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## USING THE EEI-NEM MASTER CONTRACT TO MANAGE POWER MARKETING RISKS

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### I. INTRODUCTION

A commercially oriented power purchase and sale agreement incorporating precisely defined common products, trading practices, and legal terms is an essential tool to control risk for the participants in competitive wholesale electric power markets in the United States and elsewhere. Edison Electric Institute (EEI), with the support of the National Energy Marketers Association (NEM), has responded to the need for power trading documentation better suited for today's market environment by facilitating an eighteen month effort to create the EEI-NEM Model Master Power Purchase & Sale Agreement (Master Agreement). A broad-based group within the electric industry comprised of in-house and outside counsel, energy traders, and risk managers donated extensive amounts of their time to develop what they hope will be the new standard in power trading documentation.

This article explains why standardized power contracts are important in today's bulk power markets and describes the Master Agreement development process. The article also describes the principal provisions of the Master Agreement and demonstrates how the provisions may be used in various commercial settings. Finally, the article addresses some important ancillary issues, including documenting the Master Agreement under the Federal Energy Regulatory Commission's (FERC or Commission) filing requirements for market-based Sellers.

### II. NEED FOR STANDARDIZED POWER CONTRACTS

Those who buy or sell competitive bulk power physical markets handle the nation's most volatile commodity. Bilateral bulk power trading is

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implemented through a variety of customized, structured transactions, and over-the-counter (OTC) products, including: (1) forward contracts; (2) options; (3) swaps; and (4) spreads.<sup>1</sup> Both the physical nature of electricity and the "econo-technical-legal-regulatory infrastructure" (to coin a phrase) that supports its generation, transmission, and consumption significantly increase power market transaction commodity risks.<sup>2</sup> These commodity risks include: (1) market (price); (2) liquidity (supply availability); (3) credit; (4) legal; and (5) operational (delivery ability).<sup>3</sup>

The wholesale power market price volatility and performance disruptions during the past three summers drive home the importance of adequate risk controls for power market participants. The risks are numerous for many reasons. Moreover, the dynamic interplay between electricity generation, transmission, and consumption creates extremely complex price behavior, which is difficult to predict accurately.<sup>4</sup> Demand and transaction volumes have increased in United States wholesale power markets, while surplus generation and transmission facilities have declined.<sup>5</sup> In 1998, the FERC Staff identified the following factors, combined with the previously mentioned market conditions, as the primary causes of extreme price volatility in electric markets: (1) severe weather conditions during peak demand periods; (2) inadequate credit, price, and legal risk controls; and (3) inexperience among market participants.<sup>6</sup> These factors have produced notorious declarations of financial insolvency,<sup>7</sup> ripple effects causing other market players to breach their contractual obligations,<sup>8</sup> and withdrawals from market participation.<sup>9</sup>

A lack of common essential legal terms in electricity transaction documentation and differences in the contract/tariff infrastructure, become

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1. Shirley S. Savage, *Power Market Risk Management: A Survival Guide*, 1 FIN. TIMES ENERGY 18-33 (2000); See also Perry Sioshansi & Art Altman, *Power Marketers; Who Are They, and What Do They Do?*, 11 ELEC. J. 85 (Dec. 1998).

2. Electricity is a more physically complicated energy commodity due to the physics of electron flows and lack of storage capability. Of course, like two sides of the same coin, risk and opportunity are interdependent. Rebecca Smith, *Volatility in Natural-Gas and Electricity Prices Fuels Earnings at El Paso Energy, Other Firms*, WALL ST. J., July 14, 2000, at C2.

3. Brandon Becker & Francois-Ihonor Mazur, *Risk Management of Financial Derivative Products: Who's Responsible for What?*, 21 J. CORP. L. 177 (1995).

4. Dragana Pilipovic, *ENERGY RISK: VALUING AND MANAGING ENERGY DERIVATIVES*, Ch. 1 *What Makes Energies Different?* (1st ed. 1998).

5. NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL, *THE RELIABILITY OF THE BULK ELECTRIC SYSTEMS IN NORTH AMERICA*, 2000.

6. FEDERAL ENERGY REGULATORY COMMISSION, *STAFF REPORT TO THE FEDERAL ENERGY REGULATORY COMMISSION ON THE CAUSES OF THE PRICING ABNORMALITIES IN THE MIDWEST DURING JUNE 1998* (1998). [hereinafter STAFF REPORT].

7. *Marketer Bankruptcy Filing Lists Claims Of \$236-Million From Tumult*, ELEC. UTIL. WEEK (formerly ELECTRICAL WEEK), September 7, 1998, at 16.

8. Lynn Garner, et al., *Cinergy Defends Force Majeure Action, But Angry Marketers See 'Price Majeure'*, POWER MARKETS WEEK, August 9, 1999, at 1.

9. Citing '*Volatility*' And '*Unacceptable Risk*,' NAEC Decides To Quit Power Marketing, POWER MARKETS WEEK, September 14, 1998, at 1; *Four Buyers Grab LG&E Energy Marketing Portfolios*, MEGAWATT DAILY, (November 13, 1998).

critical in times of market stress.<sup>10</sup> However, the transactions in today's marketplace are implemented through a diverse array of legal documentation, which may impose different contractual obligations on Buyers and Sellers.<sup>11</sup> Often the varied agreements inconsistently address important trading issues, such as: (1) treatment of oral transactions; (2) confirmation processes; (3) allocation of *force majeure* risk; (4) credit assurances; and (5) payment netting. Traditional utility contract and tariff forms based on unilateral, regulated service offering formats often lack the credit and legal controls, such as default and remedy provisions, needed to address the risks inherent in today's competitive and volatile electricity market.<sup>12</sup> Also, the utility-based contract and tariff structures contain asymmetric terms, which raise issues about whether the terms of a tariff or a transaction govern. To be useful in today's competitive power markets, trading contracts have to be precisely drafted so that parties know exactly what their rights and remedies are because they often will be tested in the volatile bulk power market.

Wholesale power market participants assume incorrectly that they buy and sell the same products because their traders speak in common commercial terminology. For instance, "50MW on-peak, Into Cinergy, for July-August." When market participants think they are trading the same product, they treat transactions as identical "hedges" for one another and the bulk power subject to these transactions often changes hands several times through multiple transaction (daisy-chain) trades.<sup>13</sup> If counterparties have differing contract infrastructures or if they have differing assumptions about an "industry standard" that is not defined, in reality there are different deals in these transaction chains. For example, if Party B purchases electricity from Party A that is subject to different *force majeure* or other excuses for non-performance than Party B's sale to Party C, then Party B may be assuming unanticipated risks when Party B subsequently resells the electricity to Party C. If these terms and conditions in the contracts between the participants in the daisy-chain differ, then the legal nature of the product will vary as it moves through the transaction chain.

Counsel and risk managers for marketing operations must ensure that the deals struck on the trading floor are in fact exactly what the power traders understood them to be. Moreover, the underlying legal documents in use must provide certainty that when problems occur, the economic

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10. Mark E. Haedicke, *Competitive-Based Contracts for the New Power Business*, 17 ENERGY L.J. 103, 118-19 (1996).

11. These include: cost-based and market-based tariffs; cost-based and market-based service agreements; unilateral contracts; bilateral contracts; and pool-enabled transaction terms and conditions.

12. Haedicke, *supra* note 10, at 117-18.

13. A "significant portion of (marketer) sales are part of extended 'daisy chains'" in which power is traded by several market participants, many of whom do not plan to physically deliver the power. These transactions represent multiple resales of the same generation that formerly flowed from utilities to native load customers or to other utilities for resale to their native load customers. STAFF REPORT, *supra* note 6, at 3-2.

benefit of the transactions struck with counterparties will be preserved.<sup>14</sup> The cornerstones of a successful risk management program require: (1) a sophisticated master agreement with each trading counterpart that provides credit enhancement in the form of collateral or guarantees and close-out netting; (2) a sophisticated internal tracking system to measure, manage, and control trading activity risks; and (3) risk management policies followed by highly trained individuals who have the knowledge to use the organization's risk management tools.<sup>15</sup> The Master Agreement was designed to be used, and is in use, as a sophisticated power marketing risk management tool.

