
**ENERGY BAR ASSOCIATION
NEGOTIATION OF A MASTER AGREEMENT
AND A
STRUCTURED TRANSACTION
(ILLUSTRATION OF HOW DEALS ARE DONE
AND THE MAJOR ISSUES – ROLE PLAYING)**

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PROCEEDINGS

MS. WOLFMAN: We have something a little different planned for this session instead of the normal lecture Question/Answer. We thought we'd make this a little livelier and show you how a Master Agreement is negotiated between two parties, so we have two negotiators who've agreed to play the roles here. They've been very kind in agreeing to do this.

Patricia Dondanville, is a co-leader of Schiff Hardin's Energy Client Service Group and was one of the first co-chairs of EEI's drafting committee for a Master Agreement. She's a graduate of the University of Virginia Law School and an undergraduate of the University of Notre Dame. The other party to the negotiation is Phillip Lookadoo of Thelen, Reid, Brown, Raysman & Steiner. Phil started life as a FERC regulatory lawyer and is now, exclusively, negotiating energy contracts, Master Agreements and a few related regulatory components. He has degrees in Physics and Nuclear Physics from West Virginia University and the University of Virginia, and a law degree from Emory University. And with that, I will let our negotiators guide you through what they are going to do. Thank you.

MS. DONDANVILLE: Good afternoon. We're going to start off with an audience survey. I'll set the stage a little bit first of all by asking you how many of you are lawyers versus non-lawyers. So let's see a show of hands – lawyers?

(Show of hands.)

MS. DONDANVILLE: Non-lawyers?

(Show of hands.)

MS. DONDANVILLE: How many of you have been involved in the energy industry less than a year?

(Show of hands.)

MS. DONDANVILLE: How many of you have been involved in the energy industry since before August 13, 2003?

(Show of hands.)

MS. DONDANVILLE: How many of you have been in the industry since before December 2, 2001?

(Show of hands.)

MS. DONDANVILLE: That was the day Enron went bankrupt. How many of you have been in the energy industry since before the summer of 1998?

(Show of hands.)

MS. DONDANVILLE: That was when the price of electricity in the Midwest, at least on two occasions, I'm aware of, was \$10,000 a megawatt hour. Now, let me ask one thing of the lawyers: whether you consider yourself primarily a regulatory lawyer, a contract lawyer or a commercial finance lawyer. How many are regulatory lawyers?

(Show of hands.)

MS. DONDANVILLE: How many are contract or corporate lawyers?

(Show of hands.)

MS. DONDANVILLE: And how many are finance or commercial lawyers?

(Show of hands.)

MS. DONDANVILLE: This information is helpful to us to get an idea of where you're coming from in understanding this contract negotiation or any contract negotiation. If you're a regulatory lawyer, most of you took contracts your first year in law school and that is essentially what we're harkening back to now.

What we're going to role-play this afternoon are three "acts": the risks of trading without a contract, negotiation of a Master Agreement or contract, and then what happens if you've got a contract outstanding when certain events outside the contract affect the forward markets in which you have traded.

We talked this morning about a variety of different types of "underlyings," that is, a variety of different things you can trade. I want to verify how many of you trade or are involved in the trading of natural gas?

(Show of hands.)

MS. DONDANVILLE: Power?

(Show of hands.)

MS. DONDANVILLE: Other financial energy derivatives, be they pool-traded or over-the-counter financial derivatives?

(Show of hands.)

MS. DONDANVILLE: How many of you have any background or expertise in trading things like oil, crude oil or gasoline, or in currency or interest rates, or Japanese government bond trading – other types of over-the-counter trading?

(Show of hands.)

MS. DONDANVILLE: We're going to focus our role-playing exercise today on trading power, although there's a natural gas component to it as well, with the understanding that most of us in the room are involved in the North American markets for power and natural gas.

MR. LOOKADOO: Also, for housekeeping purposes, this meeting is being recorded and if you have questions please come up to the microphone and identify yourself.

MS. DONDANVILLE: The standard disclaimers apply. None of this can be held against me or any of my clients in any negotiating session that I have currently in process or that I may in the future have in process.

Part of the materials we have distributed is a description of our characters, “The Players.” It’s behind one of the last tabs in your book. I am playing an in-house counsel at a utility, called “Electric Disco,” a power distribution company. I was required by my state regulator some years ago to divest of my generation assets.

I have recently joined the trading staff and been told that my internal, in-house counsel role has been changed from being in charge of Federal and state regulatory proceedings to being charge of the power supply contracts and the trading operations. I’m a little uncomfortable since I was given this change of assignment by the brand new general counsel. He was brought in because the former general counsel and the in-house lawyer responsible for the trading operation lost their jobs after a “risk management event” last summer with respect to power trading. I also come to this position from the background of a corporate finance lawyer – but I’ve been doing regulatory law for the last ten years, so some of my recollection of contracts and finance principles is a little rusty.

It’s my first week on the job at the beginning of Act I and my lead trader, Donnie, has invited me to a pizza party on the trading floor. You know, the traders want to get to know their lawyer. They want to buy their lawyer with pizza. On my way out the door the phone rings. You want to introduce yourself, Phil?

MR. LOOKADOO: Yes, let me introduce my character here. I’m an attorney in a mid-size law firm. I’m representing an accomplished energy trader that has the clever name of Energy R’ Us. Energy R’ Us was the name given to us by our founder. He had his daughter’s second-grade class vote on what the name should be. So Energy R’ Us is us.

We have been in the energy trading business for at least five years doing all sorts of things. We were recently bought out, so we now have a sugar daddy as an owner that gives us some great credit support. And I’ve been called by my client who said you need to “paper over a deal” we’re doing with Electric Disco. It should be a standard-type deal. We want to close next week. This should be easy, so give their in-house counsel a call.

MS. DONDANVILLE: I’m on my way out to the pizza party. My phone rings.

MR. LOOKADOO: Just as background – what we hope to do – we’re not going to really hold the phones all the time, but we’re going to try to negotiate back and forth. Then we’re going to stop and I’m going to put Patty on mute for a moment and explain why I just said what I said or what the position was that I was trying to take. Then I’ll go back on the speakerphone and we’ll resume. We may do other similar things like “I’ll have to get back to you on that one,” or “check with my manager,” or whatever.

(Begin role-play.)

ACT I

MS. DONDANVILLE: Hello?

MR. LOOKADOO: Hi, this is Phil Lookadoo. I'm with a firm called Smith, Smith, Smith, &, uh, Smith. I'm really sorry for that. I've been asked by my client, Energy R' Us, to call you and negotiate a Master Agreement for a deal that's been struck by our business fellow and your businessperson.

MS. DONDANVILLE: Excuse me, what do you mean by "a deal has been struck?"

MR. LOOKADOO: Well, what I was told was that our business people at Energy R' Us and the business people at Electric Disco have reached an agreement in terms of what the transaction should be. There's no existing Master Agreement between the two companies and we'd kind of like to get started on that. And oh, by the way, they want to close next week.

MS. DONDANVILLE: Okay. So the agreement would really be struck next week or they want to make a trade? Is that what you're saying?

MR. LOOKADOO: Yeah, basically, I think that's a fair characterization.

MS. DONDANVILLE: Okay.

MR. LOOKADOO: I think the basic terms have been agreed to, and to the extent that the market moves, of course, before the closing that would have to be reflected in the confirmation.

MS. DONDANVILLE: Okay. That's fine. So we don't have a deal. We just have the idea that we will have a deal?

MR. LOOKADOO: That's a fair statement. I like that. Yeah.

MS. DONDANVILLE: And where is the evidence of this deal? Is it in a term sheet?

MR. LOOKADOO: Actually, if I understand it correctly, there's not a term sheet. The fellows have talked to each other and discussed possibilities of what the deal should look like – basic terms – but I don't think they've reduced it to a term sheet.

MS. DONDANVILLE: So your company isn't one of those companies that calls on recorded phone lines and pretends that the deal was done last Thursday, is it?

MR. LOOKADOO: No, that's not us.

MS. DONDANVILLE: That's good.

MR. LOOKADOO: Let me put you on mute for a minute.

(Aside.)

One of the things you need to be aware of is that a lot of transactions are done by trading people, and a lot of times in-house counsel on recorded phone lines. And, recorded phone lines can be great in terms of oral evidence of a deal. That, in fact, is how many transactions are confirmed. But, when you're calling someone and they happen to be on the trading floor and you hear this beep, beep in the background, you're being recorded and that's not always good for negotiations.

