTION 5.04. *Determination of Discount.*

TMGC II shall establish and periodically adjust an annual budget of all Revenues expected to be received and all Expenses expected to be paid and, in connection therewith, shall set and from time to time adjust Discounts to be subtracted from each Buyer's Gross Price for purposes of determining the price to be paid by Buyers for Gas sold and delivered to them hereunder.

TMGC II shall set the Discounts at the greatest amount which, if subtracted from all applicable Buyer Gross Prices from and after the effective date of such Discounts, in the sole judgment of TMGC II would nevertheless result in adequate projected Revenue to pay, or to establish any reserves (if required by any Indenture or Gas Supply Contract or considered prudent by TMGC II) for, all anticipated Expenses hereunder and to comply with all Indenture provisions during the remaining expected term hereof. In no event may the Discount be less than 0% or \$0.

In setting Discounts, TMGC II may establish classes of Purchase Contracts hereunder (which may distinguish between Purchase Contracts of different terms, with different Delivery Points, with Gross Prices covering periods of different duration or determined by reference to different locales, being phased-out pursuant to *Section 11.03* beginning in different Contract Years, or having other differences) and may set a different Discount for each such class of Purchase Contracts and for Exempt Gas; *provided* that no class of Purchase Contract shall be established, and no Discount shall be set or adjusted in a manner that is not equally applicable to all Buyers in the same class, unless Buyers with Maximum Annual Quantities (or, for Buyers with none, Requirements) that comprise a majority of the Maximum Annual Quantities (or, for Buyers with none, Requirements) for the current Contract Year applicable to each class of Purchase Contracts consent to such Discount.

Each new Discount shall become effective for Gas sold and delivered in the Month following the Month in which such Discount is set and notice thereof is given to Buyers, unless deferred by TMGC II. Discounts may be suspended as and to the extent required by the provisions of any Indenture or Gas Supply Contract. TMGC II shall give prompt notice of each new Discount and each suspension of Discounts to each affected Buyer.

SECTION 5.05. *Price Rebate.*

It is the intention of the parties that TMGC II administer its program of producing, gathering, processing, storing, selling, transporting, and delivering Gas hereunder without profit on its part and that the price of Gas sold and delivered to Buyers hereunder be the lowest possible price required to pay, or to establish and maintain required or prudent reserves for, Expenses. The parties hereto recognize that, in establishing the Discount applicable to each class of Purchase Contracts from time to time hereunder, TMGC II must provide for reserves to pay Expenses (including costs of Gas payable to Related Suppliers) or to account for reductions in production that cannot be precisely predicted in advance and that, if such Expenses or reductions in production are not realized, TMGC II's reserves may be reduced.

TMGC II shall review its reserves associated with the program established hereunder at least annually. Whenever TMGC II determines that such reserves exceed the amounts which are prudent to maintain for Expenses (including costs of Gas payable to Related Suppliers) thereafter due or to apply to the retirement of Bonds, TMGC II shall declare a surplus and rebate the excess portion of such reserves to all Buyers then a party hereto, subject to the terms of the Indentures and the Gas Supply Contracts. On or before the last day of the term of the last Purchase Contract in effect, after reserving funds to pay all Expenses theretofore incurred, TMGC II shall declare as surplus and rebate to the Buyers then a party hereto all remaining reserves and other funds held by or for the account of TMGC II pursuant to this Agreement or the Indentures, subject to the terms of the Indentures and the Gas Supply Contracts.

Each rebate of excess reserves shall be allocated among Buyers (and former Buyers whose Purchase Contracts have terminated pursuant to *Clause (4) of Section 11.02*) in proportion to the product, for each Buyer or former Buyer, of (1) either (a) 1.0, if such Person is or was a Charter Buyer or has no Maximum Annual Quantity, or (b) otherwise the lesser of 1.0 or a fraction, the numerator of which is equal to such Buyer's Maximum Annual Quantity for the Contract Year in which such rebate is made and the denominator of which is equal to the arithmetic average of such Buyer's Maximum Annual Quantities for such and all prior Contract Years during the term of such Buyer's Purchase Contract and (2) the sum, for all Months from the date of such Buyer's or former Buyer's Purchase Contract through the Month preceding the Month in which such rebate is made, of the product of (a) the quantity of Gas purchased and received by such Buyer pursuant hereto in such Month and (b) the applicable percentage specified below opposite the remaining term of such Buyer's Purchase Contract as of the end of such Month (unless such former Buyer was a Charter Buyer and its Purchase Contract had an initial term of 20 years or more, in which case 100% for the duration of such initial term):

<u>Remaining Term</u>	<u>Percentage</u>
20 yrs or more	100%
At least 15 but less than 20 yrs	85%
At least 10 but less than 15 yrs	65%
At least 5 but less than 10 yrs	40%
At least 2 but less than 5 yrs	20%
At least 1 but less than 2 yrs	10%
Less than 1 yr	0%

SECTION 5.06. *Adjustment of Maximum Annual Quantity.*

Each Buyer may change the Maximum Annual Quantity, if any, of Gas to be nominated by it for purchase and receipt hereunder by an amount and as of the Day specified in a written request made by such Buyer to TMGC II, if such request is consented to in writing by TMGC II in accordance with the Indentures and Gas Supply Contracts. From and after the effective Day of any such request and consent, the Maximum Annual Quantity specified in such request and consent shall be substituted for the Maximum Annual Quantity of the applicable Buyer specified in its Purchase Contract or previously pursuant to this Section, with the consequence specified in *Section 6.03B* in the case of increases.

ARTICLE SIX

NOMINATIONS AND ALLOCATIONS

SECTION 6.01. *Proposed Nominations.*

A. *Annual Forecast.* At least 15 days prior to each Contract Year, each Buyer shall notify TMGC II in writing of the quantities of Gas that such Buyer expects to nominate for purchase from the Agent at such Buyer's Delivery Point in each Month in such Contract Year in accordance with the provisions of this Section.

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If at any time during a Contract Year any Buyer expects so to nominate for purchase from the Agent a materially different quantity of Gas in any succeeding Month than the quantity for such Month specified in the most recent notice given by such Buyer to TMGC II pursuant to this Subsection, such Buyer shall promptly notify TMGC II in writing of the revised quantities of Gas that such Buyer expects to nominate for purchase from the Agent in each succeeding Month in such Contract Year. On request of TMGC II, each Buyer shall notify TMGC II in writing of its estimated Requirements (not to exceed its Maximum Annual Quantities, if any) for each Contract Year during the term of any Production Right proposed to be acquired or entered into or Bonds proposed to be issued by TMGC II.

B. *Monthly Nominations; Annual Totals.* At least seven business days prior to the beginning of each Month each Requirements Buyer shall notify TMGC II of the quantity of Gas that such Buyer proposes to purchase and receive from the Agent at such Buyer's respective Delivery Points in such Month and, in the case of any Buyer with respect to which no Balancing Agreement or Exchange Agreement is in effect, on each Day during such Month. Each Conditional Buyer may from time to time notify TMGC II of the quantity of Gas that such Buyer proposes to purchase and receive from the Agent at such Buyer's respective Delivery Points on any Day or Days. Each Buyer shall so nominate quantities of Gas to be purchased and received from the Agent such that, during each Contract Year, to the extent of Gas available for delivery by TMGC II to the Agent at such Buyer's Delivery Point and *subject to Sections 10.03 and 11.03*, the aggregate amount of Gas nominated for purchase and receipt by such Buyer shall be equal to the least of (1) such Buyer's Requirements for Gas during such Contract Year, (2) such Buyer's Maximum Annual Quantity for such Contract Year, and (3) if, but only if, such Buyer is a Conditional Buyer, the amount of Gas offered for sale (to a Balancer or Exchanger in respect of which a Balancing Agreement or Exchange Agreement is in effect for such Buyer) by Suppliers that are parties to Supplier-Exchanger Agreements with such Balancer or Exchanger, on terms that such Buyer deems at least as favorable, after application of the Discount, associated expenses, and applicable credit policies, as the terms on which Gas is offered to such Buyer by any other Supplier and satisfying any additional conditions in such Buyer's Purchase Contract.

SECTION 6.02. *Deliveries at Index Points.*

Subject to *Section 6.03*, during each Month in each Contract Year during the term of this Agreement, TMGC II shall transfer and deliver at each Displacement Point:

A. *Balanced Deliveries:* to each Balancer pursuant to each Balancing Agreement in respect of each Buyer by which such Balancer has agreed to receive and accept Gas at such Displacement Point, a quantity of Gas such that, if the same proportion of all Gas expected to be available for delivery from TMGC II at such Displacement Point in such Month and each succeeding Month in such Contract Year were transferred and delivered to such Balancer pursuant to such Balancing Agreement and the prices used to determine the future quantities required to balance earlier deliveries thereunder are equal to the prices then projected by TMGC II, TMGC II would be entitled to receive from such Balancer at such Buyer's Delivery Point in such and each such succeeding Month in such Contract Year the respective quantities of Gas nominated pursuant to *Section 6.01B*, or last forecasted to be nominated pursuant to *Section 6.01A*, by such Buyer to be purchased and received by it from the Agent at such Delivery Point, but will not be entitled to receive more than such aggregate quantities of Gas thereunder;

B. *Exchanged Deliveries:* to each Exchanger pursuant to each Exchange Agreement by which the Exchanger has agreed to receive and accept Gas at such Displacement Point and to transfer and delivery Gas to TMGC II at a Buyer's Delivery Point, a quantity of Gas such that TMGC II will be entitled to receive from such Exchanger at such Buyer's Delivery Point in such Month the quantity of Gas nominated by such Buyer pursuant to *Section 6.01B* to be purchased and received by it from the Agent at such Delivery Point in such Month, but will not be entitled to receive more than such quantity of Gas at such Delivery Point thereunder; and

C. *Other Deliveries:* to the Agent for sale and delivery to each Buyer in respect of which TMGC II has not entered into a Balancing Agreement or an Exchange Agreement, the quantity of Gas

nominated by such Buyer pursuant to *Section 6.01B* to be purchased and received from the Agent at such Displacement Point in such Month, including Transporter's Fuel.

SECTION 6.03. *Allocations and Adjustments.*

A. *Allocations.* If the quantity of Gas available for delivery by TMGC II at any Displacement Point in any Month is less than the total quantities of Gas otherwise required to be transferred and delivered by TMGC II at such Displacement Point in such Month pursuant to *Section 6.02*, TMGC II shall transfer and deliver only the following quantities of Gas at such Displacement Point in such Month allocated on account of the following Exempt Gas Buyers, *first*, until all Exempt Gas is allocated, and on account of all Buyers (including Exempt Buyers), *second*, in each case in the following order (and, within each priority, in proportion to the amounts otherwise required to be transferred and delivered on account of each such Buyer pursuant to *Section 6.02*), up to the amounts required to be transferred and delivered on account of each such Buyer pursuant to *Section 6.02*, until the total quantity of Gas allocated by TMGC II at such Displacement Point in such Month is equal to the quantity of Gas available for delivery by TMGC II at such Displacement Point in such Month:

(1) ***TMGC I:*** *first*, TMGC I (if and while a Buyer) to the extent of the lesser of (a) the amount required to enable it to satisfy the requirements of all "Buyers", as therein defined, under the Prior Agreement that have not become such after the date of this Agreement and that have not elected to phase out their obligations thereunder prior to such Month or (b) the amount of Gas produced and saved in such Month from Mineral Interests acquired by TMGC II or any affiliate thereof from TMGC I;

(2) ***Small Charter Buyers:*** *second*, each Charter Buyer (other than a Short-Term Buyer or Withdrawing Buyer) whose Maximum Annual Quantity is less than 1,000,000 MMBtus;

(3) ***Other Charter Buyers:*** *third*, all Charter Buyers other than Short-Term Buyers, Withdrawing Buyers, and Buyers described in *Clause (2)* of this *Subsection A*;

(4) ***Second Priority Buyers:*** *fourth*, all Buyers (other than Short-Term Buyers or Withdrawing Buyers) which are Second Priority Buyers;

(5) ***Small Later Buyers:*** *fifth*, each Requirements Buyer (other than a Charter Buyer, Second Priority Buyer, Short-Term Buyer, or Withdrawing Buyer) whose Maximum Annual Quantity is less than 1,000,000 MMBtus;

(6) ***Later Buyers:*** *sixth*, all Requirements Buyers of each class established by TMGC II (other than Charter Buyers, Second Priority Buyers, Buyers described in *Clause (5)* of this *Subsection A*, Short-Term Buyers, and Withdrawing Buyers), and among such classes of Requirements Buyers in the order in which TMGC II closes admission to such classes, and among Buyers in the same class, first, Buyers with remaining Purchase Contract terms of 15 years or more and, second, other Buyers in reverse order of their remaining Purchase Contract terms (*i.e.*, longest first, shortest last);

(7) ***Conditional Buyers:*** *seventh*, all Conditional Buyers (other than Withdrawing Buyers and Short-Term Buyers) of each class established by TMGC II, and among such classes of such Conditional Buyers in the order in which TMGC II closes admission to such classes;

(8) ***Priority Withdrawing Buyers:*** *eighth*, all Long-Term Buyers that are Withdrawing Buyers and have notified TMGC II in writing of their election to receive priority allocations of Gas for the remaining term of their Purchase Contracts;

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(9) **Short-Term Buyers:** *ninth*, all Short-Term Buyers which are not described in *Clause (10)* of this *Subsection A* of each class established by TMGC II, and among such classes of Short-Term Buyers in the order in which TMGC II closes admission to such classes; and

(10) **Non-Priority Withdrawing Buyers:** *tenth*, all Withdrawing Buyers which have not notified TMGC II in writing of their election to receive priority allocations of Gas for the remaining term of their Purchase Contracts.

B. Treatment of Purchase Contract Amendments. For purposes of this Section, each amendment of a Buyer's Purchase Contract to increase such Buyer's Maximum Annual Quantity shall be treated as the execution as of the date of such amendment of a new Purchase Contract for a Maximum Annual Quantity equal to the amount of such increase.

C. Excess Supply. If the quantity of Gas expected to be available for delivery by TMGC II at any Displacement Point in any Month exceeds the total quantities of Gas otherwise required to be transferred and delivered by TMGC II at such Displacement Point in such Month pursuant to *Section 6.02*, TMGC II (1) shall use reasonable efforts (a) to sell such excess to one or more other Local Governments or State Agencies of the State of Texas that have authorized the Agent to purchase Gas on their behalf pursuant to joint purchasing arrangements and have agreed to use such Gas in accordance with *Article Ten*, if applicable, and/or (b) to exchange such Gas for Gas to be delivered to TMGC II at a later date pursuant to a balancing agreement and (2) may make other spot sales of such excess to one or more other Persons, in each case as described in *Section 3.03* or *3.05* and to the extent permitted by the Indentures and Gas Supply Contracts.

D. "Available for Delivery." As used herein, Gas is "*available for delivery*" by TMGC II (1) at a Displacement Point in any Month if such Gas is produced for the account of or sold and delivered to TMGC II at or near such Displacement Point in such Month and may be transported to such Displacement Point on commercially reasonable terms and (2) at a Buyer's Delivery Points in any Month if, after making all deliveries in such Month required by this Agreement of Gas available for delivery by TMGC II at the Displacement Points in such Month, the Agent is obligated to sell and deliver such Gas to such Buyer at such Displacement Point or TMGC II is entitled to receive such Gas under a Balancing Agreement or Exchange Agreement at such Delivery Points. All determinations of whether Gas is available for delivery by TMGC II at a Displacement Point or a Buyer's Delivery Point shall be made by TMGC II in its discretion and shall be binding on all other parties hereto.

SECTION 6.04. Monthly Nomination Quantities.

During each Day and Month in each Contract Year during the term of this Agreement, TMGC II shall sell and deliver to the Agent, and the Agent shall sell and deliver to each Buyer, at such Buyer's Delivery Points pursuant hereto:

A. Balanced Deliveries: if a Balancing Agreement is in effect in respect of such Buyer, a quantity of Gas equal to (1) the quantity of Gas nominated to be purchased and received by such Buyer in such period pursuant to *Section 6.01B* or (2) the maximum quantity of Gas which TMGC II is entitled to receive at such Buyer's Delivery Point in such period pursuant to such Balancing Agreement, whichever is less;

B. Exchanged Deliveries: if TMGC II has entered into an Exchange Agreement entitling it to receive Gas at such Buyer's Delivery Point, a quantity of Gas equal to the quantity of Gas which TMGC II is entitled to receive at such Delivery Point in such period pursuant to such Exchange Agreement; and

C. Other Deliveries: if TMGC II has not entered into a Balancing Agreement or an Exchange Agreement in respect of such Buyer, the quantity of Gas specified in *Clause C* of *Section 6.02*, as adjusted pursuant to *Section 6.03*.

SECTION 6.05. *Daily Nominations.*

TMGC II shall confirm or reduce daily nominations of Gas to be delivered to it in each Month pursuant to Balancing Agreements and Exchange Agreements, and pursuant hereto to Buyers for whom no Balancing Agreement or Exchange Agreement is in effect, as and to the extent required, in TMGC II's sole judgment, to fill all confirmed nominations of Gas in such Month in an efficient manner without storage or unreasonable transportation charges.

TMGC II shall make sales and deliveries of gas in each Day in each Month to each Buyer in respect of which a Balancing Agreement or an Exchange Agreement exists in accordance with such Buyer's nominations or, if none, in a quantity that bears the same proportion to the total quantity of Gas to be delivered to such Buyer hereunder and under its Supply Agreements on such Day as the quantity of Gas to be delivered to such Buyer hereunder in such Month bears to its total quantity of Gas to be delivered to such Buyer hereunder and under its Supply Contracts in such Month, subject to the provisions of the Balancing Agreement or Exchange Agreement in respect of such Buyer or any related Supplier-Exchanger Agreement.

TMGC II shall notify each Buyer in respect of which no Balancing Agreement is in effect of such Buyer's Nominated Quantity for each Day of each Month, as determined in accordance with this Article, by the nomination deadline of such Buyer's Transporter for Gas transported by it in such Month. Each such Buyer shall notify TMGC II of such Buyer's Transporter and its nomination deadline.

After TMGC II has notified Buyers of their Nominated Quantities for any Day, no Buyer may adjust its Nominated Quantity for such Day except with the prior consent of TMGC II. At the request of any Buyer, however, TMGC II shall use reasonable efforts to sell for Buyer's account, at any available price, any nominated Gas which such Buyer desires not to receive on any Day, and TMGC II and the Agent shall credit against the amount to be paid by the Agent and such Buyer for such Gas any proceeds of such sale received by TMGC II, subject to the requirements of any Indenture or Gas Supply Contract.

SECTION 6.06. *Notices of Proposed and Nominated Quantities.*

Each notice from a Buyer to TMGC II of such Buyer's proposed quantities and each notice from TMGC II to a Buyer of such Buyer's Nominated Quantities (1) shall be given in writing (including by facsimile or internet) or by telephone promptly confirmed in writing, (2) in the case of notices to TMGC II shall be given to any Person engaged by TMGC II to manage the nominations described in this Article at the address or number specified by TMGC II in writing to such Buyer, and (3) shall not be deemed to have been given until receipt by the Person to whom such notice is given or at the place to which notices to such Person are to be addressed.

ARTICLE SEVEN

TERMS AND CONDITIONS OF SALES

SECTION 7.01. *Incorporation by Reference.*

The Base Provisions (including all representations, warranties, and indemnities and the effect of Force Majeure) are incorporated herein by reference and, together with the elections described in this Section, shall apply to and be binding on TMGC II, the Agent, and each Buyer in respect of all sales and deliveries of Gas between such parties hereunder, except to the extent inconsistent herewith.

For each sale of Gas by the Agent to a Buyer (and by TMGC II to the Agent in respect thereof), TMGC II, the Agent, and such Buyer hereby make the same elections under the Base Provisions as those made in the Supply Contract in effect for such Buyer (or, if more than one, in the Supply Contract in respect of which such

Gas was sold to the Balancer pursuant to the applicable Supplier-Exchanger Agreement) or, if none, then the default elections specified in the Base Provisions, except to the extent inconsistent herewith and except that such parties make the following elections under the Base Provisions, which shall supercede such Supply Contract elections:

	<u>Section</u>	<u>Election</u>
1.2	Transaction Procedure	Written
7.2	Payment Date	20 th Day of Month following Month of delivery
7.2	Method of Payment	Wire or automated clearing house (ACH) transfer, unless otherwise agreed by TMGC II
10.3.1	Early Termination Damages	Early Termination Damages do not apply unless elected in the related Supplier-Exchanger Agreement, if any
10.3.2	Other Agreement Set-Off	Other Agreement Set-Offs Do Not Apply
14.5	Choice of Law	Texas

SECTION 7.02. *Special Provisions.*

The following provisions shall apply to and control all sales of Gas by TMGC II and the Agent hereunder, notwithstanding anything in the Base Provisions to the contrary:

A. *Procedures.* The provisions of *Articles Four, Five and Six* of this Agreement shall supercede and replace *Section 1* of the Base Provisions.

B. *Firm or Interruptible.* All sales and purchases of Gas hereunder shall be Firm, unless such Gas is acquired for sale to a Buyer pursuant to an Interruptible transaction agreed to by a Buyer under a related Supplier-Exchanger Agreement, in which case the sales of such Gas to the Agent and the Buyer hereunder shall also be Interruptible.

C. *Alternate Damages; Termination Options.* If Gas sold to the Agent and a Buyer is acquired by TMGC II pursuant to a transaction under a related Supplier-Exchanger Agreement, the terms of which are set forth in a Transaction Confirmation agreed to by such Buyer that specifies Alternate Damages or a Termination Option, then such Alternate Damages and Termination Option shall also apply to the sale of such Gas to the Agent and such Buyer under this Agreement.

D. *Indemnities.* The indemnities given by TMGC II, the Agent, and each Buyer pursuant to *Section 8.3* of the Base Provisions shall be limited to the extent permitted by law.