### III. EEI-NEM CONTRACT DEVELOPMENT PROCESS

The Master Agreement reflects the combined efforts of a small drafting committee<sup>16</sup> and a larger working group<sup>17</sup> that included companies responsible for eighty percent of all electricity traded in the United States.<sup>18</sup> Both groups are co-chaired by Patricia Dondanville, a partner in the law firm Schiff Hardin & Waite, representing NiSource Inc. and David Perlman, Vice President and General Counsel of Constellation Power Source, Inc. Much credit for initiating the Master Agreement development process is due Mark E. Haedicke, Managing Director and General Counsel of Enron North America Corporation.<sup>19</sup> In the fall of 1998, he encouraged EEI to facilitate a power contract standardization initiative with the participation of EEI's utility members, their affiliated power producers, and power marketers. EEI invited members of the NEM to collaborate, since the NEM had also started a standardization project.<sup>20</sup> Both or-

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14. *Cinergy's Force Majeure Shows Need for Contract Scrutiny*, THE ENERGY REPORT, August 9, 1999.

15. Savage, *supra* note 1.

16. Members of Drafting Committee: Constellation Power Source, Schiff Hardin & Waite, American Electric Power, Dynegy, Inc., Entergy Power Marketing, Enron North America, Jones Day Reavis & Pogue, Reliant Energy, Hess Energy Inc. (formerly Statoil Energy), and Edison Electric Institute.

17. Members of the Working Group: Northern Indiana Public Service Company, Commonwealth Edison Company, Ameren Energy, Williams Company, Duke Energy Trading, Enserch Energy Services, Virginia Power, Dynegy, PG&E Energy Trading, Prebon Yamane, Southern Company Energy Marketing, PSE&G, Pepco, Consumers Energy, Detroit Edison, Reliant Energy, DTE Energy Trading, Arizona Public Service, Consolidated Edison, Niagara Mohawk Energy, Ontario Power Generation, TXU Energy, Midamerican Energy Company, GPU Energy, First Energy Corp., Western Resources, GPU Service, Inc., New Century Energies, New England Electric System, Superior Water, Light & Power, Rochester Gas & Electric, Kansas City Power & Light, TECO Energy Inc., Conectiv, Illinova Energy Marketing, PECO Energy, Power Team, Minnesota Power, Aquila, Midland Cogeneration Venture, Citizens Power, Cinergy Energy Trading, Northern States Power, Indiana Power & Light Company, Steel Manufacturers' Association, and Northeast Utilities.

18. The author is the EEI coordinator for the project.

19. Haedicke is an outspoken proponent of standard agreements for energy commodity transactions. See generally Haedicke, *supra* note 10. See also Mark E. Haedicke, *Contracts for the New Natural Gas Business*, 13 ENERGY L.J. 313 (1992).

20. NEM's project chair was Christopher Bernard, General Counsel of Entergy Marketing, Inc., another enthusiastic advocate for contract standardization.

ganizations realized that widespread commercial acceptance of a standard contract would require the input and balancing of interests from all industry segments.

Work on the Master Agreement commenced at the working group kick off meeting on January 29, 1999, at EEI's offices. It was there that the working group identified the essential components of a standard wholesale electric contract and established a drafting committee to precisely define standardized terms. The drafting committee completed the bulk of the work on the Master Agreement during the first three quarters of 1999. During this time, the drafting committee presented proposed consensus terms and conditions to the larger working group for discussion and adoption. The committee also presented various contentious issues to the group for resolution. A consensus draft was circulated to the industry for review and comment in October 1999. A critical, but unresolved issue at that point was the precise definition of the products that would be referred to in the Master Agreement.

Throughout the development of the Master Agreement lawyers, traders, and risk managers participated in the working group to finish the Master Agreement product definitions and fine-tune its credit provisions.<sup>21</sup> A tremendous amount of common understanding resulted as the expanded working group tried to document what their traders and risk managers said they were doing everyday.<sup>22</sup> These working group meetings permitted the drafting group to further minimize the risk facing what traders were doing by precisely defining standard products and risk management procedures based on sound existing commercial practices. The first fully functional version of the Master Agreement (Version 2.1) was released in the spring of 2000.

In addition, the working group conducted a series of outreach activities, intended to inform the industry and regulators about the benefits and uses of the Master Agreement. These activities were also intended to maximize feedback about the Master Agreement's provisions.<sup>23</sup> Information about the Master Agreement and related meetings was, and is, disseminated through an Internet website and e-mail list server maintained by

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21. Dynege, Inc. and Reliant Energy each hosted a meeting at their Houston, Texas offices in December 1999 and January 2000, respectively.

22. Risk managers try to hedge one transaction against another. It was an eye opening experience when the working group realized that some of their risk managers were hedging "system firm" contracts against "system firm" contracts, except that the contracts were for power delivered from different systems. Traders also have hedged "firm" transactions against "system firm" contracts. The various standard products defined in the Master Agreement, including "system firm," are discussed *infra* in section IV.C.4.

23. EEI, its Alliance of Energy Suppliers, and NEM sponsored a series of workshops in Washington, D.C., Houston, and New York City. These workshops were conducted by members of the drafting group. The working group also worked with the Federal Energy Regulatory Commission (FERC) staff to rationalize how the Master Agreement complied with that agency's market-based tariff requirements. The drafting group also coordinated with governmental and cooperative power representatives, and the American Public Power Association.

the EEI.<sup>24</sup>

#### IV. ANATOMY OF THE EEI-NEM MASTER AGREEMENT

##### A. Overview

The Master Agreement has three principal components: (1) a Cover Sheet; (2) the General Terms and Conditions; and (3) a form Confirmation Letter (Exhibit A). Schedule P, included in the General Terms and Conditions, contains precise definitions of commonly traded products.<sup>25</sup> Schedule M, also included in the General Terms and Conditions, adds supplemental terms for electric cooperative or public power counterparties.<sup>26</sup> The latest version of the Master Agreement is reproduced in full as Appendix A to this article. Unless otherwise noted, all citations to article numbers, section numbers, and schedules refer to Appendix A.

The Master Agreement sets forth the core terms and conditions needed to establish a fully bilateral physical spot forward and option contract trading relationship. Its "umbrella" General Terms and Conditions apply to all transactions executed between each pair of trading counterparties.<sup>27</sup> Applying standard terms to each transaction should dramatically reduce the business risks in wholesale electricity trading by establishing certainty as to the reciprocal rights and obligations of each trading partner. Each party knows what performance is required of itself and its counterparty under the contract, and the remedies available when a counterparty does not perform.

In addition, the Master Agreement promotes liquidity in the marketplace by recognizing that oral agreements are binding and setting forth definitions for the most commonly traded products.<sup>28</sup> To avoid any disagreements over a transaction and to achieve finality, the Master Agreement incorporates specific written confirmation procedures. The procedures are commonly used in the industry. Having clear procedures and legal terms specified in the Master Agreement permits traders on the floor to focus upon the basic negotiable elements of a transaction, such as price, quantity, duration, and delivery point.<sup>29</sup>

Finally, the Master Agreement can be readily adapted for variations

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24. EDISON ELECTRIC INSTITUTE & NATIONAL ENERGY MARKETERS ASSOCIATION, MASTER POWER PURCHASE & SALE AGREEMENT (2000). A Microsoft Word version of the Master Agreement and instructions on how to subscribe to the Master Agreement list server are available at (last modified Apr. 25, 2000) <<http://www.eei.org/issues/contract>> [hereinafter MASTER AGREEMENT]. The MASTER AGREEMENT can be found in Appendix A.

25. See *infra* section IV.C.5.

26. See *infra* section IV.C.5. In addition to the Schedule P product definitions, Article One contains definitions essential for executing and performing transactions under the Master Agreement.

27. As discussed *infra* in section V., the Master Agreement must be used in conjunction with a FERC market-based tariff.