MS. DONDANVILLE: Nor is it legal in some states. One of the things that the Master Agreement, for example, the EEI Master Agreement, in particular – takes into account is it gives each counterparty's consent to recording, which can

otherwise run afoul of state or local wire-tapping laws. So many power traders will come from other industries, whether it's the bond trading industry or the securities trading industry. They may say, "of course, everybody knows that beep means it's recorded." And "everybody has consented somewhere to that recording." The short answer is in a bilateral contract power market, unless you can show me a contract provision where that person or where that entity has consented to a recording, they haven't.

What your former bond traders or your former securities law traders are recollecting are the exchange rules within which those other trading markets, the financial services trading markets, exist and the provisions of those markets, not the provisions of the over-the-counter energy trading markets.

MR. LOOKADOO: And, continuing on the aside for a moment, if you all remember Monica Lewinski and the scandal that went on, there were two different kinds of wiretapping/consent to recording states. There are one-consent states and two-consent states. You may happen to be calling someone who's in a two-consent state, meaning the persons on *both* ends of the call have to consent. On the other hand, you may be calling someone in a one-consent state and you've consented. Then you're all right. So it's not the kind of thing that you can ignore. It's something you need to be conscious of when you put together the Master Agreement relationship or the transaction. And there's an obligation on each party, typically, to give notice to their employees that their calls will be recorded.

(Resuming role-play.)

MS. DONDANVILLE: So tell me more about what you know, Phil, about this transaction that we are going to enter into sometime next week.

MR. LOOKADOO: As I understand it, there's a deal for 10,000-megawatt hours per hour during the peak hours. That's about all I've got. I don't know what the price is.

MS. DONDANVILLE: For the summer, for next summer, for year round?

MR. LOOKADOO: It's supposed to be for at least six months with the concept of *extending*, possibly, longer than that if the parties want to continue to do business together.

MS. DONDANVILLE: Then the parties would agree to another transaction. And deliverable where? What's the delivery point?

MR. LOOKADOO: I think we're looking at delivery into your service area.

MS. DONDANVILLE: Okay. And do we have an idea of the pricing or the pricing grid?

MR. LOOKADOO: I've not been given that yet. I think the business people have discussed preliminarily what that price would be.

MS. DONDANVILLE: And is it energy or energy and capacity, ancillary services included or not?

MR. LOOKADOO: It's pretty much firm LD energy.

MS. DONDANVILLE: Firm LD? When you say "firm LD energy," are you talking about "firm LD energy" in the context of the EEI agreement?

MR. LOOKADOO: Yes.

MS. DONDANVILLE: All right.

MR. LOOKADOO: And I probably should ask if there's a standard form of agreement that you guys like to use. I mean we've used ISDA agreements with the gas annex the power annex, so we can do hedges as well as physical trades. We *also use* EEI Master Agreements. Since you guys are in the Midwest, you may not want to use WSPP, but there may be lots of different preferences you guys have, so we probably ought to find out what those are.

MS. DONDANVILLE: Well, this is a deal we want to do – one deal, right that we want to get done by next Wednesday?

MR. LOOKADOO: Yes.

MS. DONDANVILLE: So it seems to me that we're probably better off keeping it simple.

MR. LOOKADOO: I'd agree.

MS. DONDANVILLE: If we were also going to set up a trading relationship to trade Japanese government bonds or interest rates, we might consider an ISDA. You guys don't even trade interest rates, do you?

MR. LOOKADOO: No, we do commodity derivatives, including gas and power.

MS. DONDANVILLE: So it's not necessary that we anticipate other commodities or other financial instruments to go through an ISDA negotiation. For just physical power and related financials, the ISDA is probably a little complex, especially, if we only really have in mind at this point one trade.

MR. LOOKADOO: Agreed. I think down the road you may find that we're a great trading partner and you guys may want to do more deals, but to get started doing an EEI master works fine for *us*.

(Aside.)

MS. DONDANVILLE: Let me take it offline a little bit and explain to you what I've heard about this deal. My trader has said "some guy named Phil is going to call you because I did a trade with him." I corrected my trader as to what he didn't do on that telephone line last week when he was talking to his buddy. Because he didn't "do a trade." He talked about the terms of a possible trade, which may or may not be done next Wednesday when we get the credit relationship in place and the Master Agreement in place.

From my conversation with my trader, I understand that the power purchase we are discussing is most important for the next summer peaking season. The reason Electric Disco really needs this power is that, in July and August, they're short power. As a result, it's very important to my client, which has public service obligations to keep the lights on during July and August, to have this be a solid slice of their physical power supply portfolio. They want to be sure that they can use it and count on it to be there – physical power. I told my trader that part and parcel of that decision-making process is to make sure you know who your counterparty is, and that "Firm LD Power," if you're supposed to receive it in July and August, is not necessarily as reliable as getting power from a large generator of such power particularly if you are instead getting power from Energy R' Us, a company of questionable credit and performance ability that was named by second graders. So we need to go through the credit support discussion in order for my trader to really make a decision as to whether or not the power that he's paying for is going to show up. Because, power that may or

may not show up is probably not worth as much as power that you're more certain is going to show up or for which you have some credit support.

MR. LOOKADOO: As a further aside, what we have done in this exercise is that we've not scripted out what we're going to do. You will find in an actual negotiation that you won't have scripted out what you're going to do. You won't really know what is underlying the other person's positions or what they're really trying to accomplish or what their objectives are. You may guess. You may guess correctly or you may be totally wrong, and that will, unfortunately or fortunately, be a part of how that process plays out. So we've intentionally not scripted this in any great detail so that it will be, unfortunately or fortunately, as realistic as we can get.

MS. DONDANVILLE: From that perspective, should we turn back to the discussion?

(Resuming role-play)

MS. DONDANVILLE: So let's just say we'll do an EEI. Is there a gas component to this at all?

MR. LOOKADOO: We've talked about the possibility. We actually have a tolling opportunity if that's something you want. When we started out —

MS. DONDANVILLE: That's not my decision. Did our traders talk about a tolling deal? Did they talk about gas as well as power?

MR. LOOKADOO: You know, I don't really know. All I was told was that it was an option on the table and whether or not it's something that your business people want to do I really don't know.

MS. DONDANVILLE: Okay. I will check.

MR. LOOKADOO: We have a power plant and it's gas-fired. So you could provide the gas for that *power plant and then the fuel supply and fuel price* risks would be within your control, if that's beneficial to you.

MS. DONDANVILLE: But, if we're talking about a transaction involving firm LD power, whether or not you have a plant is really not relevant to me, is it?

MR. LOOKADOO: If you only want to buy firm LD power that's fine too.

MS. DONDANVILLE: I thought that's what we're talking about.

MR. LOOKADOO: Yeah.

MS. DONDANVILLE: Do you want to talk about a unit firm product?

MR. LOOKADOO: It's an option, and we can provide a document if that's desirable.

MS. DONDANVILLE: That probably make sense. I have to go to a pizza party now. I have some things, obviously, that will be important to my client in connection with the negotiation. But, if you have a standard form of EEI Cover Sheet and collateral annex, paragraph ten, and maybe a long form confirmation you're used to dealing with? Why don't you go ahead and send it to me and we can talk again.

MR. LOOKADOO: Very good, be glad to.

ACT II

(Aside.)

MR. LOOKADOO: Thus starts Act II. In Act II, -Patty and I have basically decided we're going to exchange documents. So we're going to send to Electric Disco our form of EEI Cover Sheet, our form of paragraph ten to the EEI collateral annex and our standard long-form confirmation for a tolling deal. And then we'll go into the issues that arise in negotiating a master relationship and a transaction. Hopefully, you've picked up the handouts - the one is the EEI master power agreement cover sheet, another is the EEI collateral annex, paragraph ten. And we've also distributed the EEI Agreement form itself....

MS. DONDANVILLE: And some "optional provisions," which may be useful.

MR. LOOKADOO: EEI and the National Energy Marketers Association published the Master Power Agreement in 2000.

MS. DONDANVILLE: You can get all of these forms and optional provisions off the EEI website (www.eei.org) under "Master Contract." This is the contract that David Perlman and I, and our Committee members - many of whom are here today - have worked with since 1998. We continue to meet and put optional provisions up on the EEI website. But as Jeremy Weinstein, another Drafting Committee member, said at lunch, "these provisions are merely a template." They are not prescriptive. They're a template for bilateral contract parties to use to *start* the negotiation. What you're doing is establishing the trading relationship, confirming the enforceability of the contracts, and the reciprocal nature of the relationship between the two contract counterparties. You're also establishing the overall credit relationship. Then you enter into confirmations to evidence particular transactions. The whole thing is one agreement and it says so clearly at the front. That's very important for the netting provisions - which allow a non-defaulting party to closeout the relationship in the event of a default or termination event.