E. *Financial Responsibility.* *Article Ten* of the Base Provisions shall be applied as if a Buyer's Supplier were guarantor of TMGC II's and the Agent's obligations to sell and deliver Gas to or for the benefit of such Buyer, and sales and deliveries to each Buyer (and to the Agent for such Buyer's account), and of Gas acquired from each related Supplier, shall be treated as made pursuant to a separate Contract, separately terminable. Neither TMGC II nor the Agent nor any Buyer represents that it is a "forward contract merchant" within the meaning of the United States Bankruptcy Code.

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F. Term. This Agreement may not be terminated except as provided in *Section 1.04* and *Article Eleven* of this Agreement, notwithstanding anything in *Section 12* of the Base Provisions to the contrary.

G. Assignments. *Section 14.1* of the Base Provisions is superceded and replaced in its entirety by *Sections 1.03* and *11.04* of this Agreement.

H. Amendments. The last sentence of *Section 14.4* of the Base Provisions is superceded and replaced in its entirety by *Section 1.05* of this Agreement.

I. Third Party Beneficiaries. *Section 14.7* of the Base Provisions is superceded and replaced in its entirety by *Section 1.03* of this Agreement.

J. Alternate Dispute Resolution If the parties to a Supplier-Exchanger Agreement in respect of any Buyer agree to procedures for resolving disputes thereunder, then the same procedures shall apply to the resolution of disputes hereunder in respect of the sale and delivery of all Gas sold and delivered, or agreed to be sold and delivered, thereunder (and proceedings hereunder and thereunder may be consolidated), to the extent permitted by law.

ARTICLE EIGHT

TAXES

SECTION 8.01. *Property and Severance Taxes.*

The parties hereto understand and believe that TMGC II is exempt from the payment of all property taxes imposed by any municipality or political subdivision of the State of Texas on the Leases and Royalties acquired by TMGC II hereunder or the property subject thereto or used in connection therewith and from the payment of all production, severance, gathering, and similar taxes imposed by the State of Texas with respect to all Gas produced thereunder, all pursuant to article VIII, section 1 and article XI, section 9 of the Constitution of Texas and section 303.042 of the Enabling Act. TMGC II shall take and institute all necessary actions to preserve and defend such exemptions. If, as a result of or in settlement of any such action, it shall be determined that any such property, production, severance, or gathering shall not be exempt from tax, TMGC II shall pay all such taxes due and owing against such property or on account of such production, severance, or gathering.

SECTION 8.02. *Sales Taxes.*

The parties hereto understand and believe that all sales of Gas made to the Agent and the Buyers hereunder are exempt from sales, use, and other excise taxes imposed by the United States or the State of Texas or any municipality or political subdivision thereof. Buyers shall provide TMGC II and the Agent with any and all documentation necessary to evidence such Buyers' exemption from such tax. If at any time any such sale becomes subject to the payment of any sales or use tax imposed by any federal, state, or local authority, the Buyers shall pay or reimburse the Agent or TMGC II for all such taxes as shall be due or paid in respect of such sales.

SECTION 8.03. *Recovery of Taxes.*

If any taxes shall be imposed upon TMGC II in respect of its ownership or operation of the Production Rights or property used in connection therewith, TMGC II may recover such taxes by adjustment of the Discount used to determine the price of Gas sold and delivered hereunder pursuant to *Section 5.04*.

ARTICLE NINE

BILLING AND PAYMENT

SECTION 9.01. *Monthly Statements.*

On or before the 5th business day of each Month, TMGC II shall submit a statement to each Buyer showing the quantity of Gas delivered to such Buyer hereunder during the prior Month and invoicing the price for such Gas due from such Buyer to or for the account of the Agent pursuant to the terms of this Agreement. If the actual total quantities are not available by the billing date, TMGC II shall invoice on an estimated basis and adjust for differences from actual totals in the following Month's billing or as soon thereafter as available.

SECTION 9.02. *Early Payment Discounts.*

TMGC II may from time to time maintain a program providing discounts for all invoices paid on or before the date specified in such program, *provided* that such discounts are made available to all Buyers on the same basis. If TMGC II maintains such a program and any Buyer makes payment of the discounted amount on or before the date specified in such program, such discounted payment shall be considered payment of the applicable invoice in full.

SECTION 9.03. *Waiver of Set-Off, Etc.*

In order to induce Persons to purchase the Bonds so as to enable TMGC II to acquire Production Rights for a cost that enables it to sell Gas at the prices described herein, the Agent hereby waives all rights of set-off, recoupment, counterclaim, and abatement against TMGC II, the Related Suppliers, and the Trustees, and the Buyers hereby waive all rights of set-off, recoupment, counterclaim, and abatement against TMGC II, the Related Suppliers, the Trustees, and the Agent, in each case to the fullest extent that they may lawfully agree and notwithstanding any breach by any such Person of any obligation hereunder or under any Indenture or Gas Supply Contract.

SECTION 9.04. *Audits; Financial Information.*

TMGC II shall provide to each Buyer on request a copy of its financial statements and accompanying report of auditors required to be delivered to the Trustees pursuant to the Indentures or Gas Supply Contracts.

TMGC II shall permit each Buyer, or a representative appointed by it, to inspect its financial and other records during regular business hours on reasonable notice.

ARTICLE TEN

BUYERS' USE OF GAS

SECTION 10.01. *General.*

Each Buyer shall use Gas sold and delivered to it hereunder solely for public uses which it considers necessary, useful, or appropriate in connection with the operation of its electric utility system or gas utility system or enterprise or other public facilities or, in the case of TMGC I, for sale to other governmental entities that are or are eligible to become Buyers for such use.

SECTION 10.02. *To Preserve Tax Exemption.*

No Exempt Gas Buyer shall knowingly use or permit the use of Exempt Gas sold and delivered to it hereunder in a manner which (or shall knowingly take or omit to take any other action which, if taken or omitted, respectively) would adversely affect the exclusion of interest on any Exempt Bond from the gross income, as defined in section 61 of the Code, of the owner thereof for federal income tax purposes, or the exemption of the Leases and Royalties and their production from property and severance taxes. Without limiting the generality of the foregoing, each Exempt Gas Buyer shall comply with each specific covenant in this Article at all times prior to the last maturity of Bonds, *unless and until* (1) TMGC II shall have waived compliance with such covenant in writing or (2) such Buyer shall have delivered to TMGC II and each Trustee an Opinion of Counsel to the effect that failure to comply with such covenant, either generally or to the extent described therein, will not adversely affect any exclusion of interest on any Exempt Bond from the gross income, as defined in section 61 of the Code, of the owner thereof for federal income tax purposes or any applicable property or severance tax exemption, and thereafter such covenant shall no longer be binding upon such Buyer to the extent described in such Opinion of Counsel, anything in any other Section of this Article to the contrary notwithstanding. If, due to the promulgation of new or amended Regulations, the issuance of a private letter ruling to TMGC II or a published ruling, or otherwise, TMGC II concludes that compliance with any such covenant is not required to preserve the exclusion of interest on any Exempt Bond from such gross income, TMGC II shall seek an Opinion of Counsel to such effect and, upon receipt of such an opinion, shall so waive compliance with such covenant and shall notify each Exempt Gas Buyer of such waiver.

SECTION 10.03. *Use in Limited Service Area.*

Unless otherwise agreed by TMGC II in writing, each Exempt Gas Buyer agrees to resell Exempt Gas purchased and received by it hereunder in each Contract Year to such Persons, or to burn such Exempt Gas to generate electric energy that will be sold to such Persons, such that all of such Exempt Gas or electric energy will be consumed in a qualified service area or qualified annexed area of such Buyer, or of one or more other Local Governments to which such Buyer has sold such Exempt Gas or electric energy, within the meaning of section 141(d)(3)(B) of the Code. For such purposes, (1) a Buyer's or Local Government's "*qualified service area*" means an area throughout which such Buyer or Local Government provided gas or electric utility service, as applicable, at all times during each 10-year period prior to the date on which TMGC II acquires a Production Right pursuant to which Exempt Gas (or Gas exchanged therefor) sold and delivered to such Buyer is produced or otherwise delivered to TMGC II, and (2) a Buyer's or Local Government's "*qualified annexed area*" means an area (a) that is contiguous to one of such Person's qualified service areas or previously annexed qualified annexed areas and is annexed by such Person for general governmental purposes, (b) within which such Buyer or Local Government makes gas or electric utility service, as applicable, available to all members of the general public, and (c) that does not exceed 10% of the area of the qualified service area to which it is contiguous and all previously annexed qualified annexed areas contiguous thereto, determined as of the end of the calendar year preceding the calendar year in which such area is annexed.

Unless otherwise agreed by TMGC II in writing, each Exempt Gas Buyer shall forecast and nominate Gas for purchase and receipt pursuant to *Section 6.01* such that it may resell or burn its Nominated Quantities of Gas in full in accordance with the provisions of this Section.

SECTION 10.04. *No Private Use or Payments.*

Prior to the last maturity of the Bonds, no Exempt Gas Buyer shall use or permit the use of Exempt Gas sold and delivered to it hereunder directly or indirectly in any private business use, *unless* otherwise agreed by TMGC II in accordance with the applicable provisions of each Indenture and Gas Supply Contract. For these purposes, "*private business use*" means any trade or business carried on by any Person, or any activity of any Person other than a natural person, in each case excluding state and local governments, *unless* (1) such use is merely as a member of the general public, (2) such property is intended to be and is in fact reasonably available for use on

the same basis as natural persons not engaged in a trade or business, (3) no priority rights therein or special benefits therefrom are extended to such Person (other than customary and reasonable differences in rates for different classes of users), or (4) the term of committed use (including renewal options) does not exceed three years.

For purposes of the foregoing covenant, property is considered to be “*used*” by a Person if:

- A. ***Dispositions:*** it is sold or otherwise disposed of, or leased, to such Person;
- B. ***Operation and Management:*** it is operated, managed, or otherwise physically employed, utilized, or consumed by such Person, *excluding* operation or management pursuant to an agreement which meets the guidelines set forth in Revenue Procedure 97-13, including any amendments or revisions thereto or superseding Regulations, or is described in subparagraph (A) through (D) of Section 1.141-3(b)(4)(iii) of the Regulations;
- C. ***Legal Entitlements:*** capacity in or output or service from such property is reserved or committed to such Person under a take-or-pay, output, incentive payment, or similar contract or arrangement or special legal entitlements (e.g., priority rights) to beneficial use of such property are extended to such Person; or
- D. ***Economic Benefit:*** in the case of property not available for use by the general public, such property bestows a special economic benefit on such Person.

SECTION 10.05. *No Private Loan.*

No Exempt Gas Buyer shall use Exempt Gas sold and delivered to it hereunder directly or indirectly to make or finance loans to any Person other than a state or local government. For purposes of the foregoing covenant, Exempt Gas is considered to be “*loaned*” to a Person if (1) it is sold or leased to such Person in a transaction which creates a debt for federal income tax purposes or (2) indirect benefits, or burdens and benefits of ownership, of such Exempt Gas are otherwise transferred in a transaction which is the economic equivalent of a loan.

ARTICLE ELEVEN

BUYERS

SECTION 11.01. *Addition of Buyers.*

Any Local Government or State Agency shall become a party to this Agreement, as a Buyer, when such Local Government or State Agency, TMGC II, and the Agent shall have executed and delivered a Purchase Contract. Upon such execution and delivery, such Local Government or State Agency shall be entitled to all the rights, privileges, and benefits, and shall assume all of the obligations, of a Buyer hereunder, except to the extent provided in such Purchase Contract, effective on the Effective Date specified in such Purchase Contract.

SECTION 11.02. *Term of Purchase Contract.*

The term of each Buyer’s Purchase Contract shall extend from the Effective Date of such Purchase Contract to the earliest of (1) the end of the term specified in such Purchase Contract, as amended by written instrument executed and delivered by TMGC II, the Agent, and such Buyer, (2) the expiration of the term or termination of this Agreement, (3) if such Buyer has elected to phase out such Purchase Contract pursuant to *Section 11.03*, the date as of which TMGC II has surrendered, released, or terminated, or there shall have expired, all Production Rights and Gas Supply Contracts allocable to such Buyer pursuant to such Section or abandoned all

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wells drilled on the property subject to all Leases allocable to such Buyer, if no other Production Rights and no Gas Supply Contracts are so allocable, (4) the date as of which such Buyer shall have disposed of or abandoned substantially all gas distribution and electric generating facilities owned by it, unless either such facilities have been transferred to a Local Government to which such Buyer's Purchase Contract has been assigned pursuant to *Section 11.04* or such Buyer has made arrangements to exchange Gas purchased hereunder for electric energy or such Buyer has agreed to use Gas purchased hereunder for consumption in its other public facilities, or (5) the date as of which such Purchase Contract shall have terminated by written instrument executed and delivered by TMGC II, the Agent, and such Buyer or by TMGC II and the Agent for cause. At such time as the term of any Buyer's Purchase Contract has expired, such Buyer shall no longer be considered a Buyer hereunder or be a party hereto or be obligated, or entitled to any right or privilege, hereunder.

SECTION 11.03. *Phase-Out of Purchase Contracts.*

Any Buyer may elect to phase out its obligation to purchase and receive either Exempt Gas only or all Gas hereunder, by giving notice of such election to TMGC II at least 45 days prior to the effective date of such election, which will have the consequence described in this Section.

If any Buyer gives notice of a phase-out of its obligations hereunder in accordance with this Section, then the amount of Gas or Exempt Gas, as applicable, required to be purchased and received by such Buyer hereunder in each subsequent Contract Year shall not exceed the product of (1) the amount of Gas or Exempt Gas, as applicable, available for delivery at the Displacement Point at which Gas is required to be delivered to such Buyer, or to a Balancer or Exchanger on account of such Buyer, pursuant to *Section 6.02* in such Contract Year and produced or saved for the account of TMGC II pursuant to Production Rights acquired by TMGC II with proceeds of Bonds issued, or purchased or received pursuant to Gas Supply Contracts executed by TMGC II, on or before the 45th day after such notice is given and (2) a fraction, the numerator of which is such Buyer's Maximum Annual Quantity (or, for a Buyer with none, its projected Requirements) in such Contract Year and the denominator of which is the total Maximum Annual Quantity (or, for Buyers with none, projected Requirements) in such Contract Year of all Buyers to whom such Gas is available for delivery at their respective Delivery Points.

For any Day in any Contract Year in which the Gas required to be purchased and received by any Buyer hereunder is limited by the provisions of this Section, the quantity of Gas in such Contract Year to which such Buyer's obligations hereunder are so limited shall be treated as such Buyer's "*Maximum Annual Quantity*" in such Contract Year.

SECTION 11.04. *Assignment by Buyer.*

Each Buyer may assign its Purchase Contract, in whole or in part, to any other Local Government or State Agency of the State of Texas and, in connection therewith, may change the Delivery Points at which Gas sold pursuant to the assigned portion shall be delivered pursuant to *Section 5.02*, with the consent of TMGC II, which consent shall not be unreasonably withheld, *provided* that the Delivery Point for the assigned portion of such Purchase Contract is the Displacement Point to which Gas is required to be delivered by TMGC II to or on account of the assignee or a Balancing Agreement or Exchange Agreement is in effect in respect of the assignee to exchange Gas at such Displacement Point for Gas at the assignee's Delivery Point. If the assignee assumes the obligations of such Buyer pursuant hereto in respect of the assigned portion of such Purchase Contract, then all rights and obligations of such Buyer hereunder in respect of such assigned portion shall transfer to and vest in such assignee, and such Buyer shall no longer be obligated hereunder in respect thereof. If TMGC II and such assignee elect to execute a new Purchase Contract to effect any such assignment, such Purchase Contract shall be deemed to have been executed as of the date of the Purchase Contract being assigned for purposes of *Section 6.03*. At the request of any Buyer, TMGC II shall use reasonable efforts to solicit other Local Governments and State Agencies to accept an assignment of such Buyer's Purchase Contract or any portion thereof.

ARTICLE TWELVE

MISCELLANEOUS

SECTION 12.01. *Limited Obligations of TMGC II, Agent, and Buyers.*

Neither TMGC II nor the Agent nor the Buyers shall be obligated to observe and perform any obligation hereunder except from and to the extent of the property and sources of funds to which such Person's obligations hereunder are limited by this Section, to which all recourse of any other party hereto shall be limited. No provision of this Agreement shall require any party hereto to expend or risk any other funds or incur any other financial liability in the performance of any of its duties hereunder, or in the exercise of any of its rights or powers. Anything in this Agreement to the contrary notwithstanding, the performance by any party hereto of all duties and obligations imposed upon it hereby, the exercise by it of all powers granted to it hereunder, the carrying out of all covenants, agreements, and promises made by it hereunder, and liability of such party for all warranties and other covenants herein shall be limited solely to such property and sources of funds; and no such party shall be required to effectuate any of such duties, obligations, powers, or covenants except from, and to the extent of, such property and sources of funds. Whether or not therein expressly so provided, every provision of this Agreement shall be subject to the provisions of this Section.

The obligations of TMGC II hereunder shall be limited to the property and funds held or pledged, or required to be held or pledged, under the Indentures, including the Production Rights, proceeds of the Bonds, and amounts paid to TMGC II hereunder, and to its rights under the Gas Supply Contracts, including Gas received thereunder. If a Balancing Agreement or Exchange Agreement is in effect in respect of any Buyer, then the obligations of TMGC II and the Agent to sell and deliver Gas acquired or contracted to be acquired for such purpose under any related Supplier-Exchanger Agreement shall be limited to the Gas sold and delivered by the related Supplier and the rights of TMGC II thereunder. TMGC II hereby assigns such rights to the Agent, and the Agent hereby assigns such rights to such Buyer, as security for the performance of their respective obligations hereunder.

The obligations of the Agent hereunder shall be limited to the Gas delivered to it by TMGC II pursuant to *Section 4.01*, the rights assigned to it by TMGC II pursuant to this Section, the proceeds of sale of such Gas to the Buyers pursuant to *Section 5.01*, and such other funds as may be paid to the Agent by any other party hereto to enable it to observe or perform any of its obligations hereunder.

The obligations of the Buyers hereunder shall be limited to the current revenues of their respective electric utility systems and gas utility systems or enterprises, if Gas is purchased by them for such purpose, and otherwise their general current revenue (or, in the case of TMGC I, to the same extent as its obligations under the Prior Agreement) and, in the case of State Agencies, are subject to legislative appropriation. Neither TMGC II nor the Agent shall be obligated to sell and deliver Gas to any State Agency in any fiscal year of the State of Texas with an aggregate purchase price that exceeds funds appropriated for that purpose.

No party hereto or other beneficiary hereof shall have any right to demand payment or performance by any other party hereto out of money raised or to be raised by taxation.

SECTION 12.02. *No Recourse Against Officers, Etc.*

No recourse under or upon any obligation, covenant, or agreement contained in this Agreement, or for any claim based thereon or otherwise in respect thereof, shall be had against any incorporator, or against any past, present, or future director, officer, or employee or member of the governing body, as such, of any party hereto or of any successor, or against any Person with whom any such party has contracted for goods or services, either directly or through such party, whether by virtue of any constitution or statute or rule of law, or by the enforcement of any assessment, judgment, or penalty, or otherwise; it being expressly understood that this Agreement is solely a corporate obligation, and that no such personal liability whatever shall attach to, or is or shall be incurred by, the

incorporators, directors, officers, or employees, as such, of such party or any successor, or any member of its governing body, or any such contracting Person, or any of them, by reason of the obligations, covenants, or agreements contained in this Agreement or implied therefrom, and that any and all such personal liability either at common law or equity or by constitution or statute of, and any and all such rights and claims against, every such incorporator, member, director, officer, employee, or Person, as such, are hereby expressly waived and released as a condition of, and in consideration for, the execution of this Agreement.

SECTION 12.03. *Time of the Essence.*

Time shall be of the essence in the payment or performance of the obligations from time to time imposed upon the parties hereto by this Agreement.

SECTION 12.04. *No Fiduciaries.*

Notwithstanding any provision herein to the contrary, the relationship among all parties hereunder shall be as independent contractors acting as principals, and not as agents, trustees, or fiduciaries for any other party hereto. Each party hereto undertakes to perform such duties, and only such duties, on its part as are specifically set forth in this Agreement, and no implied duties, covenants, or obligations shall be inferred from or read into any provision of this Agreement.

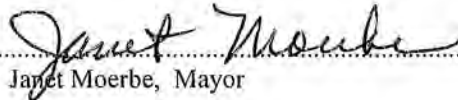
SECTION 12.05. *Independence of TMGC I, TMGC II, Related Suppliers, and Agent.*

The Agent acknowledges that the Buyers, the holders of Bonds issued from time to time, and any Person who insures payment of such Bonds will rely upon (and would be substantially harmed if the Agent does not preserve), and the Agent therefore agrees not to take any action that would interfere with, the independent identities and independent corporate existence of TMGC I, TMGC II, the Related Suppliers, and the Agent so long as TMGC II remains obligated hereby or under an Indenture or Gas Supply Contract. Without limiting the generality of the foregoing, for so long as TMGC II remains obligated hereby or under an Indenture or Gas Supply Contract, the Agent shall not include the assets or liabilities of TMGC II in the financial statements of the Agent; shall not commingle the assets or accounts of TMGC I, TMGC II, the Related Suppliers, and the Agent; shall not refer to TMGC II or its assets or activities as a division, department, or other part of, or as owned by, the Agent, TMGC I, or any Related Supplier; shall not seek to borrow money, issue bonds or other obligations, or otherwise obtain credit on the basis of TMGC II's assets; in the event the Agent shall file a petition under chapter 9 of the United States Bankruptcy Code, shall not request or consent to the consolidation of TMGC I, TMGC II, or any Related Supplier or its assets or liabilities in the case commenced by such petition; shall not commingle the assets or activities of the Agent, TMGC I, or any Related Supplier with those of TMGC II and, in the event the Agent elects to exercise any power granted to it pursuant to Section 303.045 of the Enabling Act, shall do so only in a manner that observes all requisite corporate formalities applicable to TMGC II.