28. See *infra* section IV.C.5.

29. Haedicke, *supra* note 10, at 120. See also Richard Stavros, *EEI's Master Contract: If you Draw It Up, Will They Trade?*, PUB. UTILS. FORT., Jan. 1, 2000, at 38.

in product requirements, counterparty circumstances, and transaction specifics. A flexible, "modular" structure lets parties select on the Cover Sheet a variety of optional standard terms that they wish to apply in the Master Agreement. Parties also may amend or supplement the Master Agreement in any way they desire by agreeing to such changes in the Cover Sheet. Finally, transaction specific terms may be agreed to on a case-by-case basis and documented in the written confirmation. Thus, the Master Agreement governs the terms of each transaction. All transactions, plus any supplemental schedules (including accepted written transaction confirmations), any market-based tariff of each party, and any credit support arrangements with the counterparty, which together form a single integrated agreement.<sup>30</sup>

### B. Cover Sheet

The Cover Sheet to the Master Agreement contains all the information that is specific to the two parties who enter into a trading relationship.<sup>31</sup> The Cover Sheet also provides flexibility by allowing elections for several optional standard provisions in the Master Agreement. For example, parties can elect the type of information required for performance and credit assurances. They also can specify "Collateral Threshold," credit downgrade conditions, and guarantor amounts that apply to their counterparty.<sup>32</sup> The Cover Sheet's options cross-reference the applicable sections of the General Terms and Conditions of the Master Agreement. Further, the Cover Sheet is the place to identify any customized contract riders that supplement or modify the standardized General Terms and Conditions of the Master Agreement.

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30. See MASTER AGREEMENT, *supra* note 24, section 2.2. Integration of all this documentation provides a contractual nexus to enable the Master Agreement's payment and transaction netting provisions, as well as termination and liquidation procedures to unwind the trading relationship with a counterparty. These procedures are discussed *infra* in Part IV.E.2.

31. INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION, 1992 ISDA MASTER AGREEMENT (1992)[hereinafter ISDA MASTER AGREEMENT]. The Cover Sheet uses the format of the International Swaps and Derivatives Association's (ISDA) 1992 Master Agreement. ISDA is a global trade association representing leading participants in the derivatives market. Its Master Agreement has set established international contractual standards governing privately negotiated derivatives transactions. For "over the counter" (OTC) derivatives, ISDA's Master Agreement is the most frequently used standardized contract. The 1992 ISDA Master Agreement is available at (visited Sept. 24, 2000) <<http://www.isda.org>>. The gas industry embraced the ISDA standard contract format through the Gas Industry Standard Board (GISB) Base Contract for Short Term Sales/Purchases of Natural Gas which is available at (visited Sept. 24, 2000) <<http://www.gisb.org>>.

32. These items may be checked off or specified on the Cover Sheet (ISDA MASTER AGREEMENT, *supra* note 31): (1) optional confirmation procedures (section 2.4); (2) option to accelerate payment of cover damages (Article Four); (3) specification of events of defaults, cross default amounts, parental guarantors, setoff of liquidation amounts (Article Five); (5) specification of remedies for Events of Default (Article Eight); (6) option to make transactions confidential; (7) identification of counterparty as a governmental entity subject to Schedule M of the Master Agreement; and (8) identification of supplemental agreements that add to or modify the terms of the Master Agreement. (MASTER AGREEMENT, *supra* note 24, *see also* Appendix A).

### C. *Let's Make a Deal - Formation of A Transaction*

#### 1. Oral Trading

Power marketers estimate that about ninety percent of their competitive wholesale electric transactions are made over the telephone between traders.<sup>33</sup> In today's fast-paced, high volume, and volatile trading environment, counterparties need certainty and finality for their executed transactions. The drafters believe the transaction consummation procedures specified in Article Two (Transaction Terms and Conditions of the Master Agreement) will facilitate marketing operations and increase electric market liquidity. Under the Master Agreement, an oral trade is binding at the time it is made.<sup>34</sup> Binding oral agreements may be documented by a clearly defined written confirmation process. Contractual certainty is further secured through a covenant that neither party will challenge a transaction based on the Statute of Frauds provisions of a particular jurisdiction or a party's lack of authority to execute the trade.<sup>35</sup>

Recording of trade calls between counterparties is expressly authorized under the Master Agreement to document oral transactions.<sup>36</sup> Trade call recording is a key risk management practice incorporated into the verification and confirmation processes used to monitor power marketing trade desk operations. Trade tapes provide further contractual certainty and help resolve conflicts over oral transactions.<sup>37</sup> The trade call recording provisions were drafted in recognition that some state criminal statutes require notification and/or express agreement to have a person's conversations recorded over the telephone, even in an employment setting.<sup>38</sup> Thus,

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33. Written agreements are usually preferred for longer-term, complex structured transactions that are more highly negotiated.

34. See Appendix A, section 2.1.

35. As discussed *infra* in Part IV.F.4., the working group selected New York law for Choice of Law in the Master Agreement. New York amended its Statute of Frauds in 1996 to permit binding oral agreements for "... a qualified financial contract ... if either (a) there is, ... sufficient evidence to indicate that a contract has been made or (b) the parties thereto, by means of a prior or subsequent written contract, have agreed to be bound by the terms of such qualified financial contract from the time they reach agreement (by telephone, by exchange of electronic messages, or otherwise) on those terms." N.Y.U.C.C. LAW § 1-206 (McKinney 2000). This provision offers an exception to instruments conducted basically on the trading desks of large institutions where a traders' tape serves as evidence of the contract, or if not available, a written confirmation. See also Jeffery Kagan, *The Indelibility of Invisible Ink: A Critical Survey of the Enforcement of Oral Contracts without the Statute of Frauds under the U.C.C.*, 19 WHITTIER L. REV. 423, 454 (1997) (citations omitted).

36. See Appendix A, section 2.5.

37. A recorded trade call will become the controlling evidence of the parties' agreement to a particular transaction if the confirmation process described in section 2.3 of the Master Agreement results in an unexecuted or unaccepted written confirmation (as discussed *infra* in Part IV.C.2.). If a written confirmation is deemed accepted, its terms will control over either the terms of a recording or the Master Agreement in the event of a conflict.

38. It is beyond the scope of this article to review federal and state privacy and wiretap law in detail. For a detailed review, see Carol Bast, *What's Bugging You? Inconsistencies and Irrationalities of the Law of Eavesdropping*, 47 DEPAUL L. REV. 837 (1998). It is worth noting that the federal Electronic Communications Privacy Act of 1986 (ECPA) generally prohibits interception, without a party's



the Master Agreement contains an agreement to provide any notice or to obtain any consent from a party's officers and employees as may be required by statute.

## 2. Confirmation Process

The Master Agreement allows parties to use a precisely described process for sending and accepting written confirmations. A written confirmation process is a routine risk management practice in energy trading. Written confirmations are intended to provide finality to oral transactions in order to avoid disputes by accurately reflecting its details. Confirmations are not mandatory, however, and oral transactions are still binding, even if neither party sends a confirmation.<sup>39</sup> If either party requires a written confirmation, it must be expressly requested on the trade call.<sup>40</sup>

Section 2.3 of the Master Agreement describes the confirmation process. The Master Agreement anticipates that the Seller will initiate the confirmation process by sending a written confirmation by facsimile to the Buyer.<sup>41</sup> To be deemed timely, the Seller's confirmation must be sent within three business days after an oral transaction is made. The Buyer then has two days to send the Seller a timely written objection to the confirmation's description of the transaction. If there is an objection, the parties will have to go back to the oral transaction (perhaps reviewing the trade tapes) to determine the agreed to deal.<sup>42</sup> If the Seller accepts the Buyer's timely objection, the confirmation may then be revised and signed by Seller. In that case, the mutually agreed confirmation terms are deemed binding, and will control over the general terms and conditions of the Master Agreement. If the Seller does not accept the Buyer's timely objection, it will not invalidate an oral transaction. Parties may then seek to enforce their version of the bargain through some dispute resolution process. The Buyer will be deemed to have accepted the terms of the Seller's written confirmation if the Buyer does not send a timely written objection.