You should have all of those materials. I don't think you need to look at them as we go through the negotiation, but you have them if you are curious. You have the master contract and the collateral annex in one packet, along with a long-form confirmation for the unit firm tolling deal. That's why I was a little worried when Phil started talking about a firm LD deal. I don't think we have the confirmation for that. You also have a couple of other confirmation forms.

MR. LOOKADOO: Very good.

(Resuming role-play.)

MR. LOOKADOO: Hello, Patty?

MS. DONDANVILLE: Phil, I got your documents.

MR. LOOKADOO: Good, good, good. Why don't we just do "a line-by-line" discussion? It seems like the natural way to walk through the issues.

MS. DONDANVILLE: Sure.

MR. LOOKADOO: I'll put you on speakerphone.

MS. DONDANVILLE: At the front end of it I don't have any questions. You've designated a guarantor. Who is this Parents R' Us, Inc.? Is that a 100 percent parent?

MR. LOOKADOO: Yes, Parents R' Us is actually the immediate parent, but that, unfortunately, is a holdover in the form that we should have changed, because we're now owned by Mega Oil Company who bought Parents R' Us. We're able to provide a parent guarantee of our obligations by Mega Oil. So they'll be the one providing the guarantee, not Parents R' Us.

MS. DONDANVILLE: Okay. And Mega Oil is a publicly traded company? Can I get their financials online?

MR. LOOKADOO: Sure. Go to the website or check the SEC. They're AA rated. One of the reasons Parents R' Us sold out to Mega Oil was to give us additional credit support, which would enhance our operations.

MS. DONDANVILLE: That's fine. I'll look at their credit and bring my credit people in and then send you our standard form of guarantee.

MR. LOOKADOO: That will be fine. We, of course, have a form as well and we'll have to compare but that's okay.

MS. DONDANVILLE: Well, I just want to make sure that your standard form is drafted from the beneficiary's standpoint, and has the standard suretyship waivers that are important to the person who wants to enforce the guarantee. We don't want it to be one of those little half-page guarantees that, in recent energy company bankruptcies, turned out to be worthless.

MR. LOOKADOO: I think we'd have no problem with that.

MS. DONDANVILLE: Okay.

MR. LOOKADOO: By the way, will we be contracting with the utility?

MS. DONDANVILLE: Yes.

MR. LOOKADOO: Okay.

MS. DONDANVILLE: So we have steel in the ground. We have a customer base that provides us steady cash flow. You can see it all in our disclosure documents as well.

MR. LOOKADOO: Great. And your credit rating is?

MS. DONDANVILLE: It's probably AA.

MR. LOOKADOO: Okay. That sounds great.

MS. DONDANVILLE: And we don't have any of the potential structural subordination issues that arise with a parent guarantee structure. So I'll take the lead and send you our form of guarantee.

MR. LOOKADOO: Great.

(Aside.)

MS. DONDANVILLE: That, by the way, just as an aside, never happens. The person who is offering the guarantee *always* wants to provide their form of guarantee because it's what the parent company is willing to extend to beneficiaries for purposes of credit support for the energy trading business. What you find is that those parent guarantees can have huge holes in terms of lacking suretyship waivers, et cetera, because they are drafted by the guarantor.

MR. LOOKADOO: And one of the things, too, you'll find is there are a lot of companies out there that do energy trading and derivatives and many of them are not highly-rated companies. I mean if you wanted to do a deal with an unrated trading subsidiary of a highly rated parent company, then you typically want to get a guaranty from that parent company. And so there's a lot of differences among the different trading companies and what credit strength they

do and don't have. But that's part of the negotiation. It's one of the major issues you'll deal with when you're actually negotiating one of the deals.

(Resuming role-play.)

MS. DONDANVILLE: Then further on in the cover sheet, Phil, you've chosen Option B for closeout setoff. That doesn't really work for us because, as a regulated entity, we may have affiliates against which you're not going to be able to setoff. So we're much more comfortable with Option A.

(Aside.)

MS. DONDANVILLE: Option A under "Closeout Setoff" provides for setting off the relationships or the outstanding obligations that are due and owing as between the two contract counterparties only. Option A does not allow set off against obligations that the defaulting party might owe to the non-defaulting party's parent or other affiliates and vice versa.

Option B is the one that many trading counterparties like to put in because they do, indeed, believe that anything that begins with the first two words "Investment Bank" is part of the entire counterparty relationship. From a regulated utility standpoint I can't have that. I can't have my unregulated affiliate obligations setoff against my regulated utility obligations to him or have any inter-affiliate issues raised by the contracts that I sign.

(Resuming role-play.)

MS. DONDANVILLE: So let's go to Option A. Is that okay?

MR. LOOKADOO: The one thing we'll have to do is - I don't know what other relationships my client may have with your affiliates, and what other relationships affiliates of Energy R' Us may have with your company or affiliates. So I'll need to look into that before I can sign off on that.

MS. DONDANVILLE: Okay. I can't let my guy sign something that has Option B, but you can look at whatever you want.

MR. LOOKADOO: Understood.

MS. DONDANVILLE: I don't think we have any relationship with Mega Oil unless they have offices in our service territory and we provide them retail electricity, but obviously, that wouldn't be a relationship that would be of concern or interest to you.

MR. LOOKADOO: That's probably true, but I still have to look.

MS. DONDANVILLE: Okay.

(Aside.)

MS. DONDANVILLE: You also have in your packet three alternative proposals and they are provisions that I would send back to Phil during our negotiations. These are provisions that are important to my client and I'd just like Phil to include my language in his Master Agreement cover sheet. Usually in any kind of a contract negotiation, "he who drafts, controls." So by sending Phil my language on Section 5.6 Option A, what I'm trying to do is explain to him that I don't have room to vary from that. I'm going to start from that as a base, not from his Section 5.6 Option B.

MR. LOOKADOO: As a further aside, a lot of times there are negotiations in which the lawyers doing the negotiating are trying to win points for various clients, if you will. Yet the clients may not necessarily want or need those points. They may be willing to give on those points if they can get something

else - some part of the deal. That happens pretty frequently. You'll run into that quite often. One of the things you need to always be conscious of is who the ultimate client is for you, as well as who the ultimate counterparty is. It very well may be sometimes that the outside counsel or the in-house counsel is negotiating what they believe are the things they have to do, or cannot do, or can do in your deal.

In fact, while most of the time opposing counsel's positions are aligned with his/her client's positions, many times opposing counsel is trying to make points that his/her ultimate client may not really care about. So you have to go through a sometimes painful process to get the deal closed.

MS. DONDANVILLE: In my role as an in-house counsel, I have multiple clients within the same company! In the end, the company is your client. Yet the trader is going to focus on the terms that gets him the best price for that particular slice of his power portfolio. The regulatory department of the company, on the other hand, is concerned about remaining in compliance with both state and federal requirements regulating the company's power purchase portfolio, and the company's market-based rate tariff provisions. Then the people in Finance will be concerned about the creditworthiness of the counterparty. They really don't care if this particular trade with this particular counterparty is ever done. The credit risk managers are risk adverse. That's why they're in Finance.

So it's always a balancing act for the lawyer who is in the negotiation. The goal is to get to a negotiated contract quickly - because traders always want it done yesterday - *but* with the best balance of protections in place.

(Resuming role-play.)

MS. DONDANVILLE: Shall we talk about credit support requirements? Why did you check "applicable" for "Credit Assurances"? I thought that we were using the collateral annex.

MR. LOOKADOO: This is the client's standard form. It may be an oversight because ultimately we're attaching the collateral annex and you don't necessarily have to have that checked as "applicable."

MS. DONDANVILLE: I wouldn't want it to be the case that your client decided there were reasonable grounds for you to believe - whatever reasonable grounds are - that my client's ability to pay was somehow in question, and therefore for you to think you could choose not to provide power to me in July. That's my concern. If it's not going to be "non-applicable," my credit people are going to have a real problem.

MR. LOOKADOO: Can we go offline for a second?

(Aside.)