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IN WITNESS WHEREOF, TMGC II and the Agent have duly executed this Agreement as of the day and year first written above and each Buyer has executed its Purchase Contract as of the Effective Date thereof.

CITY OF LA GRANGE, TEXAS

By: 
Janet Moerbe, Mayor

Attest/Countersign:


Lisa Oltmann, City Secretary

TEXAS MUNICIPAL GAS CORPORATION II

By: 
Janet Moerbe, President

Attest:


Harvey Busch, Secretary

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General Terms and Conditions
Base Contract for Sale and Purchase of Natural Gas

SECTION 1. PURPOSE AND PROCEDURES

1.1. These General Terms and Conditions are intended to facilitate purchase and sale transactions of Gas on a Firm or Interruptible basis. "Buyer" refers to the party receiving Gas and "Seller" refers to the party delivering Gas. The entire agreement between the parties shall be the Contract as defined in Section 2.7.

The parties have selected either the "Oral Transaction Procedure" or the "Written Transaction Procedure" as indicated on the Base Contract.

Oral Transaction Procedure:

1.2. The parties will use the following Transaction Confirmation procedure. Any Gas purchase and sale transaction may be effectuated in an EDI transmission or telephone conversation with the offer and acceptance constituting the agreement of the parties. The parties shall be legally bound from the time they so agree to transaction terms and may each rely thereon. Any such transaction shall be considered a "writing" and to have been "signed". Notwithstanding the foregoing sentence, the parties agree that Confirming Party shall, and the other party may, confirm a telephonic transaction by sending the other party a Transaction Confirmation by facsimile, EDI or mutually agreeable electronic means within three Business Days of a transaction covered by this Section 1.2 (Oral Transaction Procedure) provided that the failure to send a Transaction Confirmation shall not invalidate the oral agreement of the parties. Confirming Party adopts its confirming letterhead, or the like, as its signature on any Transaction Confirmation as the identification and authentication of Confirming Party. If the Transaction Confirmation contains any provisions other than those relating to the commercial terms of the transaction (i.e., price, quantity, performance obligation, delivery point, period of delivery and/or transportation conditions), which modify or supplement the Base Contract or General Terms and Conditions of this Contract (e.g., arbitration or additional representations and warranties), such provisions shall not be deemed to be accepted pursuant to Section 1.3 but must be expressly agreed to by both parties; provided that the foregoing shall not invalidate any transaction agreed to by the parties.

Written Transaction Procedure:

1.2. The parties will use the following Transaction Confirmation procedure. Should the parties come to an agreement regarding a Gas purchase and sale transaction for a particular Delivery Period, the Confirming Party shall, and the other party may, record that agreement on a Transaction Confirmation and communicate such Transaction Confirmation by facsimile, EDI or mutually agreeable electronic means, to the other party by the close of the Business Day following the date of agreement. The parties acknowledge that their agreement will not be binding until the exchange of nonconflicting Transaction Confirmations or the passage of the Confirm Deadline without objection from the receiving party, as provided in Section 1.3.

1.3. If a sending party's Transaction Confirmation is materially different from the receiving party's understanding of the agreement referred to in Section 1.2, such receiving party shall notify the sending party via facsimile, EDI or mutually agreeable electronic means by the Confirm Deadline, unless such receiving party has previously sent a Transaction Confirmation to the sending party. The failure of the receiving party to so notify the sending party in writing by the Confirm Deadline constitutes the receiving party's agreement to the terms of the transaction described in the sending party's Transaction Confirmation. If there are any material differences between timely sent Transaction Confirmations governing the same transaction, then neither Transaction Confirmation shall be binding until or unless such differences are resolved including the use of any evidence that clearly resolves the differences in the Transaction Confirmations. In the event of a conflict among the terms of (i) a binding Transaction Confirmation pursuant to Section 1.2, (ii) the oral agreement of the parties which may be evidenced by a recorded conversation, where the parties have selected the Oral Transaction Procedure of the Base Contract, (iii) the Base Contract, and (iv) these General Terms and Conditions, the terms of the documents shall govern in the priority listed in this sentence.

1.4. The parties agree that each party may electronically record all telephone conversations with respect to this Contract between their respective employees, without any special or further notice to the other party. Each party shall obtain any necessary consent of its agents and employees to such recording. Where the parties have selected the Oral Transaction Procedure in Section 1.2 of the Base Contract, the parties agree not to contest the validity or enforceability of telephonic recordings entered into in accordance with the requirements of this Base Contract. However, nothing herein shall be construed as a waiver of any objection to the admissibility of such evidence.

SECTION 2. DEFINITIONS

The terms set forth below shall have the meaning ascribed to them below. Other terms are also defined elsewhere in the Contract and shall have the meanings ascribed to them herein.

- 2.1. "Alternative Damages" shall mean such damages, expressed in dollars or dollars per MMBtu, as the parties shall agree upon in the Transaction Confirmation, in the event either Seller or Buyer fails to perform a Firm obligation to deliver Gas in the case of Seller or to receive Gas in the case of Buyer.
- 2.2. "Base Contract" shall mean a contract executed by the parties that incorporates these General Terms and Conditions by reference; that specifies the agreed selections of provisions contained herein; and that sets forth other information required herein and any Special Provisions and addendum(s) as identified on page one.
- 2.3. "British thermal unit" or "Btu" shall mean the International BTU, which is also called the Btu (IT).
- 2.4. "Business Day" shall mean any day except Saturday, Sunday or Federal Reserve Bank holidays.
- 2.5. "Confirm Deadline" shall mean 5:00 p.m. in the receiving party's time zone on the second Business Day following the Day a Transaction Confirmation is received or, if applicable, on the Business Day agreed to by the parties in the Base Contract; provided, if the Transaction Confirmation is time stamped after 5:00 p.m. in the receiving party's time zone, it shall be deemed received at the opening of the next Business Day.
- 2.6. "Confirming Party" shall mean the party designated in the Base Contract to prepare and forward Transaction Confirmations to the other party.
- 2.7. "Contract" shall mean the legally-binding relationship established by (i) the Base Contract, (ii) any and all binding Transaction Confirmations and (iii) where the parties have selected the Oral Transaction Procedure in Section 1.2 of the Base Contract, any and all transactions that the parties have entered into through an EDI transmission or by telephone, but that have not been confirmed in a binding Transaction Confirmation.
- 2.8. "Contract Price" shall mean the amount expressed in U.S. Dollars per MMBtu to be paid by Buyer to Seller for the purchase of Gas as agreed to by the parties in a transaction.
- 2.9. "Contract Quantity" shall mean the quantity of Gas to be delivered and taken as agreed to by the parties in a transaction.
- 2.10. "Cover Standard", as referred to in Section 3.2, shall mean that if there is an unexcused failure to take or deliver any quantity of Gas pursuant to this Contract, then the performing party shall use commercially reasonable efforts to (i) if Buyer is the performing party, obtain Gas, (or an alternate fuel if elected by Buyer and replacement Gas is not available), or (ii) if Seller is the performing party, sell Gas, in either case, at a price reasonable for the delivery or production area, as applicable, consistent with: the amount of notice provided by the nonperforming party; the immediacy of the Buyer's Gas consumption needs or Seller's Gas sales requirements, as applicable; the quantities involved; and the anticipated length of failure by the nonperforming party.
- 2.11. "Credit Support Obligation(s)" shall mean any obligation(s) to provide or establish credit support for, or on behalf of, a party to this Contract such as an irrevocable standby letter of credit, a margin agreement, a prepayment, a security interest in an asset, a performance bond, guaranty, or other good and sufficient security of a continuing nature.
- 2.12. "Day" shall mean a period of 24 consecutive hours, coextensive with a "day" as defined by the Receiving Transporter in a particular transaction.
- 2.13. "Delivery Period" shall be the period during which deliveries are to be made as agreed to by the parties in a transaction.
- 2.14. "Delivery Point(s)" shall mean such point(s) as are agreed to by the parties in a transaction.
- 2.15. "EDI" shall mean an electronic data interchange pursuant to an agreement entered into by the parties, specifically relating to the communication of Transaction Confirmations under this Contract.
- 2.16. "EFP" shall mean the purchase, sale or exchange of natural Gas as the "physical" side of an exchange for physical transaction involving gas futures contracts. EFP shall incorporate the meaning and remedies of "Firm", provided that a party's excuse for nonperformance of its obligations to deliver or receive Gas will be governed by the rules of the relevant futures exchange regulated under the Commodity Exchange Act.
- 2.17. "Firm" shall mean that either party may interrupt its performance without liability only to the extent that such performance is prevented for reasons of Force Majeure; provided, however, that during Force Majeure interruptions, the party invoking Force Majeure may be responsible for any Imbalance Charges as set forth in Section 4.3 related to its interruption after the nomination is made to the Transporter and until the change in deliveries and/or receipts is confirmed by the Transporter.

- 2.18. "Gas" shall mean any mixture of hydrocarbons and noncombustible gases in a gaseous state consisting primarily of methane.
- 2.19. "Imbalance Charges" shall mean any fees, penalties, costs or charges (in cash or in kind) assessed by a Transporter for failure to satisfy the Transporter's balance and/or nomination requirements.
- 2.20. "Interruptible" shall mean that either party may interrupt its performance at any time for any reason, whether or not caused by an event of Force Majeure, with no liability, except such interrupting party may be responsible for any Imbalance Charges as set forth in Section 4.3 related to its interruption after the nomination is made to the Transporter and until the change in deliveries and/or receipts is confirmed by Transporter.
- 2.21. "MMBtu" shall mean one million British thermal units, which is equivalent to one dekatherm.
- 2.22. "Month" shall mean the period beginning on the first Day of the calendar month and ending immediately prior to the commencement of the first Day of the next calendar month.
- 2.23. "Payment Date" shall mean a date, as indicated on the Base Contract, on or before which payment is due Seller for Gas received by Buyer in the previous Month.
- 2.24. "Receiving Transporter" shall mean the Transporter receiving Gas at a Delivery Point, or absent such receiving Transporter, the Transporter delivering Gas at a Delivery Point.
- 2.25. "Scheduled Gas" shall mean the quantity of Gas confirmed by Transporter(s) for movement, transportation or management.
- 2.26. "Spot Price" as referred to in Section 3.2 shall mean the price listed in the publication indicated on the Base Contract, under the listing applicable to the geographic location closest in proximity to the Delivery Point(s) for the relevant Day; provided, if there is no single price published for such location for such Day, but there is published a range of prices, then the Spot Price shall be the average of such high and low prices. If no price or range of prices is published for such Day, then the Spot Price shall be the average of the following: (i) the price (determined as stated above) for the first Day for which a price or range of prices is published that next precedes the relevant Day; and (ii) the price (determined as stated above) for the first Day for which a price or range of prices is published that next follows the relevant Day.
- 2.27. "Transaction Confirmation" shall mean a document, similar to the form of Exhibit A, setting forth the terms of a transaction formed pursuant to Section 1 for a particular Delivery Period.
- 2.28. "Termination Option" shall mean the option of either party to terminate a transaction in the event that the other party fails to perform a Firm obligation to deliver Gas in the case of Seller or to receive Gas in the case of Buyer for a designated number of days during a period as specified on the applicable Transaction Confirmation.
- 2.29. "Transporter(s)" shall mean all Gas gathering or pipeline companies, or local distribution companies, acting in the capacity of a transporter, transporting Gas for Seller or Buyer upstream or downstream, respectively, of the Delivery Point pursuant to a particular transaction.

SECTION 3. PERFORMANCE OBLIGATION

3.1. Seller agrees to sell and deliver, and Buyer agrees to receive and purchase, the Contract Quantity for a particular transaction in accordance with the terms of the Contract. Sales and purchases will be on a Firm or Interruptible basis, as agreed to by the parties in a transaction.

The parties have selected either the "Cover Standard" or the "Spot Price Standard" as indicated on the Base Contract.

Cover Standard:

3.2. The sole and exclusive remedy of the parties in the event of a breach of a Firm obligation to deliver or receive Gas shall be recovery of the following: (i) in the event of a breach by Seller on any Day(s), payment by Seller to Buyer in an amount equal to the positive difference, if any, between the purchase price paid by Buyer utilizing the Cover Standard and the Contract Price, adjusted for commercially reasonable differences in transportation costs to or from the Delivery Point(s), multiplied by the difference between the Contract Quantity and the quantity actually delivered by Seller for such Day(s); or (ii) in the event of a breach by Buyer on any Day(s), payment by Buyer to Seller in the amount equal to the positive difference, if any, between the Contract Price and the price received by Seller utilizing the Cover Standard for the resale of such Gas, adjusted for commercially reasonable differences in transportation costs to or from the Delivery Point(s), multiplied by the difference between the Contract Quantity and the quantity actually taken by Buyer for such Day(s); or (iii) in the event that Buyer has used commercially reasonable efforts to replace the Gas or Seller has used commercially reasonable efforts to sell the Gas to a third party, and no such replacement or sale is available, then the sole and exclusive remedy of the performing party shall be any unfavorable difference between the Contract Price and the Spot Price, adjusted

for such transportation to the applicable Delivery Point, multiplied by the difference between the Contract Quantity and the quantity actually delivered by Seller and received by Buyer for such Day(s). Imbalance Charges shall not be recovered under this Section 3.2, but Seller and/or Buyer shall be responsible for Imbalance Charges, if any, as provided in Section 4.3. The amount of such unfavorable difference shall be payable five Business Days after presentation of the performing party's invoice, which shall set forth the basis upon which such amount was calculated.

Spot Price Standard:

3.2. The sole and exclusive remedy of the parties in the event of a breach of a Firm obligation to deliver or receive Gas shall be recovery of the following: (i) in the event of a breach by Seller on any Day(s), payment by Seller to Buyer in an amount equal to the difference between the Contract Quantity and the actual quantity delivered by Seller and received by Buyer for such Day(s), multiplied by the positive difference, if any, obtained by subtracting the Contract Price from the Spot Price; or (ii) in the event of a breach by Buyer on any Day(s), payment by Buyer to Seller in an amount equal to the difference between the Contract Quantity and the actual quantity delivered by Seller and received by Buyer for such Day(s), multiplied by the positive difference, if any, obtained by subtracting the applicable Spot Price from the Contract Price. Imbalance Charges shall not be recovered under this Section 3.2, but Seller and/or Buyer shall be responsible for Imbalance Charges, if any, as provided in Section 4.3. The amount of such unfavorable difference shall be payable five Business Days after presentation of the performing party's invoice, which shall set forth the basis upon which such amount was calculated.

3.3. Notwithstanding Section 3.2, the parties may agree to Alternative Damages in a Transaction Confirmation executed in writing by both parties.

3.4. In addition to Sections 3.2 and 3.3, the parties may provide for a Termination Option in a Transaction Confirmation executed in writing by both parties. The Transaction Confirmation containing the Termination Option will designate the length of nonperformance triggering the Termination Option and the procedures for exercise thereof, how damages for nonperformance will be compensated, and how liquidation costs will be calculated.

SECTION 4. TRANSPORTATION, NOMINATIONS, AND IMBALANCES

4.1. Seller shall have the sole responsibility for transporting the Gas to the Delivery Point(s). Buyer shall have the sole responsibility for transporting the Gas from the Delivery Point(s).

4.2. The parties shall coordinate their nomination activities, giving sufficient time to meet the deadlines of the affected Transporter(s). Each party shall give the other party timely prior Notice, sufficient to meet the requirements of all Transporter(s) involved in the transaction, of the quantities of Gas to be delivered and purchased each Day. Should either party become aware that actual deliveries at the Delivery Point(s) are greater or lesser than the Scheduled Gas, such party shall promptly notify the other party.

4.3. The parties shall use commercially reasonable efforts to avoid imposition of any Imbalance Charges. If Buyer or Seller receives an invoice from a Transporter that includes Imbalance Charges, the parties shall determine the validity as well as the cause of such Imbalance Charges. If the Imbalance Charges were incurred as a result of Buyer's receipt of quantities of Gas greater than or less than the Scheduled Gas, then Buyer shall pay for such Imbalance Charges or reimburse Seller for such Imbalance Charges paid by Seller. If the Imbalance Charges were incurred as a result of Seller's delivery of quantities of Gas greater than or less than the Scheduled Gas, then Seller shall pay for such Imbalance Charges or reimburse Buyer for such Imbalance Charges paid by Buyer.

SECTION 5. QUALITY AND MEASUREMENT

All Gas delivered by Seller shall meet the pressure, quality and heat content requirements of the Receiving Transporter. The unit of quantity measurement for purposes of this Contract shall be one MMBtu dry. Measurement of Gas quantities hereunder shall be in accordance with the established procedures of the Receiving Transporter.

SECTION 6. TAXES

The parties have selected either "Buyer Pays At and After Delivery Point" or "Seller Pays Before and At Delivery Point" as indicated on the Base Contract.

Buyer Pays At and After Delivery Point:

Seller shall pay or cause to be paid all taxes, fees, levies, penalties, licenses or charges imposed by any government authority ("Taxes") on or with respect to the Gas prior to the Delivery Point(s). Buyer shall pay or cause to be paid all Taxes on or with respect to the Gas at the Delivery Point(s) and all Taxes after the Delivery Point(s). If a party is required to remit or pay Taxes that are the other party's responsibility hereunder, the party responsible for such Taxes shall promptly reimburse the other party for such Taxes. Any party entitled to an exemption from any such Taxes or charges shall furnish the other party any necessary documentation thereof.

Seller Pays Before and At Delivery Point:

Seller shall pay or cause to be paid all taxes, fees, levies, penalties, licenses or charges imposed by any government authority ("Taxes") on or with respect to the Gas prior to the Delivery Point(s) and all Taxes at the Delivery Point(s). Buyer shall pay or cause to be paid all Taxes on or with respect to the Gas after the Delivery Point(s). If a party is required to remit or pay Taxes that are the other party's responsibility hereunder, the party responsible for such Taxes shall promptly reimburse the other party for such Taxes. Any party entitled to an exemption from any such Taxes or charges shall furnish the other party any necessary documentation thereof.

SECTION 7. BILLING, PAYMENT, AND AUDIT

7.1. Seller shall invoice Buyer for Gas delivered and received in the preceding Month and for any other applicable charges, providing supporting documentation acceptable in industry practice to support the amount charged. If the actual quantity delivered is not known by the billing date, billing will be prepared based on the quantity of Scheduled Gas. The invoiced quantity will then be adjusted to the actual quantity on the following Month's billing or as soon thereafter as actual delivery information is available.

7.2. Buyer shall remit the amount due under Section 7.1 in the manner specified in the Base Contract, in immediately available funds, on or before the later of the Payment Date or 10 Days after receipt of the invoice by Buyer; provided that if the Payment Date is not a Business Day, payment is due on the next Business Day following that date. In the event any payments are due Buyer hereunder, payment to Buyer shall be made in accordance with this Section 7.2.

7.3. In the event payments become due pursuant to Sections 3.2 or 3.3, the performing party may submit an invoice to the nonperforming party for an accelerated payment setting forth the basis upon which the invoiced amount was calculated. Payment from the nonperforming party will be due five Business Days after receipt of invoice.

7.4. If the invoiced party, in good faith, disputes the amount of any such invoice or any part thereof, such invoiced party will pay such amount as it concedes to be correct; provided, however, if the invoiced party disputes the amount due, it must provide supporting documentation acceptable in industry practice to support the amount paid or disputed. In the event the parties are unable to resolve such dispute, either party may pursue any remedy available at law or in equity to enforce its rights pursuant to this Section.

7.5. If the invoiced party fails to remit the full amount payable when due, interest on the unpaid portion shall accrue from the date due until the date of payment at a rate equal to the lower of (i) the then-effective prime rate of interest published under "Money Rates" by The Wall Street Journal, plus two percent per annum; or (ii) the maximum applicable lawful interest rate.

7.6. A party shall have the right, at its own expense, upon reasonable Notice and at reasonable times, to examine and audit and to obtain copies of the relevant portion of the books, records, and telephone recordings of the other party only to the extent reasonably necessary to verify the accuracy of any statement, charge, payment, or computation made under the Contract. This right to examine, audit, and to obtain copies shall not be available with respect to proprietary information not directly relevant to transactions under this Contract. All invoices and billings shall be conclusively presumed final and accurate and all associated claims for under- or overpayments shall be deemed waived unless such invoices or

billings are objected to in writing, with adequate explanation and/or documentation, within two years after the Month of Gas delivery. All retroactive adjustments under Section 7 shall be paid in full by the party owing payment within 30 Days of Notice and substantiation of such inaccuracy.

7.7. Unless the parties have elected on the Base Contract not to make this Section 7.7 applicable to this Contract, the parties shall net all undisputed amounts due and owing, and/or past due, arising under the Contract such that the party owing the greater amount shall make a single payment of the net amount to the other party in accordance with Section 7; provided that no payment required to be made pursuant to the terms of any Credit Support Obligation or pursuant to Section 7.3 shall be subject to netting under this Section. If the parties have executed a separate netting agreement, the terms and conditions therein shall prevail to the extent inconsistent herewith.

SECTION 8. TITLE, WARRANTY, AND INDEMNITY

8.1. Unless otherwise specifically agreed, title to the Gas shall pass from Seller to Buyer at the Delivery Point(s). Seller shall have responsibility for and assume any liability with respect to the Gas prior to its delivery to Buyer at the specified Delivery Point(s). Buyer shall have responsibility for and any liability with respect to said Gas after its delivery to Buyer at the Delivery Point(s).

8.2. Seller warrants that it will have the right to convey and will transfer good and merchantable title to all Gas sold hereunder and delivered by it to Buyer, free and clear of all liens, encumbrances, and claims. EXCEPT AS PROVIDED IN THIS SECTION 8.2 AND IN SECTION 14.8, ALL OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING ANY WARRANTY OF MERCHANTABILITY OR OF FITNESS FOR ANY PARTICULAR PURPOSE, ARE DISCLAIMED.