If three business days pass after an oral transaction and the Seller still has not sent a confirmation, the Buyer may do so, which gives the Seller

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consent of electronic communications "that affect interstate or foreign commerce." 18 U.S.C. §§ 2510-22, 2701-11 (1994). ECPA does provide for two exceptions that allow an employer to legally intercept an employee's telecommunication: (1) the "business" exception; and (2) the "consent" exception. Under the "business" exception, an employer may intercept communication if done in the ordinary course of business using a qualifying device. 18 U.S.C. § 2510(5)(a) (1995).

39. It is common practice in energy trading not to send written confirmations for short-duration hourly or next day transactions.

40. See Appendix A, section 2.1.

41. The confirmation letter may be in the form of the Model Confirmation Letter included in the Master Agreement, Appendix A, Exhibit A. It establishes: (1) which party is the Buyer and which is the Seller; (2) pricing terms; (3) quantity; (4) transaction duration; (5) delivery points; and (6) the nature of the product. See *supra* note 40.

42. Many counsel in the working group have said that the trade tapes may be hard to review. Some trade desks require their traders follow a script to ensure the correct information is captured in trade calls.

two business days to make a timely objection to any terms included in the Buyer's written confirmation. The Seller will be deemed to have accepted the terms of the Buyer's written confirmation if the Seller does not send a timely written objection. While generally not a good procedure due to possible confusion, both parties often send a confirmation when they are both a Buyer and Seller. By default, the Master Agreement deems a timely Seller's confirmation, to which a Buyer does not object, to be controlling over the Buyer. However, should the Seller fail to send a confirmation within three days and the Buyer's confirmation is sent first, the Buyer's confirmation will be controlling.

An optional procedure lets the parties elect to require express oral or written consent before any additional confirmation terms, other than those relating to the essential commercial terms of a transaction (i.e., price can modify or supplement the General Terms and Conditions of the Master Agreement).<sup>43</sup> This provision was adopted in response to the concerns of some working group members that their companies' internal confirmation processing controls would not detect objectionable added terms and conditions within the Master Agreement's default two day deadline.<sup>44</sup>

### 3. Obligations and Deliveries

The Master Agreement clearly delineates the parties' obligations to perform with respect to each transaction. The Seller is responsible for selling and delivering the specified quantity of product at the agreed delivery point. Further, the Seller is responsible for any costs associated with the product or its delivery incurred up to the delivery point. The Buyer is obligated to receive the product at the designated delivery point and pay the price agreed to for the transaction, plus all costs associated with the product or its receipt at and from the delivery point.<sup>45</sup> The Seller is responsible for transmission service to the delivery point, and the Buyer is responsible for transmission service at and away from the delivery point. These responsibilities include scheduling transmission service with designated transmission providers either under terms specified in the transaction or according to the practice of the transmission providers, i.e., according to the provider's Open Access Transmission Tariff.<sup>46</sup>

### 4. Force Majeure

One of the key elements of a good trading contract is to clearly set forth precisely when a party's performance will be excused without the

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43. See Appendix A, section 2.4.

44. Adopting section 2.4 of the Master Agreement was controversial and the final terms adopted reflected a compromise. Those companies that placed a premium on transaction finality insisted that the provision be optional. Companies endorsing the provision insisted that additional terms that are not objected to, and are added to a confirmation, could not become binding.

45. See Appendix A, section 3.1.

46. See Appendix A, section 3.2.

payment of damages.<sup>47</sup> Because of the chaotic approach of the myriad of industry participants as to how to characterize what constitutes a *force majeure* event, discussions related to the definition of Force Majeure were among the most debated.<sup>48</sup> Ultimately, the working group determined that the best approach was to provide for a very narrowly defined *force majeure* as the primary standard for the Master Agreement.<sup>49</sup> Under the Master Agreement's "gold-plated" definition of "Force Majeure," the focus is not on what might constitute a Force Majeure event but instead on whether there is any way a party can perform its obligations as agreed in a transaction, even if such performance must be secured through replacement transactions in the marketplace.

With this key recognition of a party's obligation to seek alternate performance in the marketplace, a party will be excused from performance based on Force Majeure, if ever, only in the most exceptional of circumstances. In order to reduce the ambiguities of what kinds of events constitute a Force Majeure event, the Master Agreement's definition of a Force Majeure event sets forth certain event characteristics which do not, in and of themselves, excuse performance. Thus, the "laundry list" of qualifying events often found in many contracts, such as drought, civil disobedience, and acts of God, has been eliminated.<sup>50</sup> The working group decided to eliminate the "laundry list," in part, because many of the frequently used items were inexplicable, but most importantly, were misleading, taking away the true focus of a Force Majeure event from being whether performance was impossible to whether an item enumerated in the laundry list had occurred.<sup>51</sup> To make clear that a party would not be excused from

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47. The Master Agreement provides that a party claiming a legitimate Force Majeure will be excused from performance of a transaction, unless the terms of the product otherwise. See section 3.3 of the Master Agreement, found in Appendix A, which describes the procedures for suspending each party's obligations under a transaction in the event one party is prevented by Force Majeure from performing.

48. Please note that the term "Force Majeure" is used when referring to the specific definition applied in the Master Agreement, while "*force majeure*" refers to the broader legal concepts.

49. This belief is bolstered by the fact that, in the history of electricity trading, no one in the working group could identify a single circumstance where anyone successfully claimed a *force majeure* in either an OTC or a New York Mercantile Exchange (NYMEX) contract. Similarly, the NYMEX has never called a *force majeure* event in the history of its gas trading contracts even when hurricanes in the Gulf of Mexico threatened the Henry Hub delivery point.

50. For example, the working group puzzled over what "civil disobedience" and *force majeure* have in common. Another puzzler is "drought." How could the presence of drought conditions constitute a *force majeure* event if you are selling a "firm product?" If the product were "unit" specific, such a provision may have relevance but such a condition (e.g., unavailability of water) should be specifically negotiated.

51. Traditional doctrine in common and civil law support the doctrine of *pacta sunt servanda* – agreements must be kept though the heavens may fall, with impossibility (also known as force majeure) or frustration of venture the only recognized exceptions. Under the traditional doctrine, hardship short of impossibility, is no excuse for nonperformance of a contract. Ironically, modern contract doctrine provides relief on the grounds of hardship. Some United States courts also flirt with a vaguely defined doctrine of impracticability. Joseph M. Perillo, *Force Majeure and Hardship under the UNIDROIT Principles of International Commercial Contracts*, 5 TUL. J. INT'L & COMP. L. 5, 7 (1997).

performance solely because of financial events, such as loss of markets or ability to obtain a better price, the Force Majeure definition expressly states that these types of events do not excuse performance and thus are not in and of themselves within the definition. Similarly, curtailments of firm transmission are specifically excluded unless the definition of Force Majeure is otherwise satisfied.<sup>52</sup>

With the narrowly defined Force Majeure in hand, the working group then needed to determine to which products would the tight definition apply.<sup>53</sup> The working group concluded that the Master Agreement's Force Majeure definition would apply only to the "Firm (LD)" product and the "Into" product.<sup>54</sup> The working group affirmatively decided that the definition would not apply to "Unit Firm" or "System Firm" because in neither of these products is the Seller obligated to seek alternative performance in the marketplace.<sup>55</sup>

As is evidenced by how the products are structured, it was the intent of the working group to narrowly define Force Majeure for the commonly traded products, but to allow additional excuses for performance in the products. For example, if the parties want to enter into a "Firm (LD)" transaction but to include loss of firm transmission on a particular contract path as an excuse for performance, that transaction is very easily accomplished under the existing product definitions. All that would be required would be to specify and agree that the transaction was a Firm (LD) transaction but with a Firm Transmission-Contract Path contingency and then name the path subject to the contingency. If additional excuses to performance are desired, such specific events only need to be specified and agreed to. The purpose of this approach is to provide clarity and certainty to one of the most difficult areas in all of power contracting.