MR. LOOKADOO: This happens a lot. What you'll find, particularly in NAESB agreements as well as EEI agreements is parties will include credit support spelled out in great detail. And, they'll also say that the provision that effectively mimics the UCC Section 2-609 is applicable. It says that, if a party has "reasonable grounds for insecurity," they can require "adequate assurance" to be provided. What that does, if you leave it in - which Patty caught and we're not going to leave in - is, in addition to your agreeing to provide specific credit support in the Collateral Annex to an EEI Master Agreement, or a Credit

Support Annex to an ISDA Master Agreement, or in addition to providing a letter of credit for X number of dollars or a corporate guarantee, your counterparty also has the right at some point during the term of the deal to say, "Hey, we're not very comfortable with what's going on." We want you to provide additional "adequate assurance of performance." And, if you don't then provide additional adequate credit support, you could be in breach of the Master Agreement. And that may occur just at the wrong time for your business.

A lot of times this language slips through. It shouldn't, but that's a very important factor.

(Resuming role-play.)

MS. DONDANVILLE: Can we talk a little bit about confidentiality, flipping to the next page of the Cover Sheet? You've checked it as "applicable," but I'd like to add some language that, if my state or federal regulators ask me questions or want information with respect to this agreement or any transaction, obviously, I can provide anything my regulators request. Right?

MR. LOOKADOO: I don't think we have a problem with that. Our concern is that you don't make it available to a trading subsidiary (if you have one). Or if you've got other physical counterparties or other hedge counterparties, that you don't make this information – at least the proprietary information – available to them. That's our biggest concern.

MS. DONDANVILLE: Well, but the regulations would stop me from giving that kind of information to my power trading affiliate. And, in fact, I think your language allows me to provide it to affiliates.

MR. LOOKADOO: Exactly. But, what we quite often get is people saying, "Gee, can I provide this copy to my hedge counterparties and to any number of other third parties?" We think that goes beyond what is acceptable in a competitive trading environment.

MS. DONDANVILLE: That's fine. I'll send you some language and you probably won't have a problem with it. It's really just to say that, as a regulated utility, I give my regulators anything they ask for.

MR. LOOKADOO: No problem. And in fact, for a physical contract a lot of times we'll see the utility purchaser say "its contractual obligations are not binding until there's a regulatory approval," so we fully expect that.

MS. DONDANVILLE: Let's talk then about the "General Terms and Conditions" – the "Other" changes in the Cover Sheet draft. In this case, the first provision that I had a question about – well, let me point out something on the side first.

(Aside.)

MS. DONDANVILLE: Often what happens in a draft cover sheet, or a Master Agreement schedule in the ISDA context, is that you face multiple pages of other changes to the standard terms and conditions. Some changes are ministerial; just accept them. You'll see things like, on page four of Phil's Cover Sheet, Part 1, A(2) says, "Section 1.50 is amended to delete the reference to 2.4 and add 2.5." Well, that's a typo. On the EEI website there is an optional provision called "Errata" and that is to stop people from arguing about whether or not that "2.4" in the EEI preprinted form was supposed to be "2.5." I admit it – it was! The EEI contract was on my computer before it went on the EEI

website. 2.4 was a typo. So we have posted on the EEI website those “Errata.” Don’t waste your time talking or arguing about those. They were mistakes.

I would like to talk about some changes to Sections 1.51 and 1.53, which are the definitions of “Replacement Price” and “Sales Price.” Those provisions set forth how you calculate payments that are due if someone is obligated to deliver or receive a product and they don’t perform on a particular day. Replacement Price sets forth how the Buyer calculates cover damages for the Seller’s failure to deliver . Sales Price sets forth how a Seller calculates cover damages if a Buyer fails to receive. These are reciprocal. These provisions essentially provide that you go out in the market and you figure out how you would “cover” the other person’s failure to deliver or receive. As David mentioned this morning, it’s a requirement then that you pay cover damages.

(Resume role-playing.)

There are a couple of things that are important to me in calculating the parties’ obligations to each other. Phil, in several places in the EEI Master Agreement you’re required to go out and calculate particular cover damage amounts or the closeout termination payments based on “commercially reasonable means.” I just want to make sure that you’re not going to Mega Oil and getting quotes from an affiliate to determine that commercially reasonable price.

MR. LOOKADOO: I think we would be glad to stipulate that we wouldn’t go to affiliated traders for that information.

MS. DONDANVILLE: Terrific. That’s what the handout that I sent you (aside to audience – it’s in your books) says. In each one of these cases, you can do anything you want in terms of acting in a commercially reasonable manner but your replacement or sales prices must be from someone who is not an affiliate of either party. It just embeds those “from someone who is not an affiliate of either party” into each of the definitions of “Replacement Price” and “Sales Price” and also into the close out netting termination payment provisions.

MR. LOOKADOO: Right. And I might also add that, particularly in Section 1.51 we’ve proposed to delete the phrase “at buyer’s option” and replace it with “absent a purchase.”

(Aside.)

If you look at the ISDA Master Agreement and some of the other forms of Master Agreements that are out there, there is always – well, at least under the 1992 ISDA Master Agreement, there used to be two different provisions for calculating damages. In the 1992 ISDA, there were elections for “First Method” or “Second Method” and “Market Quotation” or “Loss,” and you could choose one of those two as a means of determining damages under the 1992 ISDA. This EEI with Electric Disco, of course, is a different setting, but you’ll be amazed at how much similarity there is among the different Master Agreements and the different credit support and default provisions.

One of the things that we are concerned with in this particular provision is the effect of the words “at buyer’s option.” We are concerned that Electric Disco might say, “Gee, we could get more cover damages if we used a market quotation instead of actually purchasing replacement power.” So we would say that the market quotation should only apply when, in fact, Electric Disco is not

going to purchase replacement power and incur a different cost than the market quotation being used in the cover damages calculation.

(Resume role-playing.)

So what we'd like to say is get rid of the "at buyer's option," and say "absent a purchase we'll use a market quotation."

MS. DONDANVILLE: Okay, as long as it's reciprocal. It should say specifically in the "Sales Price" definition that the seller can't determine their sales price by, at their option, going with a market price.

MR. LOOKADOO: Exactly. And you'll see in Section 1.53, paragraph four, it's done exactly that way.

MS. DONDANVILLE: In your provision, there is one anomaly between 1.51 and 1.53. There is a proviso added to the "Sales Price" that says that "if the seller is unable, using commercially reasonable efforts, to resell all or any portion of the product not received by buyer, the sales price is zero." So if the buyer decides not to receive the power, or finds out it can't receive the power late in the day, and the seller can't sell it elsewhere and has to back off generation, or in some way is not able to resell, then the sales price is deemed to be zero, which means you would get the full cover damages. That's fair.

MS. DONDANVILLE: One more thing we might talk about, Phil, I understand what you have done in terms of making Section 5.1(g), which is the cross-default provision, effectively just a way in which either party is required to post additional performance assurance. That's what you're doing here. Right?

MR. LOOKADOO: Right.

MS. DONDANVILLE: We ought to talk about the cross-default thresholds you've suggested. Ten million dollars is awfully high even for Mega Oil. I haven't looked at the balance sheet yet, but my credit guys don't ordinarily go over, say, whatever the cross-default is in your standard liquidity facility. Do you know what that is? If Mega Oil has a revolving credit facility that provides its regular liquidity, I'd really like to know what that cross-default level is.

MR. LOOKADOO: Let me find out. I don't really know, but I can find out.

MS. DONDANVILLE: That will be great.

MR. LOOKADOO: Same thing in return.

MS. DONDANVILLE: Absolutely. Electric Disco's cross default in its revolver is seventy-five million dollars. So if yours is that high, more power to you.

MR. LOOKADOO: Then we're good.

MS. DONDANVILLE: Then we're good. Let's talk a little bit about the changes that you've made to the provisions for declaration of an early termination date and calculation of settlement amount.

(Aside.)

MR. LOOKADOO: Before we go to that, let me also point out another issue under the cross-default provision. In the ISDA form agreement—the document says, "In the event of default under any Specified Indebtedness" - meaning a default under any obligation in respect of borrowed money that involves an amount in excess of a cross-default threshold amount negotiated by the parties. The ISDA provision goes on to say, default or other event, which

results in “the Specified Indebtedness becoming, or becoming capable at such time of being declared, due and payable” occurs.

The problem with this provision is the nature of a trading contract versus a loan agreement. If your lender, under a specific loan agreement, looks at a potential event of default and says, “Okay fine, we understand what happened and we’re not going to exercise our rights. We’re not going to accelerate the debt. We’re going to continue our relationship under the loan agreement, because it’s not a problem.” But if, in the ISDA Master Agreement with a trading party, you’ve included the words “becoming capable at such time of being declared,” then, while you may not have an event that has upset your lender or resulted in an acceleration of your debt, the trading counterparty may nevertheless have the right to declare a cross-default and terminate the physical or the hedge transaction.