8.3. Seller agrees to indemnify Buyer and save it harmless from all losses, liabilities or claims including reasonable attorneys' fees and costs of court ("Claims"), from any and all persons, arising from or out of claims of title, personal injury or property damage from said Gas or other charges thereon which attach before title passes to Buyer. Buyer agrees to indemnify Seller and save it harmless from all Claims, from any and all persons, arising from or out of claims regarding payment, personal injury or property damage from said Gas or other charges thereon which attach after title passes to Buyer.

8.4. Notwithstanding the other provisions of this Section 8, as between Seller and Buyer, Seller will be liable for all Claims to the extent that such arise from the failure of Gas delivered by Seller to meet the quality requirements of Section 5.

SECTION 9. NOTICES

9.1. All Transaction Confirmations, invoices, payments and other communications made pursuant to the Base Contract ("Notices") shall be made to the addresses specified in writing by the respective parties from time to time.

9.2. All Notices required hereunder may be sent by facsimile or mutually acceptable electronic means, a nationally recognized overnight courier service, first class mail or hand delivered.

9.3. Notice shall be given when received on a Business Day by the addressee. In the absence of proof of the actual receipt date, the following presumptions will apply. Notices sent by facsimile shall be deemed to have been received upon the sending party's receipt of its facsimile machine's confirmation of successful transmission. If the day on which such facsimile is received is not a Business Day or is after five p.m. on a Business Day, then such facsimile shall be deemed to have been received on the next following Business Day. Notice by overnight mail or courier shall be deemed to have been received on the next Business Day after it was sent or such earlier time as is confirmed by the receiving party. Notice via first class mail shall be considered delivered five Business Days after mailing.

SECTION 10. FINANCIAL RESPONSIBILITY

10.1. If either party ("X") has reasonable grounds for insecurity regarding the performance of any obligation under this Contract (whether or not then due) by the other party ("Y") (including, without limitation, the occurrence of a material change in the creditworthiness of Y), X may demand Adequate Assurance of Performance. "Adequate Assurance of Performance" shall mean sufficient security in the form, amount and for the term reasonably acceptable to X, including, but not limited to, a standby irrevocable letter of credit, a prepayment, a security interest in an asset or a performance bond or guaranty (including the issuer of any such security).

10.2. In the event (each an "Event of Default") either party (the "Defaulting Party") or its guarantor shall: (i) make an assignment or any general arrangement for the benefit of creditors; (ii) file a petition or otherwise commence, authorize, or acquiesce in the commencement of a proceeding or case under any bankruptcy or similar law for the protection of creditors or have such petition filed or proceeding commenced against it; (iii) otherwise become bankrupt or insolvent (however evidenced); (iv) be unable to pay its debts as they fall due; (v) have a receiver, provisional liquidator, conservator, custodian, trustee or other similar official appointed with respect to it or substantially all of its assets; (vi) fail to perform any obligation to the other party with respect to any Credit Support Obligations relating to the Contract; (vii) fail to give Adequate Assurance of Performance under Section 10.1 within 48 hours but at least one Business Day of a written request by the other party; or (viii) not have paid any amount due the other party hereunder on or before the second Business Day following written Notice that such payment is due; then the other party (the "Non-Defaulting Party") shall have the right, at its sole election, to immediately withhold and/or suspend deliveries or payments upon Notice and/or to terminate and liquidate the transactions under the Contract, in the manner provided in Section 10.3, in addition to any and all other remedies available hereunder.

10.3. If an Event of Default has occurred and is continuing, the Non-Defaulting Party shall have the right, by Notice to the Defaulting Party, to designate a Day, no earlier than the Day such Notice is given and no later than 20 Days after such Notice is given, as an early termination date (the "Early Termination Date") for the liquidation and termination pursuant to Section 10.3.1 of all transactions under the Contract, each a "Terminated Transaction". On the Early Termination Date, all transactions will terminate, other than those transactions, if any, that may not be liquidated and terminated under applicable law or that are, in the reasonable opinion of the Non-Defaulting Party, commercially impracticable to liquidate and terminate ("Excluded Transactions"), which Excluded Transactions must be liquidated and terminated as soon thereafter as is reasonably practicable, and upon termination shall be a Terminated Transaction and be valued consistent with Section 10.3.1 below. With respect to each Excluded Transaction, its actual termination date shall be the Early Termination Date for purposes of Section 10.3.1.

The parties have selected either "Early Termination Damages Apply" or "Early Termination Damages Do Not Apply" as indicated on the Base Contract.

Early Termination Damages Apply:

10.3.1 As of the Early Termination Date, the Non-Defaulting Party shall determine, in good faith and in a commercially reasonable manner, (i) the amount owed (whether or not then due) by each party with respect to all Gas delivered and received between the parties under Terminated Transactions and Excluded Transactions on and before the Early Termination Date and all other applicable charges relating to such deliveries and receipts (including without limitation any amounts owed under Section 3.2), for which payment has not yet been made by the party that owes such payment under this Contract and (ii) the Market Value, as defined below, of each Terminated Transaction. The Non-Defaulting Party shall (x) liquidate and accelerate each Terminated Transaction at its Market Value, so that each amount equal to the difference between such Market Value and the Contract Value, as defined below, of such Terminated Transaction(s) shall be due to the Buyer under the Terminated Transaction(s) if such Market Value exceeds the Contract Value and to the Seller if the opposite is the case; and (y) where appropriate, discount each amount then due under clause (x) above to present value in a commercially reasonable manner as of the Early Termination Date (to take account of the period between the date of liquidation and the date on which such amount would have otherwise been due pursuant to the relevant Terminated Transactions).

For purposes of this Section 10.3.1, "Contract Value" means the amount of Gas remaining to be delivered or purchased under a transaction multiplied by the Contract Price, and "Market Value" means the amount of Gas remaining to be delivered or purchased under a transaction multiplied by the market price for a similar transaction at the Delivery Point determined by the Non-Defaulting Party in a commercially reasonable manner. To ascertain the Market Value, the Non-Defaulting Party may consider, among other valuations, any or all of the settlement prices of NYMEX Gas futures contracts, quotations from leading dealers in energy swap contracts or physical gas trading markets, similar sales or purchases and any other bona fide third-party offers, all adjusted for the length of the term and differences in transportation costs. A party shall not be required to enter into a replacement transaction(s) in order to determine the Market Value. Any extension(s) of the term of a transaction to which parties are not bound as of the Early Termination Date (including but not limited to "evergreen provisions") shall not be considered in determining Contract Values and Market Values. For the avoidance of doubt, any option pursuant to which one party has the right to extend the term of a transaction shall be considered in determining Contract Values and Market Values. The rate of interest used in calculating net present value shall be determined by the Non-Defaulting Party in a commercially reasonable manner.

Early Termination Damages Do Not Apply:

10.3.1. As of the Early Termination Date, the Non-Defaulting Party shall determine, in good faith and in a commercially reasonable manner, the amount owed (whether or not then due) by each party with respect to all Gas delivered and received between the parties under Terminated Transactions and Excluded Transactions on and before the Early Termination Date and all other

applicable charges relating to such deliveries and receipts (including without limitation any amounts owed under Section 3.2), for which payment has not yet been made by the party that owes such payment under this Contract.

The parties have selected either "Other Agreement Setoffs Apply" or "Other Agreement Setoffs Do Not Apply" as indicated on the Base Contract.

Other Agreement Setoffs Apply:

10.3.2. The Non-Defaulting Party shall net or aggregate, as appropriate, any and all amounts owing between the parties under Section 10.3.1, so that all such amounts are netted or aggregated to a single liquidated amount payable by one party to the other (the "Net Settlement Amount"). At its sole option and without prior Notice to the Defaulting Party, the Non-Defaulting Party may setoff (i) any Net Settlement Amount owed to the Non-Defaulting Party against any margin or other collateral held by it in connection with any Credit Support Obligation relating to the Contract; or (ii) any Net Settlement Amount payable to the Defaulting Party against any amount(s) payable by the Defaulting Party to the Non-Defaulting Party under any other agreement or arrangement between the parties.

Other Agreement Setoffs Do Not Apply:

10.3.2. The Non-Defaulting Party shall net or aggregate, as appropriate, any and all amounts owing between the parties under Section 10.3.1, so that all such amounts are netted or aggregated to a single liquidated amount payable by one party to the other (the "Net Settlement Amount"). At its sole option and without prior Notice to the Defaulting Party, the Non-Defaulting Party may setoff any Net Settlement Amount owed to the Non-Defaulting Party against any margin or other collateral held by it in connection with any Credit Support Obligation relating to the Contract.

10.3.3. If any obligation that is to be included in any netting, aggregation or setoff pursuant to Section 10.3.2 is unascertained, the Non-Defaulting Party may in good faith estimate that obligation and net, aggregate or setoff, as applicable, in respect of the estimate, subject to the Non-Defaulting Party accounting to the Defaulting Party when the obligation is ascertained. Any amount not then due which is included in any netting, aggregation or setoff pursuant to Section 10.3.2 shall be discounted to net present value in a commercially reasonable manner determined by the Non-Defaulting Party.

10.4 As soon as practicable after a liquidation, Notice shall be given by the Non-Defaulting Party to the Defaulting Party of the Net Settlement Amount, and whether the Net Settlement Amount is due to or due from the Non-Defaulting Party. The Notice shall include a written statement explaining in reasonable detail the calculation of such amount, provided that failure to give such Notice shall not affect the validity or enforceability of the liquidation or give rise to any claim by the Defaulting Party against the Non-Defaulting Party. The Net Settlement Amount shall be paid by the close of business on the second Business Day following such Notice, which date shall not be earlier than the Early Termination Date. Interest on any unpaid portion of the Net Settlement Amount shall accrue from the date due until the date of payment at a rate equal to the lower of (i) the then-effective prime rate of interest published under "Money Rates" by The Wall Street Journal, plus two percent per annum; or (ii) the maximum applicable lawful interest rate.

10.5 The parties agree that the transactions hereunder constitute a "forward contract" within the meaning of the United States Bankruptcy Code and that Buyer and Seller are each "forward contract merchants" within the meaning of the United States Bankruptcy Code.

10.6 The Non-Defaulting Party's remedies under this Section 10 are the sole and exclusive remedies of the Non-Defaulting Party with respect to the occurrence of any Early Termination Date. Each party reserves to itself all other rights, setoffs, counterclaims and other defenses that it is or may be entitled to arising from the Contract.

10.7 With respect to this Section 10, if the parties have executed a separate netting agreement with close-out netting provisions, the terms and conditions therein shall prevail to the extent inconsistent herewith.

SECTION 11. FORCE MAJEURE

11.1. Except with regard to a party's obligation to make payment(s) due under Section 7, Section 10.4, and Imbalance Charges under Section 4, neither party shall be liable to the other for failure to perform a Firm obligation, to the extent such failure was caused by Force Majeure. The term "Force Majeure" as employed herein means any cause not reasonably within the control of the party claiming suspension, as further defined in Section 11.2.

11.2. Force Majeure shall include, but not be limited to, the following: (i) physical events such as acts of God, landslides, lightning, earthquakes, fires, storms or storm warnings, such as hurricanes, which result in evacuation of the affected area, floods, washouts, explosions, breakage or accident or necessity of repairs to machinery or equipment or lines of pipe; (ii) weather related events affecting an entire geographic region, such as low temperatures which cause freezing or failure of wells or lines of pipe; (iii) interruption and/or

curtailment of Firm transportation and/or storage by Transporters; (iv) acts of others such as strikes, lockouts or other industrial disturbances, riots, sabotage, insurrections or wars; and (v) governmental actions such as necessity for compliance with any court order, law, statute, ordinance, regulation, or policy having the effect of law promulgated by a governmental authority having jurisdiction. Seller and Buyer shall make reasonable efforts to avoid the adverse impacts of a Force Majeure and to resolve the event or occurrence once it has occurred in order to resume performance.

11.3. Neither party shall be entitled to the benefit of the provisions of Force Majeure to the extent performance is affected by any or all of the following circumstances: (i) the curtailment of interruptible or secondary Firm transportation unless primary, in-path, Firm transportation is also curtailed; (ii) the party claiming excuse failed to remedy the condition and to resume the performance of such covenants or obligations with reasonable dispatch; or (iii) economic hardship, to include, without limitation, Seller's ability to sell Gas at a higher or more advantageous price than the Contract Price, Buyer's ability to purchase Gas at a lower or more advantageous price than the Contract Price, or a regulatory agency disallowing, in whole or in part, the pass through of costs resulting from this Agreement; (iv) the loss of Buyer's market(s) or Buyer's inability to use or resell Gas purchased hereunder, except, in either case, as provided in Section 11.2; or (v) the loss or failure of Seller's gas supply or depletion of reserves, except, in either case, as provided in Section 11.2. The party claiming Force Majeure shall not be excused from its responsibility for Imbalance Charges.

11.4. Notwithstanding anything to the contrary herein, the parties agree that the settlement of strikes, lockouts or other industrial disturbances shall be within the sole discretion of the party experiencing such disturbance.

11.5. The party whose performance is prevented by Force Majeure must provide Notice to the other party. Initial Notice may be given orally; however, written Notice with reasonably full particulars of the event or occurrence is required as soon as reasonably possible. Upon providing written Notice of Force Majeure to the other party, the affected party will be relieved of its obligation, from the onset of the Force Majeure event, to make or accept delivery of Gas, as applicable, to the extent and for the duration of Force Majeure, and neither party shall be deemed to have failed in such obligations to the other during such occurrence or event.

11.6. Notwithstanding Sections 11.2 and 11.3, the parties may agree to alternative Force Majeure provisions in a Transaction Confirmation executed in writing by both parties.

SECTION 12. TERM

This Contract may be terminated on 30 Day's written Notice, but shall remain in effect until the expiration of the latest Delivery Period of any transaction(s). The rights of either party pursuant to Section 7.6 and Section 10, the obligations to make payment hereunder, and the obligation of either party to indemnify the other, pursuant hereto shall survive the termination of the Base Contract or any transaction.

SECTION 13. LIMITATIONS

FOR BREACH OF ANY PROVISION FOR WHICH AN EXPRESS REMEDY OR MEASURE OF DAMAGES IS PROVIDED, SUCH EXPRESS REMEDY OR MEASURE OF DAMAGES SHALL BE THE SOLE AND EXCLUSIVE REMEDY. A PARTY'S LIABILITY HEREUNDER SHALL BE LIMITED AS SET FORTH IN SUCH PROVISION, AND ALL OTHER REMEDIES OR DAMAGES AT LAW OR IN EQUITY ARE WAIVED. IF NO REMEDY OR MEASURE OF DAMAGES IS EXPRESSLY PROVIDED HEREIN OR IN A TRANSACTION, A PARTY'S LIABILITY SHALL BE LIMITED TO DIRECT ACTUAL DAMAGES ONLY. SUCH DIRECT ACTUAL DAMAGES SHALL BE THE SOLE AND EXCLUSIVE REMEDY, AND ALL OTHER REMEDIES OR DAMAGES AT LAW OR IN EQUITY ARE WAIVED. UNLESS EXPRESSLY HEREIN PROVIDED, NEITHER PARTY SHALL BE LIABLE FOR CONSEQUENTIAL, INCIDENTAL, PUNITIVE, EXEMPLARY OR INDIRECT DAMAGES, LOST PROFITS OR OTHER BUSINESS INTERRUPTION DAMAGES, BY STATUTE, IN TORT OR CONTRACT, UNDER ANY INDEMNITY PROVISION OR OTHERWISE. IT IS THE INTENT OF THE PARTIES THAT THE LIMITATIONS HEREIN IMPOSED ON REMEDIES AND THE MEASURE OF DAMAGES BE WITHOUT REGARD TO THE CAUSE OR CAUSES RELATED THERETO, INCLUDING THE NEGLIGENCE OF ANY PARTY, WHETHER SUCH NEGLIGENCE BE SOLE, JOINT OR CONCURRENT, OR ACTIVE OR PASSIVE. TO THE EXTENT ANY DAMAGES REQUIRED TO BE PAID HEREUNDER ARE LIQUIDATED, THE PARTIES ACKNOWLEDGE THAT THE DAMAGES ARE DIFFICULT OR IMPOSSIBLE TO DETERMINE, OR OTHERWISE OBTAINING AN ADEQUATE REMEDY IS INCONVENIENT AND THE DAMAGES CALCULATED HEREUNDER CONSTITUTE A REASONABLE APPROXIMATION OF THE HARM OR LOSS.

SECTION 14. MISCELLANEOUS

14.1. This Contract shall be binding upon and inure to the benefit of the successors, assigns, personal representatives, and heirs of the respective parties hereto, and the covenants, conditions, rights and obligations of this Contract shall run for the full term of this Contract. No assignment of this Contract, in whole or in part, will be made without the prior written consent of the non-assigning party (and shall not relieve the assigning party from liability hereunder), which consent will not be unreasonably withheld or delayed; provided, either party may (i) transfer, sell, pledge, encumber, or assign this Contract or the accounts, revenues, or proceeds hereof in connection with any financing or other financial arrangements, or (ii) transfer its interest to any parent or affiliate by assignment, merger or otherwise without the prior approval of the other party. Upon any such assignment, transfer and assumption, the transferor shall remain principally liable for and shall not be relieved of or discharged from any obligations hereunder.

14.2. If any provision in this Contract is determined to be invalid, void or unenforceable by any court having jurisdiction, such determination shall not invalidate, void, or make unenforceable any other provision, agreement or covenant of this Contract.

14.3. No waiver of any breach of this Contract shall be held to be a waiver of any other or subsequent breach.

14.4. This Contract sets forth all understandings between the parties respecting each transaction subject hereto, and any prior contracts, understandings and representations, whether oral or written, relating to such transactions are merged into and superseded by this Contract and any effective transaction(s). This Contract may be amended only by a writing executed by both parties.

14.5. The interpretation and performance of this Contract shall be governed by the laws of the jurisdiction as indicated on the Base Contract, excluding, however, any conflict of laws rule which would apply the law of another jurisdiction.

14.6. This Contract and all provisions herein will be subject to all applicable and valid statutes, rules, orders and regulations of any governmental authority having jurisdiction over the parties, their facilities, or Gas supply, this Contract or transaction or any provisions thereof.

14.7. There is no third party beneficiary to this Contract.

14.8. Each party to this Contract represents and warrants that it has full and complete authority to enter into and perform this Contract. Each person who executes this Contract on behalf of either party represents and warrants that it has full and complete authority to do so and that such party will be bound thereby.

14.9. The headings and subheadings contained in this Contract are used solely for convenience and do not constitute a part of this Contract between the parties and shall not be used to construe or interpret the provisions of this Contract.

14.10. Unless the parties have elected on the Base Contract not to make this Section 14.10 applicable to this Contract, neither party shall disclose directly or indirectly without the prior written consent of the other party the terms of any transaction to a third party (other than the employees, lenders, royalty owners, counsel, accountants and other agents of the party, or prospective purchasers of all or substantially all of a party's assets or of any rights under this Contract, provided such persons shall have agreed to keep such terms confidential) except (i) in order to comply with any applicable law, order, regulation, or exchange rule, (ii) to the extent necessary for the enforcement of this Contract, (iii) to the extent necessary to implement any transaction, or (iv) to the extent such information is delivered to such third party for the sole purpose of calculating a published index. Each party shall notify the other party of any proceeding of which it is aware which may result in disclosure of the terms of any transaction (other than as permitted hereunder) and use reasonable efforts to prevent or limit the disclosure. The existence of this Contract is not subject to this confidentiality obligation. Subject to Section 13, the parties shall be entitled to all remedies available at law or in equity to enforce, or seek relief in connection with this confidentiality obligation. The terms of any transaction hereunder shall be kept confidential by the parties hereto for one year from the expiration of the transaction.

In the event that disclosure is required by a governmental body or applicable law, the party subject to such requirement may disclose the material terms of this Contract to the extent so required, but shall promptly notify the other party, prior to disclosure, and shall cooperate (consistent with the disclosing party's legal obligations) with the other party's efforts to obtain protective orders or similar restraints with respect to such disclosure at the expense of the other party.

14.11. The parties may agree to dispute resolution procedures in Special Provisions attached to the Base Contract or in a Transaction Confirmation executed in writing by both parties.

EXHIBIT B TO
JOINT GAS PURCHASE CONTRACT

PURCHASE CONTRACT

1. **Joint Purchase Contract.** The Buyer specified below hereby becomes a party to and, except to the extent described herein, assumes all rights and obligations of a "**Buyer**" under the Joint Gas Purchase Contract, dated as of January 1, 2006 (the "**Joint Contract**"), among TMGC II (specified below), the Agent (specified below), and Local Governments and State Agencies, as therein defined, who become parties thereto, and TMGC II and the Agent hereby consent thereto. The terms of the Joint Contract are hereby incorporated herein by reference.

2. **Category of Purchaser.** The Buyer is *[check and complete one or more]*:

- ☐ a Requirements Buyer described in *Section 6.03A*() of the Joint Contract,
- ☐ a Conditional Buyer described in *Section 6.03A*() of the Joint Contract, and/or
- ☐ an Exempt Gas Buyer, because it will accept Exempt Gas to satisfy all or any part of its Requirements without further action on its part.

3. **Purchase of Gas.** The Buyer agrees to receive and buy from the Agent, and the Agent agrees to sell and deliver to the Buyer, at the Delivery Point, the Buyer's Nominated Quantities of Gas during the term of this Purchase Contract, which shall not exceed the Buyer's Requirements in any Contract Year. The Buyer agrees to nominate Gas for purchase so that it will buy from the Agent not less than the Buyer's Requirements in any Contract Year (subject to the next paragraph), to the extent Gas is available for delivery to the Buyer under the Joint Contract and except as otherwise provided therein, at the price specified below.

4. **Maximum Annual Quantity.** The Maximum Annual Quantity of Gas that the Buyer agrees to nominate for purchase hereunder, up to its Requirements and subject to the conditions provided in the Joint Contract, in each Contract Year is:

- ☐ its Requirements or
- ☐ as specified in *Schedule A* attached hereto.