## 5. Standard Products

The Master Agreement includes six precisely drafted common product definitions in Schedule P: (1) the Non-Firm product; (2) the Unit Firm product; (3) the System Firm product; (4) the Firm (LD) product; (5) the Into [the Receiving Transmission Provider], Seller's Daily Choice product (the "Into" product); and (6) the Firm (No Force Majeure) product. The economic/legal benefits and obligations which underlie each product are: (1) an amalgamation of the product's Schedule P definition; (2) the remedies for an unexcused failure to deliver/receive and/or schedule a product specified in Article Four; (3) the conditions for excused performance in ei-

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52. See Appendix A, section 1.23.

53. It is important to remember that the Force Majeure definition only has importance relative to the type of products being purchased and sold. Although different market participants have different capabilities, the Force Majeure definition holds everyone to the same standard of capability in determining whether an excuse from performance should be allowed. A common definition is needed not a specific party's idiosyncratic one. If the Seller feels its resources and capabilities are limited, for example, it should sell a product that reflects its capabilities.

54. See *infra* Section IV.5.A.

55. See *infra* Section IV.5.A.

ther the Force Majeure definition or embedded in the product definition itself or as otherwise specifically agreed to by the parties; and (4) the limitations of damages in Article Seven. Ultimately, the choice of product reflects a counterparty's risk appetite, willingness to pay the price to avoid risk, and the relative importance of entering into physical transactions. To satisfy these varying needs, parties are free to agree to special trading or other transactional requirements under the Master Agreement.<sup>56</sup>

a. Description of Standard Products

*Non-Firm.* The Non-Firm product excuses failure to deliver or receive this product for any reason or no reason. Thus, a failure to deliver or receive Non-Firm product would be excused if the price of obtaining the energy was unfavorable to either the Buyer or Seller.

*Unit Firm.* The Unit Firm product is intended to be supplied from a specified generator or group of generators. The Seller will be excused if the specified assets are unavailable as the result of either: (1) a GADS Forced Outage;<sup>57</sup> or (2) unanticipated events, not within the reasonable control of, or the result of the negligence of, the Seller.

*System Firm.* The System Firm product is supplied from an identified system's generating resources or pre-existing purchased power assets. This product is one that is most frequently committed on a next hour basis. It is not generally used for long-term supply. The Seller's performance is excused: (1) by an unanticipated event that prevents Seller from performing if such event is not within the reasonable control of, or the result of the negligence of, the Seller; (2) if to preserve the integrity of, or prevent or limit any instability on the system; (3) by a declaration of emergency by the system or control area system operator or the applicable reliability council; or (4) by the interruption or curtailment of transmission to the delivery point(s).

*Firm (LD).* The Firm (LD) product currently trades more than any other in today's wholesale electric market. Unless the parties negotiate otherwise, non-delivery or non-receipt of a Firm (LD) product for any reason, other than Force Majeure, requires the defaulting party to pay cover damages computed under Article Four.<sup>58</sup>

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56. The products traded under Schedule P can be customized in the confirmation for individual transactions. Appendix A, Schedule P. For example, traders in a region of the country may have particular pool rules or products that need to be accommodated (i.e., NEPOOL Unit Entitlement service). The Buyer should make sure that the Seller is obligated to provide what is needed for the reliability requirements (e.g., installed capacity or network resource) in a particular area. Such a capacity product would not be tradable as a fungible commodity, but the advantage of structuring a capacity arrangement under the Master Agreement is the sophisticated credit and payment relationships it establishes.

57. The Forced Outage must meet the criteria in the *Definitions for Use in Reporting Electric Generating Unit Reliability, Availability, and Productivity*, INSTITUTE OF ELECTRICAL AND ELECTRONIC ENGINEERS, IEEE STANDARD 726-1982, used by the North American Electric Reliability Council's (NERC) Generating Unit Availability Data System (GADS).

58. The "LD" acronym reflects terminology in use by traders, which would lead one to believe

*Into the [Receiving Transmission Provider] Seller's Daily Choice.* The "Into" product is the most commonly used product at liquid trading hubs.<sup>59</sup> It requires the Seller to deliver financially firm energy at an interconnection or interface either on a receiving transmission provider's border or within the transmission provider's control area, if the product is from a generation source within the control area. The "Into" product is the most complex and controversial product addressed by the working group.

The "Into" product is highly transmission driven.<sup>60</sup> Once the Seller designates a delivery point by notifying the Buyer, it sets the allocation of performance risk. If transmission is unavailable to the Buyer at the designated interface, the Seller may be required to designate another interface (described as an Alternative Designated Interface or ADI) or designate a generation source inside the control area where transmission is available to the Buyer.<sup>61</sup> This redesignation of delivery points may become an iterative process, which obligates the Seller to keep selecting ADIs until its obligation to deliver is deemed satisfied under the definition.

If a transmission interruption or a generation outage occurs, the Buyer's and Seller's obligations and risks depend on the following factors: (1) whether the Buyer made a timely request for and purchased firm transmission service;<sup>62</sup> (2) whether firm transmission service was available at the designated interface or ADI; (3) whether the Buyer purchased non-firm transmission service even though firm service was available; (4) whether the Buyer provided a timely notice that its transmission request was rejected to the Seller;<sup>63</sup> and (5) whether the Buyer attempted to take

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that the remedy for an unexcused failure to perform is payment of Liquidated Damages, a prearranged damage amount because of the inability to calculate specific damages. In the Master Agreement, the damages computed under Article Four for failure to deliver or receive a product are more akin to the Uniform Commercial Code (U.C.C.) cover damages remedy. See *infra* Part IV.D.

59. A hub is an aggregation of representative buses grouped by region, which help create price signals for the region. Hubs create a common point for commercial energy trading to settle with or without going to physical delivery. They also reduce the risk of delivering to one particular bus whose price is more volatile during a constraint than a collection of bus prices at a weighted average. In the Eastern Interconnection, the greatest concentration of power trading is at the Into Cinergy, Into Entergy, and TVA hubs. The three major Western Interconnection hubs are California-Oregon Border (COB), Palo Verde, and Mid-C. E. Russell Braziel, *Trading Hubs: Where Power Is Traded and Why*, POWER MARKETING ASSOCIATION ONLINE MAGAZINE, (Dec. 1998).

60. The concept of selling electricity "Into" a trading hub was developed in 1995 by traders from several power trading organizations, including Enron, Cinergy and Entergy, in advance of the NYMEX electricity futures contract. Many have noted that the Schedule P description of the "Into" product makes it both a delivery point and a product. It is a delivery point by specifying that delivery is "Into" a specified hub, but the drafting committee added characteristics and legal responsibilities to make it a specialized Firm (LD) product. Elizabeth Sager, an Assistant General Counsel with Enron North America, deserves much of the credit for developing the Into definition for the Master Agreement.

61. See Appendix A, Schedule P "Into" definition section 2. "Available" transmission is what the transmission provider identifies as available for receipt of power in its control area using either firm or non-firm service on a day-ahead or hourly basis.

62. See Appendix A, Schedule P "Into" definition section 2. Buyer must make a transmission request within 30 minutes after Seller designates the delivery point.

63. See Appendix A, Schedule P "Into" definition section 3B. Buyer has 15 minutes to notify Seller of the rejection.

the product outside the market hub control area.