As a practical matter, I’ve seen many different financing arrangements in which there was some sort of technical default relatively early on in which the lender has said “We wrote that provision the wrong way,” or offered some similar response, waived any potential default, and continued on under the financing agreement. And there’s a good likelihood that the trading counterparty is not going to know about the potential default under a loan agreement, before the lender has decided to waive that default.

Nevertheless, if the trading counterparty learns of that potential default and you have not changed this language to remove the potential default language, thereby requiring only a potential default and not requiring an acceleration of the debt, you could lose your trading agreement due to a technical cross-default that has not affected your ability to make payments under the trading agreement.

(Back to role-play.)

MS. DONDANVILLE: What you are proposing is to take Section 5.1(g) and put a provision in here saying, “5.1(g) is amended to delete the language which reads, “or becomes capable at such time of being declared?”

(Aside.)

The way in which the Master Agreement provisions are modified is not very user-friendly. People do take phrases out of very specific sections for very specific reasons. There are those changes that are just fixing typos, but many changes – like this – how big can it be? You took out seven words. Well, the short answer is: it can change the risk allocation as between the parties. Oftentimes what people do is take the base contract and actually mark it up to see how the provisions interrelate. Then, after you’ve dealt with these master contracts for a while you kind of look at it and you think, “yeah, they just took out the immature default.”

MR. LOOKADOO: One other aside, too, while I’m thinking of it. I did a contract with some California folks, shall we say, back in 2001, and they literally took the Master Agreement and redlined the Master Agreement. Don’t ever do that. It’s not supposed to be done that way. You come up with revisions to various provisions of the Master Agreement and you put those revisions in the Schedule or the Cover Sheet, but you don’t actually redline, mark or alter the pages of the Master Agreement.

In a bilateral loan deal, people always redline each other’s contracts. That’s how you exchange comments back and forth, and I think it makes negotiations

go faster, because people know exactly what you're trying to achieve as compared to providing verbal comments on various sections and then counting on the other party as the drafter to accurately capture your proposal. By exchanging redlined drafts the counterparty knows exactly what you want and you can resolve matters faster and more accurately.

But don't redline and make changes to the language in the ISDA or EEI Master Agreement itself. Do it in the Schedule or Cover Sheet. That only happened to me once, but once was too often.

(Resuming role-play.)

MS. DONDANVILLE: As I'm looking down here, maybe we could talk for a minute about Section 5.6. I mentioned earlier that this Option A versus Option B is very important and I provided to you my version of 5.6 Option A, which has a variety of additional things, in addition to not setting off affiliate obligations for either party. It also makes some modifications to the standard Option A language to focus on the parties' relationship in energy trading and on just that, specified energy trading contracts, that being obligations under this agreement, the NAESB and ISDA. I've focused on the energy trading relationship that we have now or that we're creating now and that we may create under an ISDA or NAESB in the future. Do you have any problems with that?

MR. LOOKADOO: When we get to the point of expanding our relationship, it's pretty clear that we'll want to take into consideration this EEI and any other agreements we have. I'm not so sure that I want to create that arrangement now as much as, for example, if we get to that point, we could always do a Master Netting Agreement and we could incorporate that *into* the ISDA and the NAESB.

MS. DONDANVILLE: Have you tried to negotiate one of those master netting agreements?

MR. LOOKADOO: They're painful, and we certainly couldn't do that by Wednesday of next week.

MS. DONDANVILLE: Exactly. So I'd really rather just embed it in this document now. I don't think it hurts anything to put it in now and then, if and when we do negotiate an ISDA, this provision doesn't need to be revised at the same time.

MR. LOOKADOO: I'll have to take that back to my client.

MS. DONDANVILLE: Fine. All right. What else should we talk about?

(Aside.)

MR. LOOKADOO: Let me also talk about the closeout setoffs. Depending upon who you are, depending on what kind of other transactions you may have, if this is the only deal you've got between the two counterparties, you could always agree with Option A. If it turns out that you've got a lot of different subsidiaries, a lot of affiliates, a lot of different irons in the fire and you may have many different arrangements with this other counterparty, the other counterparty may not be as creditworthy as Electric Disco. Your counterparty may be somebody that doesn't have quite the same "assets in the ground," so to speak. You may be concerned that under certain circumstances there's a default and after that default you calculate a termination payment. And the way that these agreements calculate the termination payment the non-defaulting party can

have an obligation to make a termination payment to the defaulting party. If it turns out that your counterparty is the defaulting party and you end up owing them a termination payment, that's the way the document works. You're liquidating transactions. That's typically all right. But, if one of your counterparty's affiliates owes one of your affiliates money or owes you money, and you can't set that off against the termination payment, it may be that the whole house of cards is about to collapse and you're pouring money into a bankrupt entity and you've got nothing in return. So you have to think long and hard about those provisions, and it very much is a fact-based circumstance. It really depends on what other deals and relationships you and your affiliates have with the counterparty and its affiliates.

MS. DONDANVILLE: You're right. What kind of an entity you are, what your creditworthiness is, and what your corporate structure is are all important. I represented a family of hedge funds in negotiating both ISDA Master Agreements and power trading agreements. It's almost impossible to explain to some of the larger financial trading houses that a "family" of hedge funds is a "family" of limited partnerships. Each of those funds has different limited partners. Although the general partner may be the same and the power to control might be the same so that they are "affiliates" under the definitions in the Master Agreements, the limited partners are, and therefore the money is owned by, different people. You cannot allow the creditors or the counterparties of Fund A to set off against Fund B just because Fund A and Fund B are managed by the same three guys. It doesn't really work. So each particular counterparty of a hedge fund needs to look at the net asset value of the individual fund, not whether or not their affiliate fund has an affiliate relationship with another affiliated hedge fund.

From a corporate lawyer's perspective, and a credit lawyer's perspective, all of the discussions about affiliates and setting off one affiliate's obligations against another affiliate's obligations have real ramifications, depending on the structure of your party.

MR. LOOKADOO: Agreed.

(Resuming role-play.)

MS. DONDANVILLE: So let's talk about choice of law and choice of jurisdiction. If you turn to page six of your draft Cover Sheet, we don't have a problem with New York law governing the master trading relationship. That makes sense from a trading relationship standpoint. But we can't agree to exclusive jurisdiction in the State of New York or in Manhattan. We're located in Kentucky. We want jurisdiction to be sited in Kentucky. And, come to think about it, our supply chain people have a standard arbitration provision that we put in all our contracts. So why don't I send to you (aside to audience – you'll find in your books) our standard arbitration provision and we'll put that in the Master Agreement instead of exclusive jurisdiction in New York?

MR. LOOKADOO: We can look at that and consider it. We agree to arbitration in some deals and we don't in others. I have to check, but I don't think we have a corporate policy against arbitration. So that might be fine. I'll have to take it back to the client to find out.

MS. DONDANVILLE: Especially in a trading relationship, it's typical that the parties may actually have to do business together in the future and on an

ongoing basis. I find it's better to get any dispute rapidly resolved – and arbitration is so much better than a public court proceeding.

MR. LOOKADOO: *Understood.*

(Aside.)

MS. DONDANVILLE: The EEI Master Agreement, as well as most of the other Master Agreements, already have embedded a jury trial waiver as we would all expect as lawyers. But, they do not have a choice of jurisdiction or venue waivers. Oftentimes, counterparties, especially financial trading houses, will want to put into the Master Agreement a choice of jurisdiction, either non-exclusive (which is more typical) or in this case exclusive jurisdiction, in New York.

For those of you out in the hinterlands (like me), New York is not the most convenient or inexpensive place to litigate *anything*. And, although the judges there are much more familiar with the derivatives market, because that's where the financial securities markets are, most judges still really have no understanding of the perspective of a utility located in Kentucky, in my case, as a counterparty. So I usually suggest to clients that they don't fight on the choice of New York law, but instead try to trade that for either choice of a convenient and therefore inexpensive jurisdiction or go to an arbitration provision. Once you go to an arbitration provision, there is a panoply of types of arbitration provisions that you see in contracts.

One of the reasons the EEI agreement does not have a choice of alternative dispute resolution is because there are probably eighteen or nineteen permutations of a standard arbitration provision. The Drafting Committee couldn't reach agreement on which was acceptable or "the most standard" in the industry.

MR. LOOKADOO: A lot of the Master Agreements don't necessarily provide for New York law as the law applicable to that Master Agreement. The EEI Master Agreement does. The ISDA Master Agreement does not; the parties have to make a choice. In the NAESB Master Agreement, the parties have to fill in the laws of a particular state. I think that, depending upon whom you're dealing with, a counterparty may want their local law to apply. You have to spend some amount of time on this subject in the negotiation - not a lot of time, but it's an issue sometimes that you have to negotiate for a while to get some kind of closure or some kind of conclusion. A lot of times it will be New York law.