5. **Price.** The Buyer will pay for all Gas purchased and received by it hereunder in any period at a price equal to the Gross Price identified herein for such period *less* the Discount determined by TMGC II in accordance with the Joint Contract and then in effect. The Buyer will be entitled to a partial rebate of such payments when, as, and to the extent that rebates are declared by TMGC II under the Joint Contract.

6. **Delivery and Gross Price.** A Balancing Agreement between TMGC II and a Balancer will be used by TMGC II to deliver Gas to the Buyer, unless otherwise agreed by TMGC II and the Buyer. One or more of the Buyer's existing Suppliers have executed a Supplier-Exchanger Agreement with such Balancer. For so long as such or any replacement Balancing Agreement and Supplier-Exchanger Agreement are in effect in respect of the Buyer, the Buyer's Gross Price for each Day and Month will be the weighted average prices payable by the Buyer (if a Requirements Buyer) under its Supply Contract with each such Supplier (or substitute Supplier which has so agreed) or payable by the Balancer with the consent of the Buyer under a Supplier-Exchanger Agreement (if a Conditional Buyer), for Gas delivered to the Buyer in such Day or Month, and the Buyer's Delivery Points will be the points specified in such Supply Contracts with such Suppliers (if a Requirements Buyer) or in such Supplier-Exchanger Agreements (if a Conditional Buyer), unless otherwise agreed by TMGC II and the Buyer. Thereafter,

the Buyer's Delivery Points and Gross Price will be as provided in the Joint Contract or as agreed to between them in writing.

7. **Use.** The Buyer will use all Gas purchased hereunder (or Gas exchanged therefor) [*check one or more*]:

- ☐ in its electric utility system to generate electric power and/or
- ☐ in its gas utility system or enterprise and/or
- ☐ to secure a discount in the electric energy charges paid by it or (in the case of a political subdivision corporation) its member buyers and/or
- ☐ for consumption in its (or for resale to other Local Governments and State Agencies for consumption in their) other public facilities.

The Buyer agrees that all Exempt Gas sold and delivered to it under the Joint Contract will be consumed in, or to produce electric energy consumed in, qualified service areas and qualified annexed areas and that no such Exempt Gas will be used in a private trade or business or to make a private loan, as provided more fully and except as permitted by *Article Ten* of the Joint Contract.

8. **Address.** The address of the Buyer for notices received under the Joint Contract is:

Telephone No. (____) _____
Facsimile No. (____) _____
Internet: _____

9. **Special Provisions.** [*insert special provisions, if any*].

10. **Term.** This Purchase Contract shall commence on the Effective Date hereof, which is the latest of the effective dates of the Balancing Agreement and initial Supplier-Exchanger Agreement referred to above and _____, and shall extend to _____. The term of this Purchase Contract shall automatically be extended by one year on each December 31, unless the Buyer, TMGC II, or the Agent has given written notice to the other two parties of its election not to extend the term of this Purchase Contract prior to such December 31, but in no event shall the term of this Purchase Contract be extended beyond December 31, _____, except by written amendment executed by the parties hereto. This Purchase Contract may be phased out at the election of the Buyer as described in the Joint Contract.

The parties hereto have caused this Purchase Contract to be duly executed, effective as of the Effective Date described above.

BUYER:

Attest/Countersign:

.....
Name:
Title:

By:
Name:
Title:

AGENT:

Attest/Countersign:

CITY OF LA GRANGE, TEXAS

.....
Name:
Title:

By:
Name:
Mayor

TMGC II:

Attest:

TEXAS MUNICIPAL GAS CORPORATION II

.....
Name:
Title:

By:
Name:
President

*Schedule A to
Purchase Contract*

The Buyer's Maximum Annual Quantity, if any, and projected Requirements (each expressed in MMBtus) in each Contract Year are as follows:

<u>Year</u>	<u>Maximum Annual Quantity</u> <u>(if applicable)</u>	<u>Projected Requirements</u>
2006		
2007		
2008		
2009		
2010		
2011-2045		

ATTACHMENT D

PURCHASE CONTRACT

1. **Joint Purchase Contract.** The Buyer specified below hereby becomes a party to and, except to the extent described herein, assumes all rights and obligations of a **“Buyer”** under the Joint Gas Purchase Contract, dated as of January 1, 2006 (the **“Joint Contract”**), among MuniGas (specified below), the Agent (specified below), and Local Governments and State Agencies, as therein defined, who become parties thereto, and MuniGas and the Agent hereby consent thereto. The terms of the Joint Contract are hereby incorporated herein by reference.

2. **Category of Purchaser.** The Buyer is [*check and complete one or more*]:

- ☐ a Requirements Buyer described in *Section 6.03A(____)* of the Joint Contract,
- ☐ a Conditional Buyer described in *Section 6.03A(____)* of the Joint Contract, and/or
- ☐ an Exempt Gas Buyer, because it will accept Exempt Gas to satisfy all or any part of its Requirements without further action on its part.

3. **Purchase of Gas.** The Buyer agrees to receive and buy from the Agent, and the Agent agrees to sell and deliver to the Buyer, at the Delivery Point, the Buyer’s Nominated Quantities of Gas during the term of this Purchase Contract, which shall not exceed the Buyer’s Requirements in any Contract Year. The Buyer agrees to nominate Gas for purchase so that it will buy from the Agent not less than the Buyer’s Requirements in any Contract Year (subject to the next paragraph), to the extent Gas is available for delivery to the Buyer under the Joint Contract and except as otherwise provided therein, at the price specified below.

4. **Maximum Annual Quantity.** The Maximum Annual Quantity of Gas that the Buyer agrees to nominate for purchase hereunder, up to its Requirements and subject to the conditions provided in the Joint Contract, in each Contract Year is:

- ☐ its Requirements or
- ☐ as specified in *Schedule A* attached hereto.

5. **Price.** The Buyer will pay for all Gas purchased and received by it hereunder in any period at a price equal to the Gross Price identified herein for such period *less* the Discount determined by MuniGas in accordance with the Joint Contract and then in effect. The Buyer will be entitled to a partial rebate of such payments when, as, and to the extent that rebates are declared by MuniGas under the Joint Contract.

6. **Delivery and Gross Price.** A Balancing Agreement between MuniGas and a Balancer will be used by MuniGas to deliver Gas to the Buyer, unless otherwise agreed by MuniGas and the Buyer. One or more of the Buyer’s existing Suppliers is expected to execute a Supplier-Exchanger Agreement with such Balancer. For so long as such or any replacement Balancing Agreement and Supplier-Exchanger Agreement are in effect in respect of the Buyer, the Buyer’s Gross Price for each Day and Month will be the weighted average prices payable by the Buyer (if a Requirements Buyer) under its Supply Contract with each such Supplier (or substitute Supplier which has so agreed) or payable by the Balancer with the consent of the Buyer under a Supplier-Exchanger Agreement (if a Conditional Buyer), for Gas delivered to the Buyer in such Day or Month, and the Buyer’s Delivery Points will be the points specified in such Supply Contracts with such Suppliers (if a Requirements Buyer) or in such Supplier-Exchanger Agreements (if a Conditional Buyer), unless otherwise agreed by MuniGas and the Buyer. Thereafter, the Buyer’s Delivery Points and Gross Price will be as provided in the Joint Contract or as agreed to between them in writing.

7. **Use.** The Buyer will use all Gas purchased hereunder (or Gas exchanged therefor) [*check one or more*]:
- ☐ in its electric utility system to generate electric power and/or
 - ☐ in its gas utility system or enterprise and/or
 - ☐ to secure a discount in the electric energy charges paid by it or (in the case of a political subdivision corporation) its member buyers and/or
 - ☐ for consumption in its (or for resale to other Local Governments and State Agencies for consumption in their) other public facilities.

The Buyer agrees that all Exempt Gas sold and delivered to it under the Joint Contract will be consumed in, or to produce electric energy consumed in, qualified service areas and qualified annexed areas and that no such Exempt Gas will be used in a private trade or business or to make a private loan, as provided more fully and except as permitted by *Article Ten* of the Joint Contract.

8. **Address.** The address of the Buyer for notices received under the Joint Contract is:

	Telephone No. (____) _____
	Facsimile No. (____) _____
	Internet: _____

9. **Special Provisions.**

(A) The Buyer shall forecast, nominate, and sell or burn Gas such that all such Gas is (1) furnished to customers of the Buyer who purchase such Gas other than for resale or to produce electricity for sale and are located in either (a) an area throughout which the Buyer provided natural gas transmission or distribution services at all times during the 5-year period ending on the date of issue of the bonds issued by MuniGas or an affiliate to finance the acquisition of such Gas or (b) an area recognized as the natural gas service area of the Buyer under state or federal law, or (2) used by the Buyer to produce electricity that is furnished to electric customers of the Buyer who purchase such electricity other than for resale and are located in either (a) an area throughout which the Buyer provided electricity distribution service at all times during such 5-year period or (b) an area recognized as the electricity service area of the Buyer under state or federal law, all determined in accordance with written explanations provided by MuniGas to the Buyer from time to time, or (3) used by the Buyer to produce electricity that (a) is sold to a utility owned by a state or local government and is furnished by such utility to electric customers of such utility who purchase such electricity other than for resale and are located in either (i) an area throughout which such utility provided electricity distribution service at all times during such 5-year period or (ii) an area recognized as the electricity service area of such entity under state or federal law, all determined in accordance with written explanations provided by MuniGas to such entity from time to time, or (b) is sold to a local government or state agency that subsequently sells such electricity as described in clause 3(a), or (4) sold to a utility owned by a state or local government that furnishes or uses such gas solely as described in the immediately preceding clauses (1), (2), and (3), applied as if references to “the Buyer” therein were to such utility, or (5) used to fuel the pipeline transportation of such Gas. The Buyer shall not sell electricity that is produced using Gas to a local government or state agency pursuant to clause 3(b) above unless such local government or state agency has agreed in writing to use such electricity in accordance with this Section 9(A), and has agreed, upon request from MuniGas, to provide evidence from the utilities owned by state or local governments to whom it sells electricity that such electricity is furnished to its customers in accordance with the requirements set forth in this Section 9(A).

(B) In no event shall any Gas produced from mineral interests located in the State of Texas and owned by the Agent, MuniGas, or any affiliated corporation, or exchanged for any Gas so produced, be available for sale by MuniGas through the Agent to the Buyer.

(C) Notwithstanding the Effective Date established in Section 10 of this Purchase Contract, the Buyer agrees that neither MuniGas nor the Agent shall be obligated to commence initial gas deliveries under this Purchase Contract until MuniGas, in MuniGas' sole determination, has acquired sufficient additional Production Rights to enable MuniGas to sell and Buyer to purchase the Maximum Annual Quantity specified in Schedule A without adversely affecting its ability to meet the full requirements of all other Buyers that have equal or better priority to allocations of Gas under the terms of the Joint Contract and have become a party thereto prior to the execution of this Purchase Contract.

(D) The Buyer may terminate this Purchase Contract after 180 days after the Effective Date established in Section 10, in the Buyer's sole discretion, on at least 75 days prior written notice of termination to MuniGas and the Agent specifying the termination date, unless prior to the specified date, MuniGas and the Agent have become obligated to commence initial deliveries of Gas in accordance with paragraph 9(C) of this Purchase Contract.

(E) The Buyer represents that: (1) the obligations of the Buyer under this Purchase Contract, and any renewal or extension hereof are payable as maintenance and operation costs of the Buyer's gas utility system, and all such payments are payable prior to the debt obligations of the Buyer, (2) at the time of entering into this Purchase Contract, and each annual or other renewal and extension hereof, the Buyer has not defaulted in payment of the Buyer's obligations under any natural gas purchase contract in the immediately preceding 10 years due to circumstances reflecting adversely on such Buyer's credit, and (3) in the event the representations described in the immediately preceding clauses (1) or (2) cannot be satisfied at the time as of which the Buyer may elect not to extend the term of this Purchase Contract, the Buyer will notify MuniGas of such fact and exercise such election not to extend, unless otherwise agreed by MuniGas.

(F) All amounts to be paid to or deposited with MuniGas hereunder shall be paid to or deposited with The Bank of New York Mellon Trust Company, N.A. (or any successor trustee designated by MuniGas in writing) by wire transfer of immediately available funds to such trustee in accordance with the following instructions or such other instructions as may be designated to the Buyer by MuniGas in writing:

The Bank of New York Mellon, Dallas, Texas
ABA# 021 000 018
GLA# 111-565, TAS# 224385
Attn: Jolly Jiang (713) 483-7062
Ref: MuniGas

(G) MuniGas and the Agent consent to the assignment of this Purchase Contract by Buyer to any Local Government or State Agency, whether within or outside the State of Texas, pursuant to the provisions of and with the effect described in *Section 11.04* of the Joint Contract, *provided* that any change in Delivery Point shall be subject to MuniGas' consent which shall not be unreasonably withheld in accordance with such Section and any assignment by Buyer shall be subject to the approval by MuniGas of the credit standing of the assignee as determined by MuniGas in its sole discretion.

(H) MuniGas and Agent acknowledge that Buyer is subject to the California Constitution Article 1, Section 3, and the California Public Records Act, *Cal. Gov. Code § 6250 et seq.* ("**Public Records Act**") in regard to this Purchase Contract, the Joint Contract and related documents (the "**Disclosed Documents**"), which may constitute public records subject to inspection and copying by the public under the authority of the California Constitution and the Public Records Act. Buyer shall, consistent with those laws, use reasonable efforts to provide MuniGas and/or the Agent with notice of any third party request to inspect and copy any of the Disclosed Documents, which MuniGas and/or the Agent might deem confidential and exempt from disclosure, in order that MuniGas and/or the Agent may timely seek to protect those documents from disclosure to the third party. MuniGas and the Agent acknowledge and agree that Buyer shall not be liable to MuniGas or the Agent if Buyer makes disclosure in accordance with the California Constitution and/or the Public Records Act before MuniGas and/or the Agent has timely obtained an order to prevent Buyer from making the requested disclosure to the third party. MuniGas and the Agent further agree that each shall defend, indemnify and hold Buyer harmless against any claim,

action or litigation (including, but not limited to, all judgments, costs, fees and attorneys' fees (including on appeal)) that may result from denial by Buyer of a Public Records Act request.

10. Term. This Purchase Contract shall commence on the Effective Date hereof, which is the latest of the effective dates of the Balancing Agreement and initial Supplier-Exchanger Agreement referred to above and May 1, 2014, and shall extend to December 31, 2023. The term of this Purchase Contract shall automatically be extended by one year on each December 31, unless the Buyer, MuniGas, or the Agent has given written notice to the other two parties of its election not to extend the term of this Purchase Contract prior to such December 31, but in no event shall the term of this Purchase Contract be extended beyond December 31, 2045, except by written amendment executed by the parties hereto. This Purchase Contract may be phased out at the election of the Buyer as described in the Joint Contract.

[Signature page follows]

The parties hereto have caused this Purchase Contract to be duly executed, effective as of the Effective Date described above.

BUYER:

CITY OF PALO ALTO, CALIFORNIA

By:.....
Name:
Title:

Attest/Countersign:

.....
Name:
Title:

AGENT:

CITY OF LA GRANGE, TEXAS

By:.....
Name: Janet Moerbe
Title: Mayor

Attest/Countersign:

.....
Name: Lisa Oltmann
Title: City Secretary

MUNIGAS:

MUNICIPAL GAS ACQUISITION AND SUPPLY CORPORATION

By:.....
Name: Glen Pape
Title: President

Attest:

.....
Name: Janetta Morris
Title: Secretary

*Schedule A to
Purchase Contract*

The Buyer's Maximum Annual Quantity, if any, and projected Requirements (each expressed in MMBtus) in each Contract Year are as follows:

<u>Year</u>	<u>Maximum Annual Quantity (if applicable)</u>	<u>Projected Requirements</u>
2014	N/A	
2015	N/A	
2016	N/A	
2017	N/A	
2018	N/A	
2019–2045	N/A	

ATTACHMENT E

ADDENDUM TO GAS SUPPLY CONTRACT

This Addendum to Gas Supply Contract (this “**Addendum**”), dated as of _____, 2014, among _____, _____ (hereinafter referred to as the “**Buyer**”), _____ (hereinafter referred to as the “**Supplier**”), and BP Energy Company, a Delaware corporation (hereinafter referred to as the “**Dealer**”),

WITNESSETH:

WHEREAS, the Buyer and the Supplier have entered into a contract dated as of _____ (hereinafter, together with extensions and replacements thereof and amendments thereto entered into by the Buyer and the Supplier, referred to as the “**Supply Contract**”), under which, for the term, on the conditions, and up to the maximum amount specified therein, the Supplier has agreed to sell and deliver to the Buyer, at the point or points designated therein or pursuant thereto (hereinafter referred to as the “**Buyer’s Point of Receipt**”), a portion of the Buyer’s requirements for natural gas in accordance with transactions agreed to by them from time to time;

WHEREAS, Municipal Gas Acquisition and Supply Corporation (hereinafter referred to as “**MuniGas**”) has offered to admit the Buyer as a party to a Joint Gas Purchase Contract, dated as of January 1, 2006 (hereinafter, as amended from time to time, referred to as the “**Cooperative Contract**”) under which MuniGas would sell and deliver through the City of La Grange, Texas (herein referred to as the “**Agent**”) to the Buyer, and the Buyer would receive and purchase from the Agent, at the Buyer’s Point of Receipt certain quantities of gas at a lower price than the price of gas delivered to the Buyer by or on behalf of the Supplier pursuant to the Supply Contract;

WHEREAS, in order to enable MuniGas to perform its obligations under the Cooperative Contract without excessive transportation costs for (and to accommodate seasonal imbalances in supply of and demand for) all or a portion of the gas to be sold and delivered to the Buyer pursuant to the Cooperative Contract, MuniGas and the Dealer have entered into a Gas Exchange and Annual Balancing Agreement, dated as of January 1, 2006 (as amended from time to time, herein referred to as the “**Exchange Agreement**”) under which the Dealer is required to deliver certain quantities of gas to MuniGas at the Buyer’s Point of Receipt, from and to the extent of gas sold and delivered to the Dealer by the Supplier pursuant hereto, in exchange for gas delivered by MuniGas to the Dealer at one or more other locations;

WHEREAS, the Supplier is willing to enter into this Addendum to sell and deliver gas to the Dealer at the Buyer’s Point of Receipt and to reduce the quantities of gas required to be received and purchased by the Buyer from the Supplier at the Buyer’s Point of Receipt pursuant to the Supply Contract; and

WHEREAS, although the gas sales agreement between the Supplier and the Dealer and the amendment to the Supply Contract between the Buyer and the Supplier, respectively, are being documented together in this Addendum for convenience, they are independent two-party transactions for which other parties to this Addendum bear no liability (except only as expressly stated herein);

NOW, THEREFORE, for and in consideration of the premises and of the mutual covenants, agreements, conditions, and undertakings herein set forth, the parties hereto agree as follows:

1. Sale and Delivery to the Dealer. On each day while the Supply Contract and this Addendum are in effect, the Supplier shall sell and deliver to or for the account of the Dealer, and the Dealer shall receive or cause to be received and purchased from the Supplier, at the Buyer’s Point of

Receipt and for the same price as the price for gas sold and delivered by the Supplier to the Buyer pursuant to the Supply Contract, quantities of gas equal to the Supplier's Share of the quantities of gas nominated and confirmed for delivery to the Buyer at the Buyer's Point of Receipt on such day pursuant to the Cooperative Contract, but not more than the lesser of (a) the maximum quantity of gas then required to be sold and delivered by the Supplier to the Buyer at the Buyer's Point of Receipt pursuant to the Supply Contract, determined without giving effect to *Section 2* hereof, or (b) the Supplier's Share of the quantity of gas which MuniGas schedules for delivery to the Buyer on such day at the Buyer's Point of Receipt. Such sale and purchase of gas between the Supplier and the Dealer shall be made on the same terms (including warranties and indemnities of the Supplier and the effect of *force majeure*) and subject to the same conditions as the terms and conditions of the Supply Contract to the same extent and for all purposes as if the Supplier and the Dealer had entered into the Supply Contract, except as otherwise provided herein and except that the Dealer shall not make (and shall not be deemed to have made) any representations, warranties, covenants, or certifications of the Buyer or the Supplier under the Supply Contract and the Supplier shall not have the right to audit the Dealer's books and records. If more than one price is set forth in the Supply Contract for gas sold and delivered thereunder by the Supplier (*e.g.*, due to graduated volume discounts), the price for gas sold to the Dealer pursuant to this paragraph shall be the weighted average price (determined in accordance with *Section 3* hereof) for gas sold and delivered by the Supplier to the Buyer pursuant to the Supply Contract. The Buyer and the Supplier acknowledge that the net amounts payable by the Buyer to the Supplier pursuant to the Supply Contract (as amended by this Addendum) shall equal the amounts payable by the Buyer to the Supplier pursuant to the Supply Contract (determined as if not amended by this Addendum), less the amounts payable by the Dealer to the Supplier pursuant to this Addendum. As used herein, the "**Supplier's Share**" for any day or month is equal to a fraction, the numerator of which is equal to quantity of gas then required to be sold and delivered by the Supplier to the Buyer at the Buyer's Point of Receipt pursuant to the Supply Contract, determined without giving effect to *Section 2* hereof, and the denominator of which is equal to the aggregate quantities of gas then required to be sold and delivered to the Buyer at the Buyer's Point of Receipt by the Supplier and all other gas producers and dealers who have entered into Addenda with the Buyer and the Dealer substantially similar to this Addendum (determined without giving effect to such Addenda). If the Buyer specifies a Supplier's Share that causes the limitations described in this Section to be exceeded, then such confirmation shall be deemed to confirm a sale from the Supplier to the Buyer, rather than to the Dealer, to the extent of any such excess. The Buyer shall receive from MuniGas at the Buyer's Point of Receipt all gas there delivered by the Supplier to the Dealer hereunder, and the Dealer shall be obligated to receive gas from the Supplier hereunder only to the extent of such receipt by the Buyer.