A few examples will illustrate how these factors affect the parties' obligations and risks.<sup>64</sup> Assume the Buyer and Seller both purchase firm transmission service, and the Buyer's transmission is curtailed on the delivery day. As mentioned, the Seller must move to another interface (ADI) at the border or buy generation for delivery to Buyer within the market hub control area. The Seller can require the Buyer to buy non-firm transmission or firm, if available. Each party will be responsible for any additional transmission costs incurred to reschedule to an ADI, since the interruption is due to the loss of firm transmission.<sup>65</sup> If the Seller is unable to reschedule and deliver, then the Seller will owe damages to the Buyer computed under Article Four of the Master Agreement.<sup>66</sup> The same result would occur if: (1) the Seller's generation gets cut (except Seller pays all additional transmission costs); (2) the Seller's firm transmission gets cut (the Seller and the Buyer each pay their own additional transmission costs); and (3) the Seller's non-firm transmission gets cut (the Seller pays *all* additional transmission costs).<sup>67</sup>

In another scenario, the Buyer makes a timely request for firm transmission from the Seller's designated interface, which is accepted by the transmission provider. Instead of purchasing the firm transmission, the Buyer purchases non-firm service, then on delivery day, the Buyer's non-firm service is cut. Since the curtailment was due to the quality of service taken by the Buyer, the Seller's obligation to deliver has been met. The Seller has no obligation to attempt delivery to another interface and the Buyer will owe the Seller damages calculated under Article Four of the Master Agreement.<sup>68</sup> The same result would occur if: (1) the Buyer failed to make a timely request for firm transmission after the Seller's notification of the designated interface; or (2) following Seller's notification of the designated interface, the Buyer makes a timely request for firm transmission service, but fails to notify the Seller within fifteen minutes of receiving the transmission provider's notice of rejection.<sup>69</sup>

In the final example, the Seller has arranged non-firm transmission to the designated interface and the Buyer makes timely arrangements for firm transmission within the market hub control area for ultimate delivery to an outside control area. On the delivery day the downstream control area transmission cuts the Buyer's path, because of the non-firm transmission purchased upstream by the Seller.<sup>70</sup> The Seller's obligation will be met and the Seller will not be obligated to deliver to another interface. The

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64. Elizabeth Sager developed these examples for EEI's workshops on the Master Agreement.

65. See Appendix A, Schedule P "Into" definition section 3A(iv).

66. See Appendix A, Schedule P "Into" definition section 3A(iii).

67. See Appendix A, Schedule P "Into" definition section 3A(iv).

68. See Appendix A, Schedule P "Into" definition section 3C.

69. See Appendix A, Schedule P "Into" definition section 3D.

70. Under NERC Policy 9, a transmission path may be cut based on the "weakest link" in the chain. NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL, OPERATION MANUAL (2000).

scheduled delivery was interrupted as a result of the Buyer's attempted delivery of the product beyond the trading hub. The Buyer will owe the Seller damages calculated under Article Four of the Master Agreement.<sup>71</sup>

*Firm (No Force Majeure).* As the name implies, the Firm (no Force Majeure) product does not excuse performance for Force Majeure events. Use of this product avoids any argument about whether there was a Force Majeure event or not. There is simply no excuse for nonperformance. If there is neither a delivery nor a receipt, cover damages are calculated under the procedures specified in Article Four.

*Transmission Contingencies.* One of the controversies encountered by the working group was concern that some market participants wanted the unavailability and/or interruption of transmission to be an excuse for nonperformance. Some participants noted that in the intra-day market it is impossible to obtain firm transmission, use alternate delivery points without losing firm contract path, or re-supply the market with firm transmission. Another issue was the transmission implications of the North American Electric Reliability Council's (NERC) Operating Rules, especially NERC Policy 3 (Interchange) and NERC Policy 9 (Transmission Loading Relief Procedure).<sup>72</sup> These policies affect the ability to obtain and keep transmission service under the procedures contemplated for the Into and other products. Questions were raised about how long the Buyer needs to arrange for firm transmission service. Indeed, the duration of transmission is always the key to the duration of the product.

To accommodate these concerns, the Master Agreement allows any transaction to be made "Transmission Contingent." Schedule P includes several transmission related events that would excuse performance. Under the definition of Firm Transmission, Contract Path, or Delivery Point, the obligation to deliver or receive will be excused if firm transmission service at or from the delivery point (in the case of "Delivery Point") or along the Buyer's or the Seller's firm contract path (in the case of "Contract Path") is interrupted or curtailed under the terms of the transmission provider's Open Access Tariff. Under the product "Transmission Contingent," performance will be excused if a party's desired transmission is unavailable or interrupted.

#### *D. When the Deal Does Not Go Down – Remedies for Failure to Deliver/Receive*

The Master Agreement provides separate procedures to make a party whole for a counterparty's nonperformance, depending on the nature of

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71. See Appendix A, Schedule P section 4.A.

72. NERC Policy 3 requires certain transaction specific information to be provided to the control area operator on a "tag" before a transaction can be scheduled for reliability purposes. (NORTH AMERICAN ELECTRIC RELIABILITY COUNCIL, OPERATION MANUAL (2000)). Service requests can be rejected if the tag information does not meet the specifications. NERC Policy 9 permits NERC security coordinators to order control area operators to curtail or limit interchange transactions for reliability purposes. *Coalition Against Private Tariffs*, 83 F.E.R.C. ¶ 61,015 (1998).



the breach. Article Four of the Master Agreement provides a clear methodology to calculate cover damages for a counterparty's failure to deliver or receive or schedule a product.<sup>73</sup> As discussed in section E, Article Five furnishes more severe remedies for events of default, customer relationship ending events, which if not cured would warrant liquidation and termination of all trading positions with a counterparty.

The cover damages provisions in Article Four permit the performing party to mitigate its exposure by entering into replacement transactions with third parties.<sup>74</sup> If the Seller fails to schedule or deliver all or part of the product in a transaction, the Buyer acting in a commercially reasonable manner can purchase replacement power at the delivery point and collect from the Seller the positive difference, if any, from subtracting the contract price from the replacement price.<sup>75</sup> The Buyer also can "book-out" its sales obligation to a downstream third party and treat the net positive settlement cost as a replacement price.<sup>76</sup> If the Buyer fails to schedule or receive all or part of the product, the Seller can sell the product in a commercially reasonable manner at the delivery point to a third party and collect from the Buyer the positive difference, if any, from subtracting the contract price from the sales price.<sup>77</sup>

Article Four gives maximum flexibility to measure damages by also allowing the performing party to use the market price at the time and location where the transaction was to occur as "synthetic cover."<sup>78</sup> The market

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73. See Appendix A, Article Four.

74. This procedure is similar to the cover damages provision of the U.C.C. § 2-712. ("Cover;" Buyer's Procurement of Substitute Goods.)

75. See Appendix A, section 4.1. "Replacement Price" is defined in section 1.51, see Appendix A, section 1.51. The Buyer can include the cost of obtaining replacement product plus any additional related transmission charges incurred. Penalties cannot be included.

76. Book-outs are a frequent practice in the energy market when there are daisy chain transactions. A book-out is a series of telephone conversations that occur when, in order to save transmission capacity and for other operational reasons, schedulers agree to financially settle a series of previously-agreed bilateral transactions rather than actually delivering or receiving power. For example, if A is contractually obligated to sell power to B, B is contractually obligated to sell power to C, and C is contractually obligated to sell power to D, the parties might arrange for A to simply deliver power to D and for everyone else to settle their transactions financially. If the chain goes full circle with D contractually obligated to sell power to A, the whole daisy chain might be booked out. Patricia Dondanville & Caroline Goodson, *Memorandum to EEI Drafting Committee*, Feb. 24, 1999. (on file with the Energy Law Journal and the author).

77. See Appendix A, section 4.2. "Sales Price" is defined in Appendix A, section 1.53. The Seller can deduct the cost of selling the product, plus any additional related transmission charges incurred. Penalties cannot be deducted. The Seller may also use a book-out settlement to determine the sales price.