MS. DONDANVILLE: In ISDA, it's just a choice of New York or London. Right?

MR. LOOKADOO: Well, you can pick another state, if you want to, under ISDA and you could under a NAESB as well – particularly, under a NAESB. I think you'll see Texas law quite often, or Oklahoma, or Louisiana, if you're dealing with a producer from one of those states.

MS. DONDANVILLE: The EEI Drafting Committee talked about all of those potential jurisdictions. Because I'm from Chicago I figured "Why not Illinois?" But, the Committee came down to the decision that New York law was the best law for a national platform mostly because New York does have the most developed law in terms of over-the-counter derivatives trading. The provisions on recording telephone conversations, statute of frauds and other

provisions on various other enforceability aspects under New York law, are just much clearer in this kind of a contract.

(Resuming role-play.)

MS. DONDANVILLE: Let's see.

MR. LOOKADOO: Do you want to talk about market disruption?

MS. DONDANVILLE: Sure. Why don't you talk about market disruption? Where is that? We're not trading based on an index here, are we?

MR. LOOKADOO: Well, we might be.

(Aside.)

We've got a couple of confirmations attached. Let's jump back to those really quickly, if you don't mind. We've included three confirmations. One is the infamous "long form confirmation" that was alluded to, for a tolling deal. That's the first one you'll find. The second one is a confirmation for a firm LD product that has an index price that is not specified, but it shows a published index price under the caption for Contract Price. And in that case what we have is Party A, which is Energy R' Us, is the seller and Electric Disco, Party B, is the buyer.

We've also got a confirmation in which Party B, Electric Disco, is the seller and Party A, Energy R' Us is the buyer, both of which are under a published index. So there are multiple points to be raised in this context, but one of the issues with respect to the published index is what happens if that index stops being published? What happens if, for example, you had the Cal PX as your published index and that was the source for setting your power price, and the Cal PX in February 2001 says, "Gee, we're going to shut down and not come back and do business any more?" What do you do?

MS. DONDANVILLE: The EEI Drafting Committee talked about this in connection with developing the Master Agreement. What happens if there's a hurricane and the Henry Hub isn't published? It wasn't published for nine days after Katrina. Those time periods, those market disruption events when you've got a long-term contract in existence make it very difficult to decide the daily price or the price during a particular delivery period.

MR. LOOKADOO: Exactly. And what you'll find is, depending on the Master Agreement, depending upon the context of the people you're negotiating with, they may have certain ideas of what should be considered a market disruption event and what fallback steps should be taken in the event a market disruption occurs.

You'll also find, and this is just kind of a trivial aside, but I'll throw it out there anyhow. Under the ISDA documents, there's a document called the 2005 ISDA Commodity Definitions and for a lot of banks and other hedge providers, when you use the 2005 ISDA commodity definitions and the 2002 ISDA Master Agreement, they want that document to be somewhat pristine and you won't be able to make elections among the defined market disruption events or what fallback provisions will be applicable, because they want the default provisions to be applicable.

On the other hand, if you use the older 1992 ISDA Master Agreement and the prior versions of the ISDA Commodity Definitions, then these same counterparties will allow you to elect from among the various defined market

disruption events and also which pricing fallback provisions will be applicable and in what order if one of the elected market disruption events occurs.

MS. DONDANVILLE: Well, as you can see, it takes a long time to negotiate one of these transactions. We're trying to do it by next Wednesday. Actually, we're trying to do it in the next two minutes! You end up walking through things and picking and choosing the things that are important to your client to argue about. It's important to my client to see that the structure of the credit relationship is appropriate. We haven't even gotten a chance to talk about that and the elections and the collateral annex.

Let me just highlight the one thing that would be important to me in the collateral annex, which is the threshold amount. The credit relationship between two counterparties is really three-fold. First, it is balance sheet oriented. It is a question of who is the stronger party, and therefore, the least likely to go bankrupt first. That aspect tends to be embedded in the threshold amount, the reciprocal threshold amount so I want an "unsecured line" that reflects my "steel in the ground" and my customer base. That's the credit relationship underlying from a balance sheet perspective.

The second point is that the credit relationship and provisions reflect the ongoing cash flow ability of each counterparty – the ability to pay your obligations under the relationship. That can be reflected in two ways. What Phil has embedded in the long form confirmation is a credit relationship that says that Electric Disco should post cash collateral to prove that I can pay his sixty days worth of receivables for his power that he's flowing to me. That doesn't make sense to me. There's no reason that he should have to doubt my ability to pay sixty days worth of his little, tiny chunk of my power supply contract. So I would push that back, and say that doesn't make sense in the context of our overarching credit relationship.

The third aspect of the credit relationship is the collateral annex. And the collateral annex (under the ISDA it's called the credit-support annex) looks at the relationship between the counterparties each day and all trade days. The CSA looks at who's "in the money" and who's "out of the money" if we had to call a default today. So it looks at merely the paper trading relationship between the two counterparties. It doesn't look at how much steel I have in the ground. It doesn't look at how strong his parent is. That's handled by his guarantee. The credit support annex looks just at the trading relationship and it collateralizes the party that's out of the money in that circumstance.

(Resuming role-play.)

MS. DONDANVILLE: From my perspective as someone with steel in the ground and a huge customer base, a captive customer base, what I see as my strength is to have a very high threshold amount. I would suggest that mine be somewhere in the 100 million dollar level and yours be somewhere around twenty million dollars.

MR. LOOKADOO: And we would counter, as Mega Oil with many oil and gas reserves and 100 dollars a barrel oil prices, that we've got more assets than Electric Disco.

MS. DONDANVILLE: I thought the guarantee was only intended to secure the threshold amount. So what kind of a cap can I put on the threshold?

MR. LOOKADOO: We intend to put a cap on the guarantee and we would be willing to say that the threshold would be equivalent to our cap.

MS. DONDANVILLE: Okay. I'll take that back to my credit people.

(Aside.)

MS. DONDANVILLE: Oftentimes, what you find is they want to put a very low cap on the guarantee and then, because of their vast and storied parent, have a very large threshold limit. That makes sense from a balance sheet perspective, but it doesn't make sense necessarily from a cash flow perspective, given the sometimes inability to get a corporate parent to fund the ongoing operations of a trading subsidiary.

MR. LOOKADOO: One of the things you need to be cautious of is a lot of times - we were doing a deal with an entity from a western state, shall we say, back in the early 2000s and we were looking for a guarantee from an investment grade rated entity to provide credit support. We were told, basically, "Okay fine, we'll provide credit and we'll provide a guarantee from someone in the corporate family that is investment grade rated or better, and if that entity's credit rating drops below investment grade, then we will provide a replacement. If, however, it happens to be our affiliated, regulated utility that provides that guarantee, then there's no obligation to replace that guarantee if their credit rating drops because they're a regulated utility, and that could never happen."

And then that regulated utility filed for bankruptcy, and all of a sudden the guarantee we received wasn't worth very much. So you need to not be, if you will, pushed around when you're working on credit issues because credit problems can affect everybody.

Remember the folks that disappeared back in the early date - what was the date Patty that you mentioned - 2001?

MS. DONDANVILLE: December 2, 2001. It ruined my Thanksgiving. Anybody else?

MR. LOOKADOO: That very large and very credit-worthy energy company caused a lot of wringing of hands, shall we say, upon their demise. So you want to be very cautious when you put the credit provisions into any deal and you can't afford to assume too much. There are a lot of different players out there that can have financial problems. We can name names and go into all kinds of anecdotes, but it's not necessary, I think.

MS. DONDANVILLE: There are a lot of events outside of your counterparty credit relationship and your counterparty contract relationship that can affect your outstanding trades. Shall we close Act II and move to Act III?

MR. LOOKADOO: I think that's very appropriate.

ACT III

(Aside.)

MS. DONDANVILLE: We're going to pretend that Phil and I, by Wednesday I might add, reached an agreement on a Master Agreement and credit relationship, and put in place that first long form confirmation. A week has gone by and we also put on those other two trades: one where his client is the seller, and one where my client is the seller. So we have three trades outstanding under a Master Agreement and something untoward hits the NYMEX exchange.

There is a market disruption event and they don't publish. Or Megawatt Daily decides to go out on vacation.