2. Sale and Delivery to Buyer. The quantity of gas to be sold and delivered by the Supplier to the Buyer and received and purchased by the Buyer from the Supplier at the Buyer's Point of Receipt pursuant to the Supply Contract on each day shall be reduced by the quantity of gas sold and delivered by the Supplier to or for the account of the Dealer at the Buyer's Point of Receipt pursuant to *Section 1* hereof, and the Buyer and the Supplier release each other from all obligations under the Supply Contract relating to such quantity of gas, other than the representations, warranties, covenants, and certifications of the Buyer in respect thereof that are not made by the Dealer hereunder. If more than one price is set forth in the Supply Contract for gas sold and delivered thereunder by the Supplier, then the price at which such reduced quantity of gas shall be sold to and purchased by the Buyer thereunder shall be equal to the weighted average price referred to in *Section 1* hereof.

3. Payments. The Buyer shall send (or shall cause the Supplier to send) a copy of each transaction confirmation to MuniGas when and as issued or received, and the Buyer shall also compute and, on or before the last business day of each month, shall notify MuniGas and the Supplier of the Supplier's Share of all gas confirmed for delivery by MuniGas to the Buyer at the Buyer's Point of Receipt in such month pursuant to the Cooperative Contract. MuniGas shall provide a copy of the

transaction confirmation to Dealer upon request. To the extent of gas delivered by the Supplier at the Buyer's Point of Receipt in such month, the Supplier's Share of the quantities so notified by MuniGas shall be deemed to be delivered to the Dealer, rather than to the Buyer, in such month, subject to the further provisions of this paragraph. The Supplier shall cause such deliveries to be invoiced to the Dealer, at the price referred to in *Section 1* hereof, by the 10th day of the following month, and the Dealer shall pay for such deliveries by the later of the 25th day of such following month or 10 days after receipt of such invoice or, if the day for such payment is not a Business Day, then on the next Business Day. All other gas delivered by the Supplier at the Buyer's Point of Receipt in such month shall be deemed to be delivered and shall be invoiced by the Supplier to the Buyer at the same price in accordance with the provisions of the Supply Contract. Solely for purposes of computing any applicable weighted average price, all gas sold and delivered by the Supplier to the Buyer or the Dealer at the Buyer's Point of Receipt in such month pursuant to this Addendum or the Supply Contract shall be deemed to have been sold and delivered to the Buyer. The Dealer shall be entitled to net and set off amounts owing to Supplier hereunder against any other amounts owed by the Supplier to the Dealer under any other agreement between the Supplier and the Dealer. The Buyer does not guaranty and shall not be liable for any payment owed by any other party hereto to any other party hereto.

4. No Liability; Indemnity. The Supplier and the Buyer agree that the Dealer shall not be liable under any theory to the Supplier or the Buyer for (a) any breach by the Buyer of any term of the Supply Contract, the Cooperative Contract, this Addendum, or any other contract to which the Buyer is a party, (b) any breach by the Supplier of any of the terms of the Supply Contract, this Addendum, or any other contract to which it is a party, or (c) any breach by either the Supplier or the Buyer, or their agents, of any duty of care, law, regulation, or other legal obligation applicable to it, for gas sold and delivered by the Supplier to the Buyer (or to the Dealer hereunder) pursuant to the Supply Contract or any other supply arrangement applicable to any third party seller of gas to the Buyer (or to the Dealer hereunder). The Dealer and the Buyer agree that the Supplier likewise shall not be liable under any theory to the Buyer or the Dealer for (a) any breach by the Buyer of any term of the Supply Contract, the Cooperative Contract, or any other contract to which the Buyer is a party, (b) any breach by the Dealer of any of the terms of the Exchange Agreement or any other contract to which it is a party, or (c) any breach by either the Dealer or the Buyer of any duty of care, law, regulation, or other legal obligation applicable to it, for gas sold or exchanged and delivered by the Dealer pursuant to the Exchange Agreement. In addition, the Dealer shall have no obligation to nominate or confirm for delivery any quantity of gas for any period. Except for the obligations to receive and purchase gas at the price described in *Section 1*, the Dealer shall have no obligations or liabilities in favor of the Supplier or any other person hereunder or under the Supply Contract (whether or not in the context of *force majeure*), including, without limitation, obligations or liabilities (i) for taxes, warranties of title or merchantability, royalties, indemnities, scheduling fees, imbalance charges, overpull or unauthorized gas penalties or charges, operational flow order penalties or charges, or similar costs, or losses resulting from the liquidation of hedge positions or (ii) to maintain or operate any measurement or transportation facilities, to manage transportation contracts or pipeline capacity, to enter into financial hedge transactions with the Buyer, to provide risk management services or consulting services of any type (including, but not limited to, hedging strategies, projecting gas supply costs and fuel requirements, or regulatory services), to pay any early termination damages or cover damages, to provide security or collateral, to provide any type of fixed price, trigger price, or other risk management products to Buyer, or to act as agent in any capacity for Buyer or Supplier under the Supply Contract. The obligations of the Dealer to the Supplier hereunder shall not be affected by any failure by MuniGas to observe and perform its obligations under the Exchange Agreement or any imbalance existing thereunder. The Supplier acknowledges that any event which constitutes force majeure or otherwise excuses performance by the Buyer under the Supply Contract or by MuniGas under the Exchange Agreement or Cooperative Contract with respect to any receipt or purchase of gas supplied pursuant to this Addendum, including any breach by contractual counterparties under any related contract that has such effect, shall excuse performance by the Dealer hereunder.

The Supplier shall indemnify the Dealer and hold it harmless from and against any loss, cost or liability accruing to the Dealer resulting from (a) any claim by the Buyer or any other person of breach by the Supplier of, or negligence or misconduct by the Supplier in performance under, the Supply Contract or this Addendum, or breach of any duty of care, law, regulation, or other legal obligation applicable to the Supplier in connection therewith or herewith, (b) any claim which attaches before title to gas sold and delivered by the Supplier to the Dealer hereunder passes to the Dealer, and (c) any failure of gas sold and delivered by the Supplier to the Dealer hereunder to meet quality standards under the Supply Contract.

5. Nondisclosure by Dealer. The Dealer shall not disclose to any person the terms of the Supply Contract (the “**Confidential Information**”) except for disclosures of such terms (i) to Municipal Energy Resources Partners, Ltd. (“**MERP**”), Municipal Energy Resources Corporation (“**MERC**”), MuniGas, and directors, officers, employees, contractors, auditors, agents, and representatives of and counsel to the Dealer and the Dealer’s parent companies and affiliates (the “**Representatives**”), MERP, MERC, or MuniGas who need the Confidential Information for purposes of performing the services provided under this Addendum, the Exchange Agreement, and all other documents executed by Dealer in connection herewith and therewith or (ii) that are requested or required (by oral questions, interrogatories, requests for information or documents in legal proceedings, subpoena, civil investigative demand, or other similar process) to be disclosed or otherwise are required to be disclosed by law or in connection with legal proceedings regarding this Addendum, or the Exchange Agreement or the enforcement hereof or thereof. Notwithstanding the foregoing, the following will not constitute Confidential Information for purposes of this Addendum, or the Exchange Agreement: (i) information which is or becomes generally available to the public other than as a result of a disclosure by the Dealer or its Representatives; (ii) information which was already known to the Dealer on a nonconfidential basis prior to being furnished to the Dealer by the Supplier or the Buyer; and (iii) information which becomes available to the Dealer on a nonconfidential basis from a source other than the Supplier or the Buyer or a representative of the Supplier or the Buyer, if such source was not subject to any prohibition against transmitting the information to the Dealer and was not bound by a confidentiality agreement with the Supplier or the Buyer.

6. Governing Law. This Addendum shall be governed by and construed in accordance with the laws of the State of Texas.

7. Notices. Except as otherwise provided in this Addendum, any notice, request, demand, statement, bill, or other document required to be given to any party by this Addendum, and any notice which any party hereto may desire to give any other party hereto, shall be in writing and will be considered duly delivered when mailed by registered mail, return receipt requested, or sent by facsimile or electronic transmission with receipt acknowledged, to the address or number of the receiving party listed opposite its signature below or to any other address or number previously furnished in writing for such purpose by the receiving party to the other parties hereto.

8. Successors and Assigns. The provisions of this Addendum shall be binding upon and inure to the benefit of the successors and assigns of each of the parties hereto. No party hereto may assign any of its rights or obligations hereunder without the consent of the other parties hereto, except to a trustee, individual or corporate, as security for bonds, securities, or other contractual obligations. No such consent shall be unreasonably withheld, *provided* that any party may refuse so to consent if the assignee does not meet such party’s credit requirements. Upon such consent and assignment, the assigning party shall be released from all further liability hereunder, unless otherwise agreed by it.

9. Waivers. No waiver by any party hereto of any default by any other party hereto in the observance or performance of any provision of this Addendum shall operate as a waiver of any future default, whether of a like or of a different character.

10. *Relationship Between the Parties.* In connection with the negotiation of, the entering into, and the confirming of the execution of this Contract, each party acknowledges and agrees: (i) it is acting as principal (and not as agent or in any other capacity, fiduciary or otherwise); (ii) the other party is not acting as a fiduciary or financial or investment advisor for it; (iii) it is not relying upon any representations (whether written or oral) of the other party; (iv) the other party has not given to it (directly or indirectly through any other person) any advice, counsel, assurance, guaranty, or representation whatsoever as to the expected or projected success, profitability, return, performance, result, effect, consequence, or benefit (either legal, regulatory, tax, financial, accounting, or otherwise) of this Contract; (v) it has consulted with its own legal, regulatory, tax, business, investment, financial, and accounting advisors to the extent it has deemed necessary, and it has made its own investment, hedging, and trading decisions based upon its own judgment and upon any advice from such advisors as it has deemed necessary, and not upon any view expressed by the other party; (vi) all trading decisions have been the result of arm's length negotiations between the parties; and (vii) it is entering into this Contract with a full understanding of all of the risks hereof and thereof (economic and otherwise), and it is capable of assuming and willing to assume those risks (economic and otherwise).

11. *Entire Addendum.* This Addendum and the Supply Contract contain the entire agreement among the parties, and except as stated herein or therein there are no oral promises, agreements, warranties, obligations, or conditions, precedent or otherwise, affecting it.

12. *Amendments.* Any change, modification, or alteration of this Addendum shall be in writing, signed by the parties hereto, and no course of dealing between or among any parties hereto shall be construed to alter any term hereof, except as expressly stated herein. No amendment to the Supply Contract shall affect the rights and obligations of the Dealer hereunder (other than changing the price at which gas is to be purchased by it hereunder) unless approved in writing by the Dealer. The Buyer shall provide the Dealer and MuniGas with a copy of each such amendment promptly after execution thereof.

13. *Severability.* Except as otherwise stated herein, if any provision hereof or application thereof shall be declared or rendered unlawful by a court of law or regulatory agency with jurisdiction over any party hereto or deemed unlawful because of a statutory change, the remaining applications thereof and provisions of this Addendum shall nevertheless remain valid and enforceable.

14. *Corporate Obligations.* No recourse under or upon any obligation, covenant, or agreement contained in this Addendum, or for any claim based thereon or otherwise arising in respect thereof, shall be had against any incorporator or sponsor, or against any past, present, or future director, officer, employee, or member of the governing body, as such, of any party hereto or of any successor, or against any person or entity with whom any such party has contracted for goods or services, either directly or through such party, whether by virtue of any constitution or statute or rule of law, or by the enforcement of any assessment, judgment, or penalty, or otherwise; it being expressly understood that this Addendum is solely a corporate obligation, and that no such personal liability whatever shall attach to, or is or shall be incurred by, the incorporators, sponsors, directors, officers, or employees, as such, of such party or any successor, or any member of its governing body, or any such contracting person, or any of them, by reason of the obligations, covenants, or agreements contained in this Addendum or implied therefrom, and that any and all such personal liability either at common law or equity or by constitution or statute of, and any and all such rights and claims against, every such incorporator, sponsor, member, director, officer, employee, or person, as such, are hereby expressly waived and released as a condition of, and in consideration for, the execution of this Addendum.

15. Government Regulation. The delivery and receipt of gas by the Dealer, the Buyer, and the Supplier or their designees hereunder are subject to all valid laws with respect to the subject matter hereof and to all valid present and future orders, rules, and regulations of duly constituted governmental authorities having jurisdiction.

16. Benefits of Contract. Nothing in this Addendum, expressed or implied, shall give any benefit or any legal or equitable right, remedy, or claim under this Addendum to any person or entity other than the parties hereto, MuniGas, and their successors and assigns permitted hereby.

17. Effective Date. Notwithstanding the date hereof, this Addendum shall not become operative or effective until the first day of the month following the later of (1) the effective date for qualification of the Buyer as a “Participant” under the Exchange Agreement and (2) first effective date for designation of a “Dealer’s Point of Receipt” under the Exchange Agreement.

18. Term and Termination. This Addendum shall extend for a period of 30 years unless sooner terminated pursuant to this Section. This Addendum shall terminate on the earliest of (a) the cancellation, termination, or expiration of the Supply Contract, (b) the extension, renewal, modification, amendment, or replacement of the Supply Contract in a manner that adversely affects the rights and obligations of the Dealer hereunder (other than by changing the price at which gas is to be purchased by it hereunder) without the prior written approval of the Dealer, or (c) cancellation, termination, or expiration of the Exchange Agreement or of the rights and obligations of the Buyer under the Cooperative Contract. The Buyer, the Supplier, and the Dealer shall give the other parties notice of any such event which is known to it and would result in the termination of this Addendum. In addition, the Supplier may terminate this Addendum on account of any default by the Dealer in paying its obligations hereunder on the same terms and conditions as the Supplier may terminate the Supply Contract on account of any such default by the Buyer in paying its obligations thereunder. No such termination shall affect the obligations of the Supplier to indemnify the Dealer.

[Signature page follows]

IN WITNESS WHEREOF, the parties hereto have duly authorized and caused this Addendum to be executed as of the date first hereinabove written in multiple originals.

Supplier's Addresses and Nos.:

Telephone: () -
Facsimile: () -
Internet: _____

_____, as Supplier

By:
Name:
Title:

Dealer's Addresses and Nos.:

BP Energy Company
201 Helios Way
Houston, Texas 77079

For Confirmations:

Telephone: (713) 323-1866
Facsimile: (713) 323-4934

For invoices and payments:

Attn: Gas Accounting
Telephone: (713) 323-4919
Facsimile: (713) 323-5935

For all other communications:

Attn: Contract Administration
Telephone: (713) 323-2000
Facsimile: (713) 323-0203

BP ENERGY COMPANY, as Dealer

By:
Name:
Title:

Buyer's Addresses and Nos.:

Telephone: () -
Facsimile: () -
Internet: _____

_____, as Buyer

By:
Name:
Title:

ATTACHMENT F

PARTICIPANT ADDENDUM NO. 1

This Addendum to that certain Gas Exchange and Annual Balancing Agreement, dated as of January 1, 2006 (as amended from time to time, the “*Exchange Agreement*”), between Municipal Gas Acquisition and Supply Corporation (“*MuniGas*”) and BP Energy Company, a Delaware corporation (the “*Dealer*”), is entered into by such parties and the Participant designated herein to designate a Participant, or one or more of such Participant’s Buyer’s Points of Receipt or a new Supply Contract and Supplier for such Participant, all of which shall be as follows effective with the Day that commences on the Effective Date specified below:

Participant:	<i>[Insert name of the Participant]</i>
Participant’s Address:	<i>[Insert the Participant’s address]</i>
Participant’s Buyer’s Point(s) of Receipt:	<i>[Insert description of station(s) where Supplier sells and delivers gas to the Participant]</i>
Effective Date:	<i>[Insert effective date of change]</i>
Supplier:	<i>[Insert name of Participant’s Supplier]</i>
Supplier’s Address:	<i>[Insert Supplier’s address]</i>
Supply Contract:	<i>[Describe, by name and date, the Supply Contract. A copy of the Supply Contract is to be attached as Exhibit A]</i>
Supply Contract Expiration Date:	<i>[Insert last day of term of Supply Contract]</i>

This Addendum supersedes all prior addenda to the Exchange Agreement designating the same Participant.

Executed and delivered to be effective as of the above Effective Date.

BP ENERGY COMPANY

**MUNICIPAL GAS ACQUISITION AND
SUPPLY CORPORATION**

By:
Name:
Title:

By:
Name: Glen Pape
Title: President

[NAME OF PARTICIPANT]

By:
Name:
Title:



City of Palo Alto
Finance Committee Staff Report

(ID # 4832)

Report Type: Action Items

Meeting Date: 8/5/2014

Summary Title: MuniGas Natural Gas Purchase Agreement

Title: Utilities Advisory Commission Recommendation that the Finance Committee Recommend that City Council Adopt a Resolution Authorizing the City's Participation in a Natural Gas Purchase from Municipal Gas Acquisition and Supply Corporation for the City's Entire Retail Load, an Amount Estimated to be Approximately \$150 Million over Ten Years, Waiving the City's Choice of Law and Venue Requirements, and Authorizing the City Manager to Execute all Associated Agreements Required to Effect the Natural Gas Purchase

From: City Manager

Lead Department: Utilities

Recommendation

Staff and the Utilities Advisory Commission (UAC) recommend that the Finance Committee recommend that the City Council adopt a resolution:

1. Authorizing the City's participation in a natural gas purchase from Municipal Gas Acquisition and Supply Corporation for the City's entire load, an amount estimated to be approximately \$150 million over ten years; and
2. Waiving the choice of law and venue requirements of Section 2.30.340(c) of Palo Alto's Municipal Code, to permit the City to enter into the purchase transaction with MuniGas under Texas law.
3. Authorizing the City Manager to execute all associated agreements required to effect the natural gas purchase.

Executive Summary

Gas prepay transactions are a mechanism for municipal utilities to utilize their tax-exempt status to achieve a discount on the market price of gas. Staff has evaluated many options for prepay participation over the years and has concluded that the MuniGas transaction is the best fit for the organization. Staff recommends that the City participate in a gas prepay transaction by purchasing gas from MuniGas at a discounted price, and taking delivery of the gas from one of the City's existing suppliers that also participates in the MuniGas program. Taking advantage

of this low-risk opportunity will reduce the city's gas commodity cost by about \$1 million per year and save retail gas customers about 7.5% on their monthly gas commodity bill.

At its June 4, 2014 meeting, the UAC voted unanimously to recommend that the Council take the recommended action.

Background

Gas Utility Long-term Plan

The most recent Gas Utility Long-term Plan (GULP) was approved by City Council in April 2012 (Staff Report #2552, Resolution 9244). The plan covers a wide-range of areas, including the change from purchasing gas up to three years in advance to purchasing gas on the market and passing those costs directly to the customers via a rate based on the monthly market index price. GULP's "Supply Cost Management" objective is to "lower delivered gas cost over the long term". The associated GULP strategy is to "take advantage of the City's low cost of capital to acquire gas supply and assets".

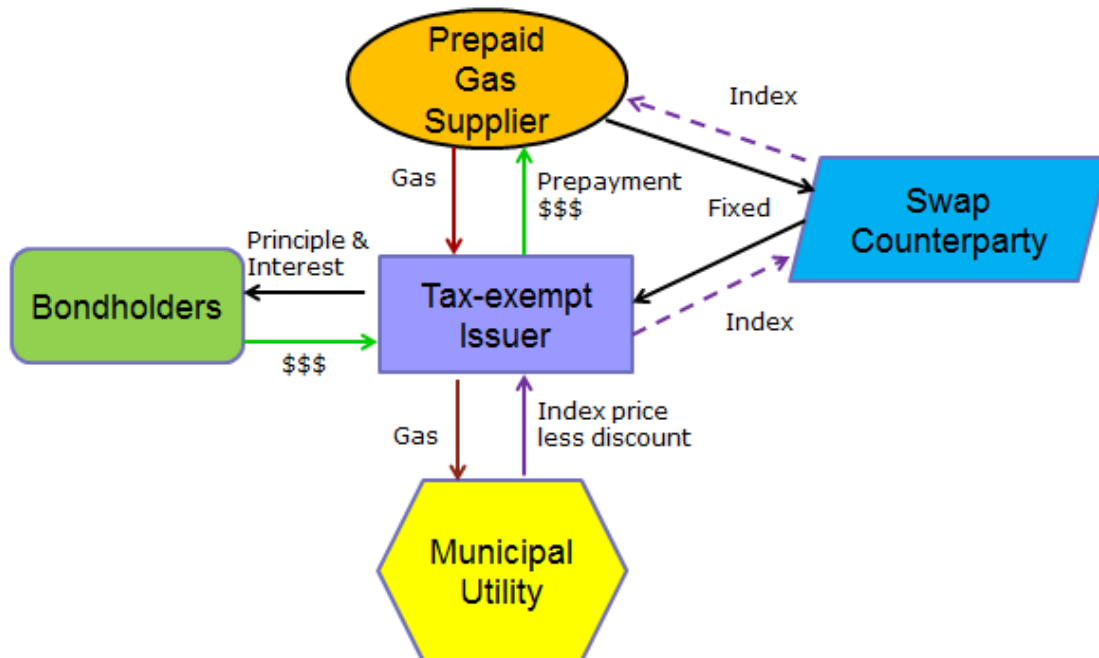
Standard Gas Prepay Overview

While the recommendation is not that the City participate directly in a prepay transaction, the following provides background information regarding the underlying prepay structure and the various participation options that have been evaluated in the past.

In October 2003 the Internal Revenue Service adopted regulations explicitly permitting tax exempt financing of public utility electricity and natural gas pre-purchases. The federal Energy Policy Act of 2005 further codified this benefit. Since that time, dozens of prepay deals worth billions of dollars have been completed by municipal utilities all over the country. In California, the Sacramento Municipal Utility District, Roseville Electric, Redding Electric Utility, Modesto Irrigation District, Silicon Valley Power, and a consortium of Southern California utilities have all prepaid for natural gas and enjoyed a discount on their gas commodity supplies as a result. Since all prepaid tax-exempt gas must be consumed by a qualified tax-exempt entity, this opportunity is not available to investor-owned utilities such as PG&E.