78. Although controversial in the working group, synthetic cover is a common remedy in commercial law. U.C.C. § 2-713. See also David W. Carroll, *A Little Essay in Partial Defense of the Contract-Market Differential as a Remedy for Buyers*, 57 S. CAL. L. REV. 667 (1984) (arguing that the contract-market differential provides an accurate compensatory remedy and the possibility of overcompensation is overstated); Eric S. Schneider, *UCC § 2-713: A Defense of Buyers' Expectancy Damages*, 22 CAL. W. L. REV. 233 (1986) (arguing that expectancy damages include both transaction costs and opportunity costs, which are best represented by contract-market damages measured at the time of performance); Robert E. Scott, *The Case for Market Damages: Revisiting the Lost Profits Puz-*

price would be used to compute either a replacement price or sales price, depending on whether the performing party was the Buyer or the Seller in a transaction. If a party intends to use market prices, they must be prepared to document and justify that the prices were derived in a commercially reasonable manner.<sup>79</sup>

Payment of damages under Article Four is done by default in the normal billing and payment cycle for completed transactions. There is an option to accelerate collection of damages prior to normal billing and payment cycle by requiring payment within five business days of receiving an invoice. This option must be negotiated by the parties in advance and selected on the Cover Sheet. There are two views on using acceleration. Indiscriminate use of this option could have the practical effect of souring the trading relationship with a counterparty, resulting in retaliatory accelerated damage claims. There also is concern about complicating accounting/back office operations and disruption of cash flow expectations. Others perceive acceleration as a credit tool that needs to be taken into consideration. While it may not be useful in the normal course of business, it may be helpful to the extent your counterparty is failing to perform and you feel that they maybe unable to pay the unanticipated liquidated damages under Article Four when the time comes. In addition, if a counterparty's failure to perform continues, a party may be forced to cover on a day to day basis, thereby increasing its exposure or credit risk to that counterparty. The accelerated invoice provision allows a party to "stop the bleeding" early. In this case, acceleration gives a party a chance to receive early payment of those financial amounts that were unanticipated, resulting from an unexpected failure to perform, and if the counterparty cannot pay, an event of default can be called under Article Five (Events of Default; Remedies).

#### *E. Major Meltdowns. Events of Default and Credit Risk Protection*

To protect against the credit risks inherent in today's power markets, the Master Agreement incorporates effective and reciprocal "real time" credit terms.<sup>80</sup> The working group included many forms of credit protec-

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zle, 57 U. CHI. L. REV. 1155 (1990) (arguing that expectancy interest in market contracts should be measured ex ante and not limited ex post to estimated profits from completed performance); David Simon & Gerald A. Novack, *Limiting the Buyer's Market Damages to Lost Profits: A Challenge to the Enforceability of Market Contracts*, 92 HARV. L. REV. 1395 (1979) (arguing that enforcement of market damages as of the time of performance deters breach and ensures specific performance between traders).

79. For example, if a party uses a source like *MEGAWATT DAILY*, it should use an index, not the highest or lowest price. The ISDA Master Plan uses a standardized method to determine market price, whereby a party finds four market makers in the same city, eliminates the high and low price and averages the middle prices. The drafting committee did not use the same particularized detail because electric markets are not commonly liquid. A "commercially reasonable" method for determining market prices is evolving in electricity marketing, so the drafters preferred to have a standard measurement develop over time.

80. The Master Agreement credit protections follow the conventions of the 1992 ISDA Master and 1994 ISDA Credit Annex. For a detailed explanation of the operation of these documents see Mi-

tion to select from in Article Eight (Credit and Collateral Obligations) because of the numerous ways credit is handled by various power-marketing organizations. Once the credit protections are negotiated with a counterparty and set down in an executed Master Agreement Cover Sheet, they will control the credit risk exposure in a day-to-day business relationship. A party can demand adequate assurances of performance in the form of information, collateral, or guarantees based on subjective or objective evaluations of a counterparty's credit risk. In addition, Article Five protects a party's commercial interests when any one of several events of default occur. If not cured within a specified time, these events could seriously compromise a counterparty's ability to meet its financial obligations.

In sum, the credit and default provisions of the Master Agreement are designed to give counterparties the full economic benefit of the transactions they enter into and to apply pressure on counterparties to live up to their obligations.

### 1. Credit Protection Mechanisms

The Master Agreement provides an array of reciprocal credit and collateral requirements for each party (Party A) and counterparty (Party B) to be negotiated and specified on the Cover Sheet.<sup>81</sup> Each party has three options to request and receive information about its counterparty's creditworthiness. By default, the parties can negotiate customized information to request from their counterparty.<sup>82</sup> This option is well suited for closely held entities for which there are not a lot of financial information readily available. The parties also may request each other's annual report and quarterly financial statements.<sup>83</sup> Another option broadens the credit protection to allow the parties to request the same information about other entities such as parental or other guarantors.<sup>84</sup>

The Master Agreement also provides for several options involving the posting of collateral to ensure performance. Under the "Credit Assurances" option, Party A also has the right to demand assurance of future performance from Party B in the form of performance assurance in the event Party A feels insecure about Party B's performance.<sup>85</sup> Performance assurance is defined as collateral in the form of either cash, letter(s) of

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chael A. Goldstein, *Energy Commodity Derivatives*, 1147 P.L.I. CORP 517 (1999) and Barry Taylor-Brill, *Negotiating And Opining on ISDA Masters*, 1147 P.L.I. CORP 79 (1999). See also Nina Hval, *Credit Risk Reduction in the International Over-The-Counter Derivatives Market: Collateralizing the Net Exposure with Support Agreements*, 31 INT'L LAW 801, 806 (1997); Adam R. Waldman, *OTC Derivatives & Systemic Risk: Innovative Finance or the Dance into the Abyss?*, 43 AM. U. L. REV. 1023, 1060 (1994).

81. See Appendix A, section 8.1 for Party A's Credit Protection from Party B and section 8.2 for Party B's Credit Protection from Party A.

82. See Appendix A, sections 8.1(a), 8.2(a), Option C.

83. See Appendix A, sections 8.1(a), 8.2(a), Option A.

84. See Appendix A, sections 8.1(a), 8.2(a), Option B.

85. The following examples illustrate Party A's Credit Protection from its counterparty, Party B. As discussed *supra* note 81, Party B has reciprocal rights against Party A.

credit, or other security acceptable to the requesting party.<sup>86</sup> If Party B fails to respond to a reasonable request for performance assurance within three days, it triggers an event of default under Article Five which could result in early termination of the trading relationship. Under the credit assurances provisions (which are the default provisions if no other option is selected), Party A may request performance assurance based on a very subjective evaluation (even a "sense of insecurity") about Party B's creditworthiness.<sup>87</sup> Party A has the sole right to determine the amount or type of performance assurance in a commercially reasonable manner. In practice, Party A could accept performance assurance by receiving additional information from Party B instead of collateral. Thus, an adequate performance assurance could run the spectrum from squelching a rumor to the posting of significant amounts of collateral, depending on how much Party A needs something objectively identifiable to reinforce its sense of security about Party B.

Using the Master Agreement's default creditworthiness evaluation to obtain some form of "Performance Assurance" based on subjective judgment, however, could become a quagmire for disputes over whether Party A acted reasonably. Thus, the Master Agreement includes optional provisions that provide more of a "bright line" creditworthiness standard. Providing a "Guarantee Amount" agreed to upfront is a relatively straightforward credit protection.<sup>88</sup> Another option lets Party A receive a performance assurance in the event the "mark-to-market" exposure to Party B exceeds a credit limit called the "Collateral Threshold," which is specified on the Cover Sheet.<sup>89</sup> The Cover Sheet states that if there is an existing "Event of Default" with respect to Party B, the collateral threshold is zero. Party A may determine its daily exposure based on a formula specified in Article Eight.<sup>90</sup> First, Party A calculates a "Termination Payment" under the procedure specified in section 5.3 of the Master Agreement as if all outstanding transactions were being liquidated.<sup>91</sup>

Next, the termination payment is added to any "Independent Amount" that was negotiated in advance and included on the Cover

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86. See Appendix A, section 1.45. Section 8.3 gives each party a security interest in any collateral provided as a performance assurance under Article Eight.

87. See Appendix A, sections 8.1(b), 8.2(b). This remedy is based on the common law contract principle of anticipatory repudiation, which has evolved under modern commercial law to the right to demand adequate assurance of future performance embodied in U.C.C. § 2-609. New York law, which governs the Master Agreement, recognizes the right to demand assurance of future performance for good reason even for contracts not governed by the U.C.C. See *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 163 F.3d 153 (N.Y. 1998) and *infra* Part IV.F.4.

88. See Appendix A, sections 8.1(e), 8.2(e).

89. A mark-to-market valuation determines the present value of the expected cash flows from a transaction using current market prices. Mark-to-market valuation of the transactions in a trading desk portfolio (book) is a critical credit risk management tool that should be performed on a daily basis. See also Savage, *supra* note 1, at 16.