What's my first action when I hear from the traders that they didn't get their Megawatt Daily this morning? They can't price things. They don't know what to do and the short answer, in any of the Act III circumstances, is to look at your contract. Your obligations, your rights, your remedies with respect to each counterparty are defined solely by your contract. This is not a market where you can look to, or should look to, a regulator to help you out. And, hopefully, you don't have to go to the courts to resolve what are your rights or your remedies because you've got those embedded in your negotiated Master Agreement. So assuming that we put that market disruption event in there, and I call you up, Phil, and say:

(Resuming role-play.)

MS. DONDANVILLE: You know, I can't get Megawatt Daily quotes. What are we going to do about the reciprocal trades we have on?

MR. LOOKADOO: Yeah, we've experienced that with a couple of other trades as well. What we're trying to do right now is sit and wait. We don't have invoices due until early next month, and we think they're going to come back on and resume trading/publishing within the next day or two. So we prefer to just wait.

MS. DONDANVILLE: So, if we didn't have the market disruption event provision in there, would you be concerned that we didn't have an enforceable trade anymore because it had become impossible to perform?

MR. LOOKADOO: That would be a definite concern. I think that we would also look to – if we were faced with silence, for example, under an ISDA agreement, you would have automatically subjected yourself to the default choices. So you need to go back and look at your documents to see what you've got.

MS. DONDANVILLE: Do you remember how NAESB handles market disruptions?

MR. LOOKADOO: I was afraid you were going to ask me that. You know, I don't recall.

(Aside.)

MS. DONDANVILLE: Anybody in the audience? I don't think it does.

VOICE: I think the most recent NAESB version does.

MS. DONDANVILLE: The 2006 version? Again, these Master Agreements, as they've developed, have learned from each other's developments. In fact, in many cases, the drafters copied from each other's drafting. The lawyers and the folks that are trying to administer these contracts are really trying to do an industry service to make sure that the provisions in the various standard Master Agreements are similar or identical to each other. Then we will be able to actually draw usable conclusions from precedent when the courts interpret one, or the regulators interpret one contract. We can draw some learning and some consistency, or hopefully some certainty, for our clients under the other Master Agreements as well.

MR. LOOKADOO: Yes, in that regard, too, if you look at the ISDA agreement, it's now got a gas annex and a power annex. The power annex, remarkably, looks a lot like the EEI agreement.

MS. DONDANVILLE: Good. That's what we were trying to do.

MR. LOOKADOO: And the gas annex looks amazingly like a NAESB agreement, which is not -

MS. DONDANVILLE: Actually, it looks more like the EEI's gas annex, which was taken from the NAESB.

MR. LOOKADOO: Yes, exactly.

MS. DONDANVILLE: Act III, Scene 2. Now I have heard there are rumors and press reports about Energy R' Us. If there's one thing traders do it's talk on the phone here and pass on rumors. Press reports indicate that a major market player - that would be Energy R' Us - is in serious financial distress. Of course, I'm a regulated utility. I am never in serious financial distress.

(Laughter.)

MS. DONDANVILLE: My traders are calling me and saying "do we have collateral from - what was that company's name, Energy R' Us? They've got our peaking capacity for July and it's June 25th." I'm disappointed to say, at that point, if I've given up the EEI provision allowing me to demand Credit Assurances, I don't have a question as to whether or not I have reasonable grounds for insecurity. What if I did have that credit assurances provision in my master? Then the question becomes do I have reasonable grounds for requesting performance assurance, to ask for adequate assurances? How do I do that? How do I document those reasonable grounds for requesting performance assurance? And then I would call up Phil. More likely, my trader would call up his trader to demand performance assurances.

(Back to role-play.)

MR. LOOKADOO: Okay, Energy R' Us is having some difficulties. We think they're going to pull through, but they are having some difficulties.

MS. DONDANVILLE: We think so too.

MR. LOOKADOO: But you should not be worried because you have a parent guarantee from Mega Oil and they are not in distress.

MS. DONDANVILLE: Could I have a confirmation of that guarantee from Mega Oil? Or maybe we just want to - you just want to assign the trade, my trade to Mega Oil so that I have a direct trading relationship with them. How about that?

MR. LOOKADOO: I think it's premature to do that. We have some issues and we're trying to work them out, but we're not willing to -

MS. DONDANVILLE: Tell me more about your issues. How many of your banks have unmatured defaults outstanding?

MR. LOOKADOO: I'm not sure I have that information. I'll have to check with the client.

MS. DONDANVILLE: How many of your trading counterparties have demanded performance assurance?

MR. LOOKADOO: Actually, they all have *some form* of credit support package that continues to have significant value, so none of them have.

MS. DONDANVILLE: And, so none of them have the right to demand performance assurances, or the ability to call for additional performance assurance?

MR. LOOKADOO: That's true. They all have some form of meaningful credit support such as a letter of credit, cash, or a parent guarantee.

MS. DONDANVILLE: And they're all satisfied. No one else has called you this morning.

MR. LOOKADOO: We've had some inquiries.

(Laughter.)

(Aside.)

MS. DONDANVILLE: This was, indeed, what happened in the early 2000s when first one large energy company was in credit distress, over that Thanksgiving weekend in 2001. Then another energy company began to have trouble, and then another energy company began to have trouble. And frankly, this is what happened in the credit default swap markets this spring when those markets were having trouble. Trading counterparties had "reasonable grounds" to feel "insecure" as to whether or not a large financial institution was going to be able to perform on its trades on an ongoing basis. That's why that language is useful *if* you're never going to be subjected to it, and dangerous *if* there is any credit event in your experience that occurs. It leads to some very tense telephone calls, e-mails and recorded telephone exchanges.

MR. LOOKADOO: Yes, even if you're a utility. For example, with frozen retail rates but uncapped wholesale prices, which can skyrocket and go wherever they want to go, even a regulated utility can find itself in a liquidity crisis. You want to be cautious that you don't subject yourself to a standard that you can't live with.

MS. DONDANVILLE: That's one of the reasons why the EEI Master Agreement, and all these Master Agreements (as forms) are drafted on a reciprocal basis. Because you never do know which counterparty the market is going to go against at any particular point in time.

(Resume role-play.)

MS. DONDANVILLE: You are my power supplier and it's Thursday, and your schedulers didn't deliver power Monday, Tuesday, or Wednesday. And, they used that easy-to-say but hard-to-prove word "force majeure" when they said "the plant's down. It's a unit firm contract, or it's a force majeure that affects the unit." Sorry. I've got to question whether or not that was really price majeure or force majeure that caused Energy R' Us to fail to deliver repeatedly.

MR. LOOKADOO: I might add that we would never sell to someone else at a higher price when we've committed to sell to you, because we don't work that way.

MS. DONDANVILLE: That's great. Can we add that to our contract?

MR. LOOKADOO: We believe that's a corporate policy that goes along with doing business in good faith.

MS. DONDANVILLE: I agree entirely. I think that, as long as you're willing to put that corporate policy into a contract provision so that I can enforce it against you, I'd be happy.

MR. LOOKADOO: We did experience a force majeure and we will be glad to give you a summary of what happened and why it was a force majeure and why we declared that.

MS. DONDANVILLE: Okay. What exactly happened – say we're talking about the firm LD contract, which does have a force majeure provision embedded in it. What happened that constituted that force majeure?

MR. LOOKADOO: Right now, I don't have the information. I'll have to get that from the client. I'm sure they'll be providing it soon, because they're mindful of their obligation to give you notice and to explain the particulars of that transaction or of that event, and to resolve it with all expediency.

MS. DONDANVILLE: Right. Not just the event – in other words, don't just tell me that there was a hurricane. I read that on the news. Explain to me how that hurricane, how that force majeure, prevented you from fulfilling your obligation under my contract.

MR. LOOKADOO: Agreed.

(Aside.)

MS. DONDANVILLE: There is litigation going on right now with respect to that circumstance in the gas markets. Not as to whether the hurricanes happened. We all know that the hurricanes happened. But whether or not the consequences of the specific hurricane happening prevented a particular counterparty from fulfilling its obligations. And if so, to what extent, for how long did force majeure give that counterparty an excuse.

MR. LOOKADOO: What you'll find is that if you're doing bilateral contracts there's a great deal of time spent on what the definition of force majeure happens to be. If you're doing a trading deal, there's not that much time generally spent on what the definition of force majeure happens to be, but yet, it's very important. In one relevant episode involving, I think, it was an Ohio entity, there was a declaration of force majeure when that utility failed to perform under certain power agreements. According to the energy periodicals at that time, the problem was initially claimed to be force majeure, there were lots of subsequent discussions, and – ultimately, I understood that there were significant payouts made to the counterparties under various types of transactions in order to resolve those claims. So force majeure is not an easy issue.