The amount of the discount is dependent on many factors, including the cost of capital differential between the supplier and the tax-exempt entity, the length of the prepay term, the underlying gas price, the gas volume, and the marginal federal and state corporate tax rates. Figure 1 depicts the standard prepay structure.

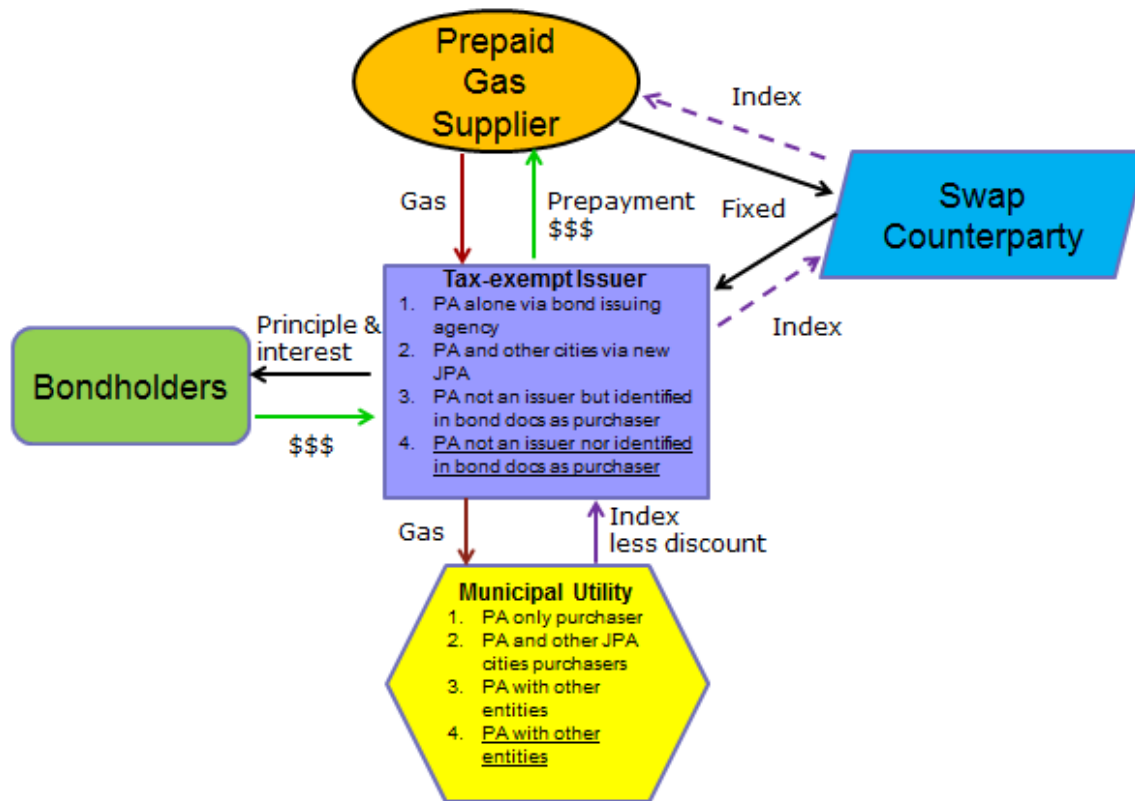
Figure 1: Standard Gas Prepay Structure



In a standard pre-pay structure, a tax-exempt financing entity formed by a municipal agency issues bonds and uses the proceeds to prepay for natural gas. The gas is delivered to the municipal utility at a market index price less a discount. Because the utility is paying a floating index price and the bond holders require fixed payments, a swap counterparty is used to convert index-based receipts for a fixed cash stream. The issuer can then pay principal and interest to the bondholders.

Over the years, staff has investigated a variety of ways for the City of Palo Alto Utilities (CPAU) to participate in prepay transactions. Figure 2 shows the roles CPAU could play if involved directly in a prepay transaction.

Figure 2: Roles CPAU Could Play in a Gas Prepay



The four roles CPAU could play in a gas prepay are described below:

1. **Palo Alto acts alone to establish a financing entity to issue bonds and prepay for gas.** This alternative has volume certainty and offers the highest level of control with respect to the contract terms. On the downside, discounts will be relatively small because the volume of gas for a Palo Alto-only deal will be small, and Palo Alto will bear all the transaction costs (estimated by staff to be approximately \$2 million).
2. **Palo Alto joins a consortium of municipal utilities to establish a financing entity to issue bonds and prepay for gas.** This is the same as alternative 1 except that a group of municipal utilities shares the up-front costs. Discounts are larger due to the larger combined gas volume. On the other hand, compromises are inevitable in a consortium, and the process may be slowed by having additional decision makers.
3. **Palo Alto is not directly involved in the prepay transaction but is listed in the bond documents as a taker of gas.** The discount would be less because the bond issuer would demand some of the benefit, and Palo Alto would give up control of the contract terms. However, the staff and consultant time needed to participate would be greatly reduced.

4. **Palo Alto shops for excess gas from another's prepay deal.** If a municipal buyer buying prepaid gas has a reduced need for the gas due to operational factors, that gas must be sold to another qualified municipal buyer. Discounts are minimal, and there is no volume certainty.

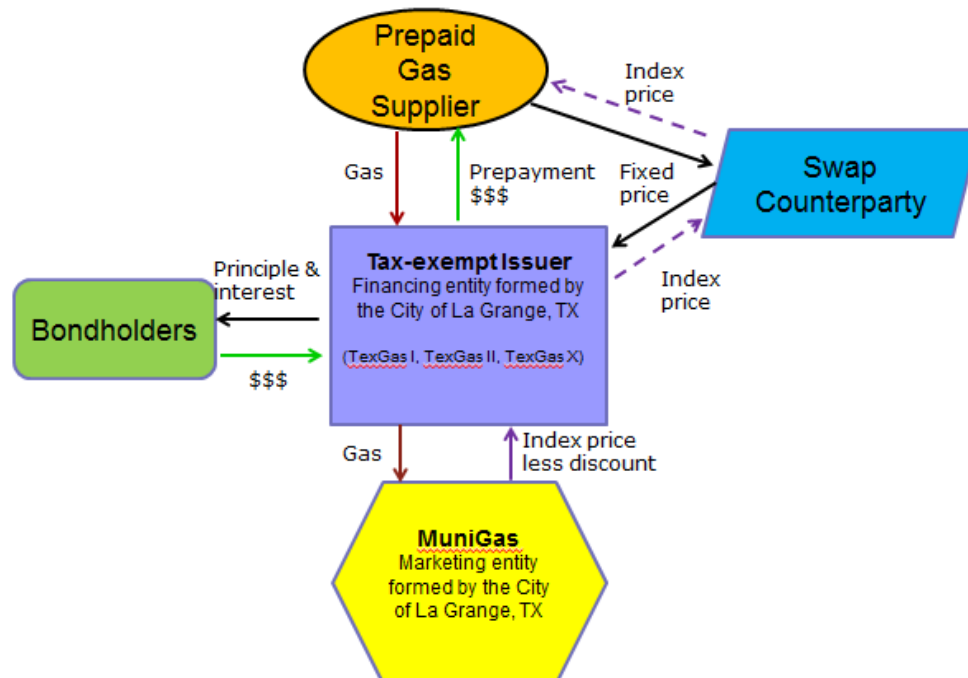
Although, as noted above, all other California utilities of any significant size have completed prepay transactions, CPAU has been unable to take advantage of the opportunity. One obstacle that has now been removed was the laddering gas purchasing strategy. Prepaid gas is sold to the municipal utility at a market index price. In order to implement a hedging strategy, the municipal utility would need to use financial instruments to hedge the underlying index instead of purchasing physical fixed- or capped-priced products. CPAU now buys all gas on the spot market index and passes the monthly market price through to customers. Since CPAU does not hedge against market price changes, there is no need to seek approval for the use of financial instruments when purchasing all physical gas at a monthly market index price.

Discussion

Overview of the MuniGas Transaction Structure

The MuniGas transaction includes an underlying prepay transaction identical to that illustrated in Figure 1. Figure 3 shows the roles of the various counterparties in the MuniGas prepay structure.

Figure 3: MuniGas Prepay Structure

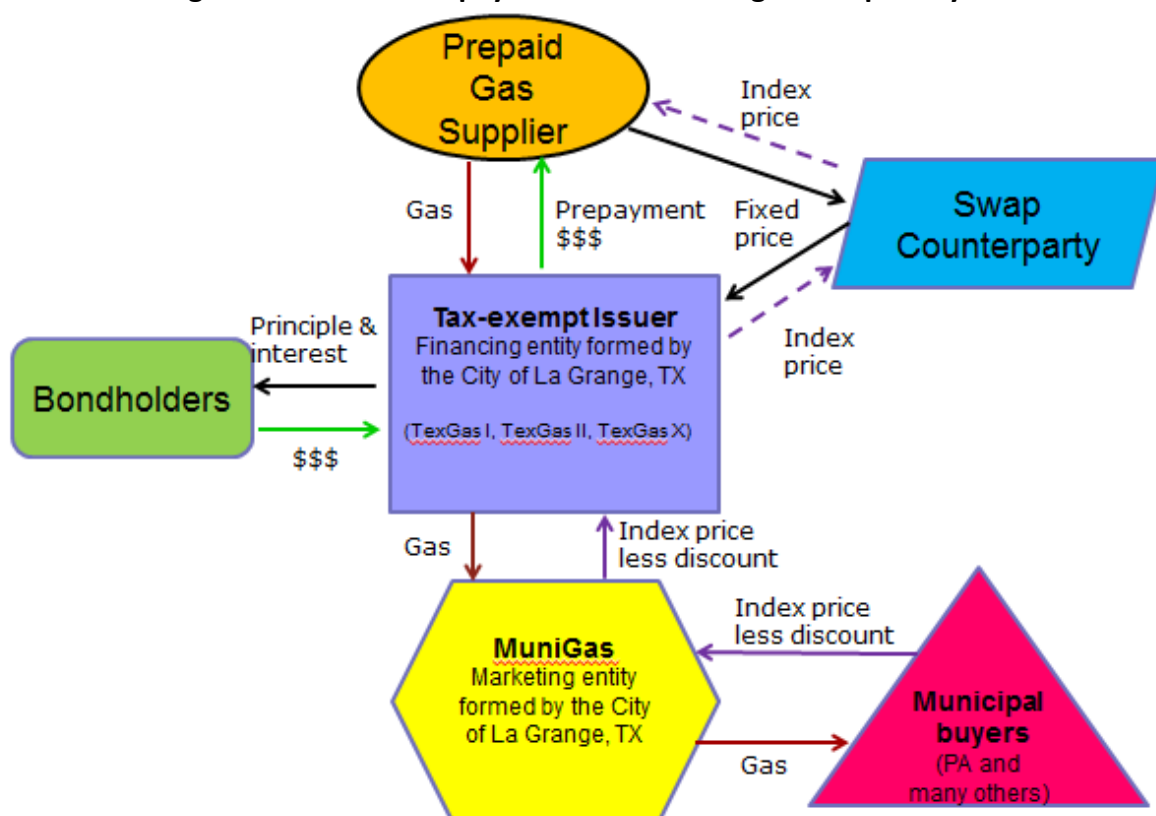


In the MuniGas transaction, the tax-exempt issuer is a Texas public facility corporation created by the City of La Grange, Texas. A Texas public facility corporation is much like a California joint

action agency formed solely for financing purposes, with the exception that only one municipality, the sponsor, is necessary to form a public facility corporation in Texas. The City of La Grange has formed a public facility corporation, named TexGas I, TexGas II, etc., for each prepay deal. The City of La Grange also formed MuniGas, the entity that markets the prepaid gas.

The municipal buyers (e.g. municipal utilities such as CPAU) are at arm's length from the underlying prepay transaction. Gas is purchased by the municipal buyer from MuniGas, the marketing entity, through a gas purchase agreement. Figure 4 adds the municipal buyer to the diagram.

Figure 4: MuniGas Prepay Structure Including Municipal Buyers



MuniGas History

The first MuniGas transactions occurred in 1998 and 2003 through a financing entity then known as the Texas Municipal Gas Corporation (TMGC). In 2003, the City of La Grange formed the marketing entity, MuniGas, to expand the program. In the early deals, all of the prepaid gas was committed under long-term contracts prior to issuance of the bonds.

In 2006, \$2.4 billion in bonds were sold to buy a 20-year gas supply from Merrill Lynch. This transaction was the first of its kind in that not all gas was committed under contract at the time the prepay transaction was completed, and this is a unique characteristic of the MuniGas

structure. The large size and merchant nature of the transaction caused some concern in the municipal bond community as underwriters and bond counsels worried that the Internal Revenue Service might audit the transaction and ultimately prohibit the use of tax-exempt financing for the acquisition of prepaid gas supplies. This did not occur. In 2007, another \$1.9 billion in bonds were sold to buy another 20-year supply from JP Morgan; again, not all the gas was committed under contract prior to the bond issuance, so it was not known which tax-exempt entity would purchase the gas.

In 2008, the credit and economic crisis began to unfold. Traditional credit spreads collapsed, and prepay transaction became uneconomic. As the recession came to an end, the credit markets recovered, and MuniGas resumed prepay transactions. In 2012, \$1.4 billion in bonds were sold to buy a 20 year gas supply from Macquarie US Gas Supply.

Today, MuniGas sells gas to 105 municipal utilities in 20 states. Approximately 90% of the gas is sold under long-term contracts while about 10% is sold on a spot basis. MuniGas keeps a “wait list” of interested customers, and when enough long-term contracts are in place, another TexGas public facility corporation is formed and bonds are issued to execute the next prepay transaction.

Discounts

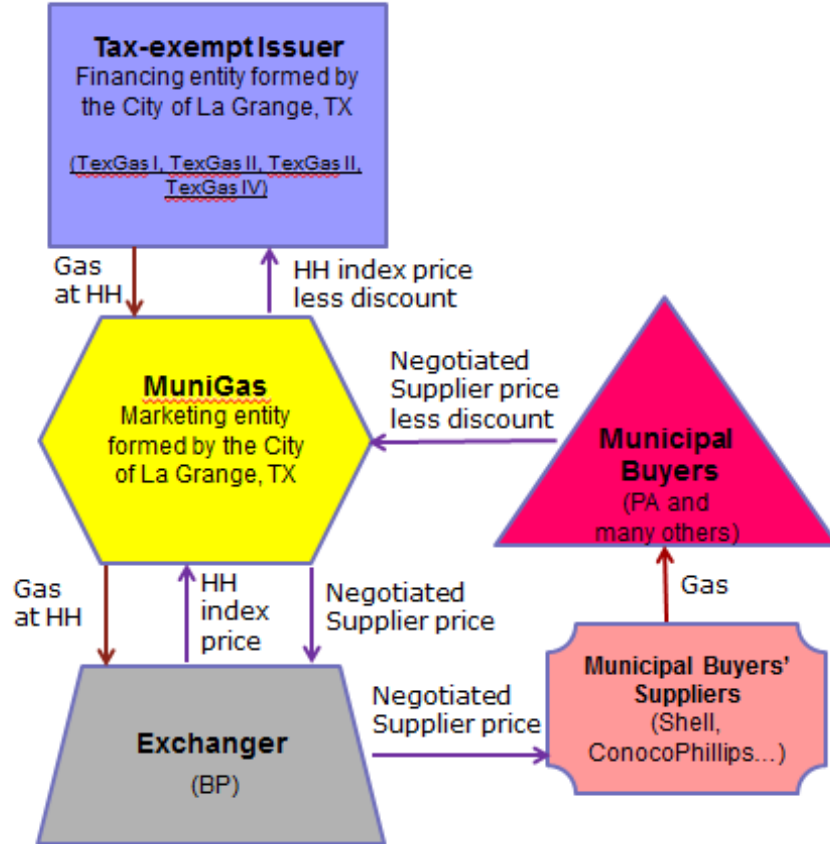
Discounts for the MuniGas long-term customers have ranged from about \$0.28 to \$0.39 per million British thermal units (MMBtu). As a point of reference, a \$0.30 per MMBtu discount applied to CPAU’s retail gas load (approximately 3.2 million MMBtus) is equivalent to approximately \$1 million per year. Assuming a \$4 per MMBtu underlying gas price, a \$0.30 per MMBtu discounts would yield a 7.5% commodity rate decrease for a CPAU customer. The discount will be reflected every month in CPAU gas customers’ monthly commodity rate.

Discounts are allocated by MuniGas and are the maximum possible after program costs and bond obligations are covered. Longer-term customers are granted higher discounts than those that execute shorter-term agreements. All MuniGas transactions are combined into one pool of gas, so discounts can change slightly over the term of the contract. MuniGas endeavors, and has historically achieved, a minimum discount of \$0.30 per MMBtu.

Cash Flows and Using an Exchanger to Facilitate Physical Delivery of Gas

All MuniGas prepay transaction are done at the industry standard trading point of Henry Hub, Louisiana. Because most municipal utilities need the gas to be delivered to some other location, an “exchanger” is used to displace the gas at Henry Hub, and the municipal buyer’s regular gas suppliers deliver the gas to the municipal utilities’ desired delivery point. In CPAU’s case, the delivery points are Malin, Oregon at the California/Oregon border and the PG&E Citygate. Figure 5 shows the somewhat complicated resulting cash flow.

Figure 5: MuniGas Cash Flow Diagram (HH is Henry Hub)



The gas exchange and resulting cash flow is implemented as follows:

1. The Exchanger (British Petroleum or BP) takes delivery of the prepaid gas at Henry Hub and pays to MuniGas the Henry Hub index price.
2. The municipal buyer negotiates with its gas supplier a price for gas at its desired delivery point. This negotiation is no different from the way CPAU currently buys gas using the Council-approved master agreements and the competitive bidding process.
3. The municipal buyer's gas supplier delivers the gas at the delivery point.
4. The municipal buyer pays to MuniGas the negotiated price less the MuniGas deal discount.
5. MuniGas pays the Exchanger the negotiated price.
6. The Exchanger passes that payment through to the municipal buyer's supplier.

For example, assume the MuniGas discount is \$0.30 per MMBtu and assume CPAU negotiates with Shell, one of its suppliers, a price of PG&E Citygate index less \$0.01 per MMBtu. Now the parties to the deal act as follows:

- BP, the Exchanger, pays Shell for the gas at the PG&E Citygate index price, less \$0.01 per MMBtu.
- Shell delivers the gas to CPAU at the PG&E Citygate.

- CPAU pays MuniGas the PG&E Citygate index price, less \$0.31 per MMBtu (\$0.30 + \$0.01 per MMBtu).
- MuniGas pays the Exchanger the PG&E Citygate index less \$0.01 per MMBtu.
- As a result:
 - The Exchanger is kept whole.
 - The gas supplier receives the negotiated price.
 - CPAU pays the negotiated price AND gets the MuniGas discount.

Contracts and Legal Review

There are six documents that apply to a buyer participating in the MuniGas program. These documents were presented to the City as non-negotiable, given the large number of parties and the complexity of the upstream transactions. The City Attorney's Office and outside counsel reviewed the documents to analyze the legal risks involved with any proposed deviations from the City's standard practice, in order to assess the significance of any key differences and negotiate any essential changes to the contract terms. The contracts included as attachments to this report are for reference. Final contracts listing the parties' names and current dates will be included with the final report to Council.

Upon executing the Purchase Contract, Palo Alto would become a party to the:

1. **Joint Gas Purchase Contract:** This Joint Contract will be between Texas Municipal Gas Corporation IV, the City of La Grange, Texas, and each of the local governments described therein¹ (which includes the MuniGas NAESB).

The City, as Buyer, would be required to execute the following:

2. **Purchase Contract:** a Purchase Contract between the City of La Grange, Texas, Texas Municipal Gas Corporation IV, and Buyer;
3. **Addendum:** an Addendum to Gas Supply Contract among Buyer, Supplier and BP Energy Company; and
4. **Participant Addendum:** an Addendum No. 1 between MuniGas Gas Acquisition and Supply Corporation, BP Energy Company and the designated Participant (which is the same as the buyer).

In addition, the City must provide a:

5. **Resolution** Authorizing Gas Purchase Contract; and
6. **Secretarial Certificate** of Buyer.

1. Joint Gas Purchase Contract

The main contract governing the municipal buyer's gas purchase from MuniGas is the North American Energy Standards Board (NAESB) with special provisions. This contract is the same one CPAU uses for all its gas master agreements and the contract is executed by the municipal buyer and MuniGas. The NEASB, along with the special provisions incorporated by reference, is

¹ The "MuniGas II" offering in 2006/2007 was limited to Texas municipalities.

called the Joint Purchase Contract. While most of the terms that differ from Palo Alto's standard NAESB terms are commercial and non-controversial, three terms differ from the City's typical requirements. The City Attorney's office and outside counsel evaluated the differences and felt they were acceptable given the unique nature of the discount purchase deal at issue, and staff's assessment of the commercial advantages of entering into such a transaction. Each term is discussed below:

a. Early Termination Damages:

Under the City's standard NAESB Master Agreement, Early Termination Damages typically apply. This means that if a counterparty defaults, then the City as non-defaulting party has the right to designate an early termination date for the liquidation and termination of all transactions under the contract. Under this scenario, the non-defaulting party determines the amount owed by each party for all gas delivered and received and all other related unpaid charges. Then the non-defaulting party accelerates each terminated transaction at its then-market value. If the market value is higher than the contract value, the balance is owed to the City/non-defaulting party; otherwise the difference is owed to the seller. The City's current NAESB also requires the defaulting party to pay the non-defaulting party for a long list of costs incurred in liquidating each terminated transaction, including fees, transaction costs, and attorney's fees.