When events occur you need to make sure that your people, or your client and their people, document what's going on and have in mind that they can't just claim force majeure without having some factual basis for that claim, a detailed description of the event, and some substantive explanation for how the event really does affect their ability to perform. How they acted after the occurrence of the event is also critical.

MS. DONDANVILLE: In fact, in any of these times of market stress, which, of course, is the only time that any of this matters, it's very important that the lawyers be involved with whomever is in charge of the client's negotiating position vis-à-vis your counterparty. It's very important to document what you're doing and why what you're doing is within the terms of your contract. Any of these issues that are ultimately litigated are only litigated four, five, six years later. Everyone's memory is gone. Given the short tenure of some of the trading folks (and in Electric Disco's case, some of the lawyers...) those people

may be long gone from your organization and may not be able to testify as clearly about how carefully you were negotiating in good faith.

MR. LOOKADOO: Agreed.

MS. DONDANVILLE: Shall we talk about what happens if I just stopped paying you.

MR. LOOKADOO: Good point.

(Resuming role-play.)

MR. LOOKADOO: We have a problem, Patty. We're not receiving payment.

MS. DONDANVILLE: You know, I'll get back to you, Phil. I've got another call coming in. Can I just – I'll call you in a few minutes.

(Laughter.)

MR. LOOKADOO: I don't think you're going to get away with that one, Patty. We have to talk and we have to come up with a resolution rather quickly. You don't want us to pull the plug on the deal. It may cause ripple effects with your other deals and you may have other issues out there as well.

MS. DONDANVILLE: You know, Phil, I've got bigger issues right now than your particular trades. I think my credit guy has already talked to your credit guy and they seem to be just fine. So why don't we not talk about - you're talking about calling in an event of default?

MR. LOOKADOO: Absolutely.

MS. DONDANVILLE: Have you carefully gone through with your client the details of your notice periods and your rights?

MR. LOOKADOO: We have talked about what we have to do, what we can do, and the periods of notice, grace, and cure rights that are in our agreement. We fully understand what would happen. We'd rather not go through those steps. On the other hand, if we don't get paid we have to, because we have our own transactions with counterparties that we have to perform.

MS. DONDANVILLE: Yeah, I'm just worried that you understand our perspective, which is that your actions may cause our bankruptcy, or our inability to continue in business. You will have effectively caused it - as a result of which most of your trades, or your claims on us, will be equitably subordinated to those of our other creditors.

MR. LOOKADOO: I don't think we have that risk. We've looked at the circumstances and I don't think we have a problem on our side of it. I don't think we've caused it.

MS. DONDANVILLE: Then you've got to do what you got to do. I hope your bankruptcy guys are involved.

MR. LOOKADOO: We're prepared.

MS. DONDANVILLE: We'll probably talk soon.

MR. LOOKADOO: We will.

(Aside.)

MS. DONDANVILLE: So then we're in Scene V. Those conversations begin to spiral downward from the standpoint of someone who is getting these calls from multiple counterparties. A party doesn't ordinarily default in payment just to one counterparty for grins. It is usually part of a larger problem. It becomes very terse and you should involve the creditor's rights or bankruptcy

lawyers to make sure that your actions are, indeed, in compliance with your contracts, that you're within your rights, that you're making the correct demands and within the correct timeframes.

MR. LOOKADOO: I might add, in that regard, one of the things that people quite often do when they're writing these provisions is, in terms of explaining what is an event of default, explaining what is an additional termination event or various other types of things; particularly, under an ISDA schedule, or under an EEI schedule as well, is they'll use loose words. Those words can be interpreted differently. At that point it's very difficult to determine exactly what your rights are, because the words are not written as specifically and as tightly as they could have been or should have been. Inevitably, at that point, you find yourself thinking, okay, do I have a right or do I not have a right? And, if I act on this and I cause a problem for Electric Disco and it turns out that I was wrong, I may have created all sorts of additional liabilities for myself that I really don't want to incur.

MS. DONDANVILLE: Which is exactly the point of my raising those concerns in Phil's mind to tell him that if, indeed, he thinks he's going to follow through with respect to enforcing his remedies he'd better be sure he has those remedies, that he's applied the appropriate contract provisions and that he's within his rights. Because otherwise I can make it difficult for him.

MR. LOOKADOO: And you'll find that there are many circumstances in which your client may feel like they've been mistreated by a counterparty. They may want to pull the plug, as they say, or take action of some sort. And, when you read the actual provision, it's not at all clear that they have the right to do that. Under those circumstances you have to really be cautious because, while you don't want to get fired as the outside counsel, on the other hand you want to deliver the right advice.

MS. DONDANVILLE: Nor do you want to get fired as the inside counsel!

MR. LOOKADOO: But you want to make sure you deliver the right message because, ultimately, if any actions are taken one way or the other, they will have consequences and you want to make sure that your client has been advised correctly as to what their rights are under the facts and circumstances that have arisen. The consequences need to be something that you're thinking of. You can't afford to let yourself get caught up in the emotions of the moment with your client because that may cloud your vision and may cause you to not be giving the right advice at the right time.

MS. DONDANVILLE: Shall we sum up? Do you want to do your epilogue and then I'll do mine?

MR. LOOKADOO: Sure. I believe we've got two and a half minutes, so it's a two-minute drill.

EPILOGUES

MR. LOOKADOO: I think energy trading and derivatives are great areas to work in. If you haven't been involved in it, you ought to give it a try because it's really interesting stuff. You stay on top of all the things that are going on by necessity. You have to work late hours and you have to stay involved in understanding what's going on. You can't do this kind of practice from a

distance where somebody else reviews the contracts and you hear about it second hand. Because if you do you're liable to give that wrong advice at the wrong time.

On the other hand, there are a lot of complexities in these deals. There are a lot of fact-based provisions, even though the concept was to create Master Agreements that would be easy to work with or easier to work with. If you've ever tried to read an ISDA agreement, you'll know that that's definitely not the case. I was working with someone just yesterday who had never worked with an ISDA before. They said, "I can't even read a sentence because I can't find definitions in the document for the capitalized terms used in that document." Well, that's because many of those terms are not defined in the ISDA Master Agreement. The definitions are in the five volumes that you have to have on your bookcase to take a look at to figure out what the sentence means.

By the same token, banks and hedge funds and various kinds of companies have worked with ISDA agreements and they're familiar with them, or EEI Master Agreements. I know one fellow in my office who liked to work with customized, if you will, "one off" contracts because they were far better than the EEI. Well, now he's using EEI Master Agreements all the time. It was funny to hear him say that because, not that long ago he was saying, "Gee, what happens here? What happens there? I don't understand this." Well, now he understands the EEI Master Agreement, because he's used it for several deals, just like the many other people who also use these Master Agreements. And these Master Agreements do, in fact, perform the service they were intended to accomplish, which is to come up with a more level platform in which people can perform transactions. They're complex, they require some understanding and negotiation, but they work and that's my bottom line.

MS. DONDANVILLE: Master Agreements are intended to take ninety percent or eighty percent of the negotiations between lawyers off the table, to enable traders and the business people to use the energy trading markets to do what they need to do and want to do. As John Varholly said earlier today, "the business people want to either make money or hedge risks." So Master Agreements are an attempt to take the lawyers out of the middle of that and not make these things take three, four, six months to negotiate. Instead, Phil and I are able to do it by "next Wednesday!"

Contracts and Master Agreements are important, as we talked about throughout the day, for enforceability purposes so that you have rights and remedies vis-à-vis your counterparty should something go wrong. You can't look to either the market or the regulators or another third party to help you enforce your rights. The provisions that are important should be in your contracts. It requires an investment in time to learn the contracts that you choose to work with, and it requires back office staff to manage those contract relationships. Trading, buying and selling energy products requires a different look at your policies and procedures to make sure that you're quantitatively managing price risk, and that you're managing the operational risks that comes from running a bilateral contract shop. And it requires sort of an ongoing awareness of how the markets are changing all around.

It is somewhat different than a regulatory practice. In a regulatory practice, most of my partners are looking at what happens at FERC on an ongoing basis.

In the bilateral contract market, it is much more difficult to watch because it's happening all over the country, usually over the telephone, and in courts all over the country dealing with different types of contracts. So, for those of you who are relatively new to dealing in the bilateral contract markets, welcome. It's a great place to be a contract and credit lawyer. There is no more fertile ground for innovation than the minds of people who are out there to make money or to provide power supply to their customers at the least cost they can figure out. It's a fun place to watch a rapidly developing market and to continually learn new things.

THE END.