MuniGas' Joint Purchase Contract provides that Early Termination Damages do *not* apply. While Early Termination Damages make sense in fixed-price contracts like the City's typical NAESBs, it makes less sense to apply them to the MuniGas deal. This is because the MuniGas "contract value" is a discount off of a floating index, and the "market value" is the floating index. The difference is the index discount. If Early Termination Damages applied, and MuniGas defaulted, it would owe Palo Alto the amount of the discount. Here, since Early Termination Damages do *not* apply, if MuniGas defaulted, Palo Alto would go back to buying index-priced gas without the discount. This would put the City in substantially the same, and no worse, position than it would be in had it never entered the MuniGas deal.

b. One-Way Termination

Under the City's standard NAESB Master Agreement, once Early Termination Damages are calculated, One-Way Termination applies. This means that the non-defaulting party will not owe the defaulting party any money for terminated transactions, even if the market price has dropped below the contract price. MuniGas' Joint Purchase Contract provides that *Two-Way* Termination applies in the event of default. This means that it is possible that a non-defaulting party could be required to pay the defaulting party a termination payment, if the market price has dropped below the contract price at the time of default.

As described above, if MuniGas defaults, the agreement will terminate and Palo Alto will be in the same position it was before entering into the deal – purchasing gas at the market price with no discount. Thus, Two-Way Termination as applied to this type of transaction poses little risk to the City.

c. Choice of Law is Texas

The Joint Purchase Contract and all the MuniGas agreements are governed by Texas law. This provision constitutes a departure from the gas contract requirements in Section 2.30.340(c) of Palo Alto's Municipal Code, but was not a negotiable item. Council may waive this requirement by resolution.

2. Purchase Contract

The second document is the Purchase Contract in which the municipal buyer/City declares the Maximum Annual Quantity (this can be amended) of gas requested and the initial contract term. The contract will automatically renew one year at a time beyond the initial term unless terminated by the municipal buyer. The Purchase Contract is executed by the municipal buyer, MuniGas, and the City of La Grange. By executing the Purchase Contract, the buyer/City becomes a party to the Joint Gas Purchase Contract.

The Purchase Contract originally stated that the buyer's obligations under the Purchase Contract were payable prior to the City's debt obligations. The City successfully negotiated for the inclusion of language in the Purchase Contract to ensure that the City's gas utility's maintenance and operations costs are payable prior to the City's obligations under the Purchase Contract. This is consistent with the City's existing bond covenants and current practices.

The City also successfully negotiated for the inclusion of an acknowledgement that the City is subject to the California Public Records Act, and provides for notice by the City of any Public Records Act request related to the MuniGas documents.

3. Addendum

The third document is the Supplier Addendum which is executed by the municipal buyer, each of the municipal buyer's gas supplier(s) and MuniGas. This addendum establishes the supplier's performance to be governed by master agreements. There is also language regarding confidentiality since MuniGas and the Exchanger will be privy to pricing information negotiated between the municipal buyer and the suppliers. This confidentiality obligation is upon the dealer, and does not apply to the City's need to comply with a Public Records Act request as described above regarding the Purchase Contract.

4. Participant Addendum

The fourth document is the Participant Addendum to the Balancing and Exchange Agreement. The underlying Balancing and Exchange Agreement is between BP, the Exchanger, and

MuniGas. This addendum is largely administrative, listing the name of municipal buyer, delivery points, and the municipal buyer's suppliers.

5 and 6. Resolution and Secretarial Certificate

Lastly, MuniGas requires a Resolution and Secretarial Certificate authorizing and verifying the execution of Purchase Contract, Supplier Addendum, and Participant Addendum. Council approval of large contracts via resolution is the City's standard business practice.

Term

Staff recommends a 10-year term for 100% of CPAU's gas load. MuniGas allocates discounts to customers in accordance with the term of commitment and considers 10 years to be long-term. MuniGas will not deliver any more gas than what is used by CPAU's customers, therefore, a decreasing annual gas demand will not expose the City to any volumetric risk. The contract may be terminated prior to 10 years with a one-year notice, but the discount will be greatly reduced for the remaining year. Conversely, the contract has an automatic one-year annual extension unless either party provides notice of termination by December 1.

Risks

While the MuniGas discounts are a result of a complex prepay transaction, for the municipal buyer, the contract is a relatively straight-forward gas purchase agreement.

The risk of the MuniGas prepay transaction unwinding is borne by the bondholders. From the municipal buyer's perspective, the discount to index would cease to exist and CPAU would be back to the current situation of buying market priced gas without the discount. Several events can cause a prepay transaction to fall apart, including credit deterioration of swap counterparties, chronic failure to deliver gas by prepay gas supplier and payment default by one of the prepay parties. Another situation that can cause the demise of a prepay transaction is failure to sell gas for a qualified use. Prepaid gas must be consumed by a qualified end use, such as by a municipal utility. Another risk to the underlying prepay transaction is that competition to MuniGas could result in stranded gas and the collapse of the program. No other organization has thus far been willing to get into the MuniGas business space, but it is not impossible that competition could arise.

A second risk is that the Exchange Agreement with BP is not renewed. The Exchange Agreement is the contract between BP and MuniGas (Palo Alto is not a party) that establishes the roll of BP as the exchanger. In this case, CPAU would have the administrative burden of receiving gas at Henry Hub and would have to arrange for an exchange of gas to the PG&E Citygate. However, staff estimates that this burden would cost CPAU much less than the annual value of the prepay transaction.

The pool of enabled gas suppliers will be limited to those enrolled in the MuniGas program. Staff considers the risk associated with this to be small because, of CPAU's five existing suppliers (ConocoPhillips, Shell, BP, JP Morgan, and Powerex), the first three are already

involved in MuniGas transactions with other customers and a fourth is willing to become enabled through the program, should CPAU proceed. Entering into the MuniGas transaction will not constitute any contractual default with the City's existing suppliers. Those master agreements will remain in effect.

With any sort of long-term commitment comes an opportunity risk - the risk that a better opportunity with a larger discount will arise after the City has already signed contracts with MuniGas. It is even possible that a future MuniGas transaction will yield larger discounts and that CPAU will have to forego the opportunity.

The MuniGas program has a history of success. Bond counsel for all MuniGas prepay transactions is Fulbright and Jaworski L.L.P, the premier legal firm regarding prepays, and each bond issuance is vetted by Attorney General of Texas. Because the delivery of the gas is governed by CPAU's own master agreements, there is no additional operating risk. In addition, the City's counterparty credit rating requirement of BBB- will be met. The credit rating of the most recent MuniGas issuer, TexGas III, is A3.

Conclusions

Gas prepay transactions offer the only opportunity for CPAU to reduce gas commodity costs significantly below market. This is an opportunity that is not available to PG&E. The MuniGas program is a very low risk way to take advantage of the City's tax-exempt status to achieve a commodity discount for all CPAU gas rate payers and meet the council-approved GULP objectives. Staff feels that the significant economic and commercial advantages of entering into a MuniGas purchase outweigh the relatively low risks associated with accepting most of MuniGas' contractual provisions. The index less discount price structure is a perfect fit with CPAU's market index-based index pass-through rate.

Commission Review and Recommendation

The Utilities Advisory Commission (UAC) reviewed the recommended action at its June 4, 2014 meeting. The UAC discussed the merits of reducing the cost of gas compared to that of PG&E. Staff clarified that, in the worst-case scenario of the prepay deal terminating, Palo Alto would be back to the status quo of purchasing gas on the market without the MuniGas discount.

After discussion, the UAC voted unanimously (4-0, with Commissioners Chang, Foster and Hall absent) to recommend that Council approve the recommended action. The draft minutes from the UAC's June 4, 2014 minutes are provided as Attachment G.

Timing

Execution of the attached contracts will place CPAU on the MuniGas waitlist. When MuniGas determines that enough volume has been committed under long-term contracts, TexGas IV will be formed to issue bonds and prepay for gas and deliveries will commence, hopefully before the end of the calendar year. Council approval of the forthcoming resolution will authorize the City Manager to execute the required agreements when necessary.

Resource Impact

The total gas commodity budget is approximately \$15 million per year (based on a gas price of \$4.50 per MMBtu), and staff anticipates a discount of \$0.30 per MMBtu resulting in a saving of approximately \$1 million per year. The discount will be passed through to retail gas customers. Staff time to administer the contract is anticipated to be negligible.

Policy Implications

Adoption of the proposed Resolution supports the objectives and strategies identified in the Council-approved Gas Utility Long-term Plan and the Council-approved Utilities Strategic Plan's strategic objective to reduce the cost of delivering service.

Environmental Review

Execution of the attached contracts does not require review under the California Environmental Quality Act (CEQA) since the proposed action does not meet the definition of a project under Public Resources Code Section 21065. In the alternative, execution of the attached contracts is exempt from CEQA pursuant to Section 15061(b)(3) of the CEQA Guidelines because it can be seen with certainty that there is no possibility of significant environmental effects occurring as a result.

Attachments:

- Attachment A: Resolution (PDF)
- Attachment B: Secretarial Certificate (PDF)
- Attachment C: Joint Gas Purchase Contract (PDF)
- Attachment D: Purchase Contract (PDF)
- Attachment E: Supplier Addendum (PDF)
- Attachment F: Participant Addendum (PDF)
- Attachment G: Excerpted Draft UAC Minutes of June 4, 2014 meeting (PDF)

ATTACHMENT H



EXCERPTED FINAL MINUTES OF THE JUNE 4, 2014 UTILITIES ADVISORY COMMISSION MEETING

ITEM 1: ACTION: Staff Recommendation that the Utilities Advisory Commission Recommend that City Council Approve the City's Participation in a Natural Gas Purchase from Municipal Gas Acquisition and Supply Corporation for the City's Entire Retail Load, an Amount Estimated to be Approximately \$150 Million over Ten Years, Waive the City's Choice of Law and Venue Requirements, and Authorize the City Manager to Execute all Associated Agreements Required to Effect the Natural Gas Purchase

Senior Resource Planner Karla Dailey presented information about the MuniGas natural gas purchase program. Dailey recounted the history of pre-pay discussions and actions by the UAC. She then reviewed the relevant sections of the Gas Utility Long-term Plan. She presented an overview of pre-pay transactions and then highlighted the difference between a standard pre-pay transaction and the MuniGas structure. She compared all of the pre-pay participation options against each other including the pros and cons.

Dailey described the history of the MuniGas program and the anticipated natural gas market price discounts that will result from participating. She presented a brief summary of the legal analysis and the potential risks associated with the transaction. She concluded with a list of next steps and staff's request that the UAC recommend that City Council approve a 10-year natural gas purchase from Municipal Gas Acquisition and Supply Corporation and authorization for the City Manager to execute all required agreements.

Chair Cook asked if prior consideration of the City participating in a gas pre-pay transaction was before termination of the gas laddering purchasing strategy. Dailey answered that it was and added that Palo Alto could have participated in a gas pre-pay transaction, but that financial instruments would have been needed to hedge the gas portfolio to implement the laddering strategy.

Commissioner Melton asked what types of entities are the swap counterparties, and Dailey replied that banks typically serve that function.

Chair Cook asked why gas suppliers are willing to provide discounts to the price of gas, and Dailey replied that it is because they get all the money up front and this is valuable to them, especially because those suppliers have a relatively high cost of capital.

Commissioner Melton asked if MuniGas was the only organization that offers this particular structure and Dailey confirmed that this is the case.

Commissioner Waldfogel asked if any gas disruptions of prepaid gas occurred during the credit crisis, and Dailey answered that there were not. Commissioner Melton followed up with a question regarding any other pre-pay deals that have failed. Dailey confirmed that a pre-pay transaction involving Lehman Brothers collapsed when that firm declared bankruptcy and that the unwinding of the transaction happened exactly as the structure was designed leaving the bondholders holding the bag.

Chair Cook stated that if Palo Alto decided to do this, we might not get to do it for a while since we'll have to be on a waiting list, and this was confirmed by Dailey.

Chair Cook inquired about how the physical gas is delivered. Dailey explained that Palo Alto will still get the physical gas the same way we do now. All the operational details about deliveries of gas are ruled by our master agreements. The gas in this deal is delivered at Henry Hub.

Chair Cook recalled the issue this winter with difficulty getting sufficient gas deliveries due to the polar vortex and asked if there is any more risk from doing the MuniGas deal than buying gas from the regular market. Dailey replied that there is no more risk with getting physical gas delivered.

Commissioner Eglash pointed out that the savings shown do not include the cost of staff time to manage the contract. Dailey agreed and said that those resource needs are small and basically would involve keeping track of the gas we purchased, just as we do now.

Commissioner Eglash asked about the supply risk in the unlikely event that the deal collapsed and wanted to know if Palo Alto would still be able to get the gas. Dailey replied that physical gas would still flow from our suppliers to Palo Alto.

Commissioner Eglash asked what market conditions make a pre-pay deal good or bad, and Dailey replied that high gas prices yield larger discounts. Commissioner Eglash asked, compared to current gas price conditions, if there is a better time to do a deal. Dailey explained that Palo Alto could wait and enter into a transaction later when prices are higher, but that Palo Alto would forego the discount in the meantime. Commissioner Eglash confirmed that he was not in favor of waiting for more ideal market conditions.

Commissioner Waldfogel said the deal looks attractive, and asked if Palo Alto's supply cost will be lower than PG&E's. Dailey answered yes. He then asked about the City's ability to buy "green" gas, biogas for example, in the future. Dailey stated that we could buy other gas supply products through our master agreements and still realize the MuniGas discount. Commissioner Melton commented that as long as we buy gas from any of our suppliers that can be part of the MuniGas deal, we would be able to get the discount on all types of gas.

Commissioner Eglash asked about restrictions on buying a new source of supply in the future and Chair Cook and Commissioner Eglash asked for clarification on this point with respect to gas from an anaerobic digester for electric generation. Dailey answered that the MuniGas deal is specifically for gas consumed by Palo Alto's retail gas utility customers, so there are no restrictions regarding any types of gas purchased for the electric utility.

Commissioner Waldfogel expressed concern regarding the uncertainty of our gas suppliers' willingness to sign the supplier addendum and suggested that support for the recommendation may be conditional on making at least 4 of our suppliers signing the agreement.

Action:

Commissioner Eglash made a motion to support the staff recommendation. Commissioner Melton seconded the motion. The motion carried unanimously (4-0 with Commissioners Chang, Eglash, and Hall absent).

Commissioner Waldfogel commented that this is a lot to absorb in the course of the meeting. The memo and the contract were long and complicated. He stated that it's a lot to take in all at once. However, he stated that it sounded like staff has thought through the risks and the alternatives, but that it deserves careful thinking

Commissioner Cook added that the item might have been covered over two meetings due to its complexity.

Commissioner Waldfogel suggested that these complicated issues may benefit from additional focused analysis, including the creation of a UAC subcommittee to allow a subgroup to delve deeper.

Commissioner Eglash noted that the staff has worked on this for a long time and brought it forward when it made sense and he indicated that he was supportive the proposal.



FINANCE COMMITTEE DRAFT EXCERPT

Regular Meeting
Tuesday, August 5, 2014

2. Utilities Advisory Commission Recommendation that the Finance Committee Recommend that City Council Adopt a Resolution Authorizing the City's Participation in a Natural Gas Purchase from Municipal Gas Acquisition and Supply Corporation for the City's Entire Retail Load, an Amount Estimated to be Approximately \$150 Million over Ten Years, Waiving the City's Choice of Law and Venue Requirements, and Authorizing the City Manager to Execute all Associated Agreements Required to Effect the Natural Gas Purchase.

Karla Dailey, Senior Resources Planner, presented a brief outline of the background, technical issues, and a proposal on the pre-pay programs of natural gas purchases. In 2004, Staff did not recommend pursuing a gas pre-pay program because of too much uncertainty. Between 2008 and 2010 there were multiple and lengthy discussions between Staff and the Utilities Advisory Commission (UAC). The Council approved the Utilities Department plan in 2010 to take advantage of the City's low cost of capital to acquire gas supply and assets. According to the Internal Revenue Services (IRS) municipal agencies could legally leverage ability to issue low-cost, tax-exempt debt to pre-pay for gas and electricity. The pros of accomplishing a sole pre-pay program would allow for Palo Alto to have complete control, with the con being higher administrative costs. Combining efforts with other city's lowered the administrative costs which was a pro but held the con of introducing the possibility of unknown issues from them. There had been a number of layers of structured analysis; beginning with an outside consultant who was intimately involved with the Roseville system. A legal analysis was performed by the City's legal Staff as well as outside counsel.

Vice Mayor Kniss understood this type of system would be a first for Palo Alto.

Ms. Dailey stated that was correct.

Vice Mayor Kniss asked why Staff and the UAC did not consider the option between the 2004 and 2010 discussions.

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Ms. Dailey stated it was a complex structure and for one reason or another it did not feel like the right fit for the organization. Until recently Palo Alto had a very structured and successful hedging program in place.

Vice Mayor Kniss asked if the Council approved the program how competitive would it make Palo Alto compared to the surrounding cities with the gas prices.

Ms. Dailey said the surrounding cities were supplied by Pacific, Gas & Electric (PG&E) which bought market index priced gas; however, they were not eligible for the pre-pay program so Palo Alto would be \$0.30 lower.

Chair Berman said on the commodities side.

Ms. Dailey stated that was correct.

Vice Mayor Kniss said \$0.30 was a substantial amount.

Ms. Dailey replied yes.

Council Member Holman asked how the \$0.30 would be passed down to the rate payers.

Ms. Dailey stated the savings should equate to a 3.75 percent discount.

Council Member Holman said on the comparison of options there were a variety of discounts. She asked how the discounts were ascertained.

Ms. Dailey stated the discounts were based on volume and term.

Council Member Holman confirmed the method was extrapolation rather than discussion with other municipality.

Ms. Dailey stated that was correct.

Council Member Holman asked if there was contact with other municipalities that were a part of the MuniGas program to determine the viability of that process.

Ms. Dailey said she had conversations with Sacramento Municipal Utility

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District (SMUD) and other communities involved in the MuniGas program and there seemed to be consensus of satisfaction.

Council Member Holman stated when the Staff Report was presented to Council it should reflect the translation for rate payers.

Ms. Dailey concurred.

Council Member Holman asked the consequences of the remaining pre-paid amount if the program defaulted.

Ms. Dailey stated there was no actual pre-pay expense. The City bought gas at a discounted rate on a month to month basis.

Council Member Burt agreed the program appeared to be a low risk with a return for investment. With the 3.75 percent reduction in the cost to the rate payers he asked where that placed Palo Alto in relation to PG&E and the other municipalities.

Ms. Dailey stated presently the City's distribution rates were higher than PG&E.

Council Member Burt understood the City was currently higher but his question was how much closer the proposed program brought them to PG&E rates.

Ms. Fong mentioned PG&E was intending to increase their distribution and transmission rates but Staff did not have their numbers readily accessible.

Council Member Burt felt that was important information.

Ms. Dailey stated the information would be included in the Staff report going before Council.

Council Member Burt said the program locked the City in for a decade and precluded them from moving into a greener program in the future; if the market evolved.

Ms. Dailey disagreed because Palo Alto was still having their gas delivered by the suppliers the City had the Master Agreements with. If the market was developed for green gas the City could purchase the energy through one of

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the current suppliers while continuing to receive the MuniGas discount.

Council Member Burt asked what knowledge Staff had on the drillers and suppliers of gas.

Ms. Dailey stated the market gas currently purchased would be the same.

Council Member Burt confirmed the suppliers commoditized it for resale.

Ms. Dailey said that was correct. She mentioned Palo Alto was doing a Palo Alto Green program; however, it was initially being supplied with offsets not physical gas.

Chair Berman confirmed the City was receiving a \$0.30 discount per Unit of Energy (MMBtu) whereas currently the cost was \$4 per MMBtu. He asked if there was a historic trend in the MMBtu's and if so, where was the trend heading. He asked whether the City's discount would remain of \$0.30 whether the rate went up or down.

Ms. Dailey said that was correct, the discount would not change. A significant group of people felt because shale gas was in abundance there would be relatively low gas prices for the distant future.

Chair Berman clarified if gas prices sky rocket the City's discount would increase.

Ms. Dailey stated the discount for the entire bond issuance would rise with the rise of gas prices.

Vice Mayor Kniss asked for clarification of the legal aspect.

Ms. Dailey explained the City's legal department did not perform a thorough vetting of what the Texas Law could mean to Palo Alto.

Vice Mayor Kniss asked the City Attorney if there was a need for more explanation.

Molly Stump, City Attorney, stated the law provisions in contracts were standard. Typically Palo Alto insisted on California State Law in contracts because it was generally friendlier to Palo Alto as a party. Every state in the union had a set of business laws; for the most part there was a body of law

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that was common. The Attorney's office carefully reviewed the transaction and subsequently sent the contract to outside counsel for review. The determination was their laws were commercially reasonable and it would be appropriate for Palo Alto to use Texas Law under the contract.

Chair Berman said Staff had mentioned Palo Alto would be placed on a waiting list if they entered into the agreement while MuniGas entered into a new agreement. Their history reflected a new agreement would be set for 2015.

Ms. Dailey agreed MuniGas was currently building their waitlist and reviewing the market looking to identify a supplier as a counter party.

Chair Berman said it sounded positive and hopefully if Council moved forward Palo Alto would not be on the waitlist for long.

Ms. Dailey clarified there was a provision if a party was on the waitlist longer than 180 days there was an exit clause.

MOTION: Council Member Berman moved, seconded by Vice Mayor Kniss to recommend the City Council adopt a Resolution:

1. Authorizing the City's participation in a natural gas purchase from Municipal Gas Acquisition and Supply Corporation for the City's entire load, an amount estimated to be approximately \$150 million over ten years; and
2. Waiving the choice of law and venue requirements of Section 2.30.340(c) of Palo Alto's Municipal Code, to permit the City to enter into the purchase transaction with MuniGas under Texas law; and
3. Authorizing the City Manager to execute all associated agreements required to affect the natural gas purchase.

MOTION PASSED: 4-0