90. See Appendix A, sections 8.1(c), 8.2(c).

91. See Appendix A, sections 5.2, 5.3. See also *infra* Part IV.E.2.

Sheet.<sup>92</sup> The independent amount is often used in cases where a party has, or a party expects to have, highly volatile positions with the other party. Since collateral under the Master Agreement is delivered after exposure has exceeded a party's collateral threshold, a party may want to add a "reserve" of additional "phantom exposure" in the agreement to provide some cushion against volatile positions with the other party.

If the termination payment plus the independent amount, if any, exceeds Party B's collateral threshold, then Party A may request as performance assurance the excess amount adjusted upwards to the next "Rounding Amount" less any amounts previously posted as collateral.<sup>93</sup> For example:

Actual Exposure Party A has to Party B	\$5,452,000
Party B's Independent Amount	\$5,000,000
TOTAL EXPOSURE	\$10,452,000
Party B's Collateral Threshold	(\$10,000,000)
Already Posted Performance Assurance	(\$0)
Party B Rounding Amount	(\$100,000)
NEW PERFORMANCE ASSURANCE	\$500,000

Assuming Party B has posted collateral already, it can ask periodically to have Party A recalculate its mark-to-market exposure to determine whether a new performance assurance amount is required. If the Party B's posted performance assurance is in letter of credit form, Party A can be required to recalculate its exposure on a weekly basis and cash collateral can be reevaluated daily. If the recalculated performance assurance level is less than what is currently posted, the excess amount of collateral would be refunded to Party B.

Another objective measurement of creditworthiness allows Party A to get performance assurance for a "Downgrade Event" if a credit rating agency lowers Party B's or some other designated entity's credit rating below a level selected on the Cover Sheet.<sup>94</sup> Party B, an affiliate, or a guarantor can be selected, depending on which entity has a rating Party A wants to rely on. In the event the downgrade event occurs, Party B has to provide performance assurance as reasonably determined by Party A. The downgrade event is a standard tool under many energy company contracts and is universally used in financial markets. If desirable, the downgrade

92. Party A can also structure the Master Agreement to have the independent amount be triggered in the event of a material adverse change, such as a downgrade of Party B's credit rating. In this scenario, the independent amount is zero under normal conditions but becomes a positive number upon the occurrence of some prescribed event.

93. The rounding amount is designed to avoid delivering or returning nuisance amounts of collateral. It is used for rounding a collateral delivery amount to the nearest multiple, \$100,000 for example, to avoid delivering or returning collateral in irregular amounts. It can also be used to increase a collateral delivery amount slightly to make the delivery of collateral occur less often.

94. See Appendix A, sections 8.1(d), 8.2(d) which make paragraph (b) apply exclusively if paragraphs (b), (c), or (d) are not specified on the Cover Sheet.

event could be tied to the amount of performance assurance a party may be required to post by setting the collateral threshold level relative to a party's credit ratings. Randy S. Baker, Director, Credit Risk for Duke Energy Corporation, suggests the following collateral threshold based on a party's credit rating:<sup>95</sup>

<i>Credit Rating (S&amp;P / Moody's)</i>	<i>Collateral Threshold</i>
AAA / Aaa	\$30,000,000
AA- to AA+ / Aa3 to Aa1	\$30,000,000
A- to A+ / A3 to A1	\$20,000,000
BBB to BBB+ / Baa2 to Baa1	\$10,000,000
BBB- / Baa3	\$ 5,000,000
BB+ / Ba1 or below	\$0

Ultimately, the choice of any of the Article Eight credit protections depends on whether the parties want to apply subjective or objective creditworthiness criteria. It is more appropriate to use a very objective standard for a rated entity. A subjective standard may be preferable when dealing with a closely held entity that does not disseminate much information available about its finances. The selection of credit arrangements involves a balance between each party having a continual responsibility to respond to their counterparty's requests for security against having the ability to react in a timely fashion when that counterparty has run into a problem.

## 2. Events of Default and Remedies

Article Five of the Master Agreement clearly identifies several objective events of default that compromise a party's ability to honor its obligations under the contract, including: (1) non-payment; (2) false representation; (3) failure to perform a material covenant or obligation; (4) bankruptcy; (5) failure to perform Article Eight creditworthiness and collateral requirements; (6) an entity's failure to assume all obligations after a merger or asset transfer; (7) cross default on an existing indebtedness; and (8) defaults by a guarantor.<sup>96</sup> Fundamental to the structure of the Master Agreement is a specific exclusion for non-delivery or non-receipt of product from the "events of default," as long as a party makes timely cover payments under Article Four.<sup>97</sup>

Thus, the events of default are a "wake up call" that a counterparty is in trouble and Article Five provides a roadmap for the action to be taken next. Once an event of default has occurred and is continuing, the non-

95. Presented at the EEI-NEM workshop: *Power Transactions: Using the EEI-NEM Master Contract from Deal to Payment*, New York (Apr. 25, 2000) (on file with the Energy Law Journal and the author).

96. See Appendix A, section 5.1.

97. See Appendix A, section 5.1(c).

defaulting party essentially has three options that it can exercise either simultaneously or individually, depending on the severity of the problem and whether the event is likely to continue.<sup>98</sup> The non-defaulting party can withhold payment of any amounts due to the defaulting party, suspend performance during the time that an event of default has occurred and is continuing, or declare an early termination. Unless the non-defaulting party declares an "Early Termination Date" to "pull the plug" and liquidate all mutual transactions, the performance suspension period can only last up to ten business days.<sup>99</sup>

Should the non-defaulting party decide to wind down its existing transactions, it must declare an early termination date. This is the date on which *all* transactions will be liquidated and terminated by calculating settlement amounts and a termination payment.<sup>100</sup> A party must select an early termination date from the date it gives notice to a counterparty up to twenty days later. There is one exception to all transactions being terminated on the stated termination date. Specifically, the exception is used if for some reason it is commercially impractical to terminate on that date or there is a regulatory reason, such as the required notice period to terminate a transaction under the FERC regulations.<sup>101</sup> In that event, a party can put those off until it is possible or lawful to terminate the transactions.

The settlement amount in essence "accelerates" damages for the entire remaining term of each transaction.<sup>102</sup> To determine the settlement amount, the non-defaulting party calculates for each terminated transaction: (a) its economic gains on a net present value basis (resulting from the termination of those transactions that are "out-of-the-money" to the non-defaulting party); (b) deducts the net present value of its economic losses (resulting from the termination of those transactions that are "in-the-money" to the non-defaulting party); and (c) adds in its costs. The settlement amounts for every transaction are then aggregated into a termination payment by netting out the settlement amounts due the defaulting party against the settlement amounts due the non-defaulting party, along with other amounts that may be due from one party to another under the agreement. The non-defaulting party has the option of netting out any collateral it holds as performance assurance from the settlement amounts to

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98. Some occurrences in section 5.1 provide for a three-day cure period before an event of default may be called.

99. See Appendix A, section 5.7. This condition provides some fairness for both parties. It gives the non-defaulting party ten business days to decide whether or not to proceed with a full-fledged default and wind up every transaction and it gives the defaulting party some early certainty as to what happens next. A party can also suspend performance for potential events of default, which are events that are likely to become full-fledged defaults.

100. See Appendix A, section 5.2. The working group chose to have all transactions terminated to ensure that the party that is throwing the other party into default does not "cherry pick" transactions by using an event of default to take gains and shed losses. This condition is modeled after the ISDA Master Agreement.

101. 18 C.F.R. § 35.16 (1996). As discussed *infra* Part V., this notice requirement only applies to contracts that must be on file at the FERC.

102. See Appendix A, section 5.3.

avoid having those assets caught up in a bankruptcy proceeding.

Once the termination payment is calculated, the non-defaulting party has to give notice along with some reasonable detail about how it was calculated "as soon as practicable" after the liquidation occurs. It may take some time to provide this information; therefore, no set time was established. Once notice is sent to the other party, the amount that is payable is due within two days. The termination payment made on the early termination date could go to either the non-defaulting party or the defaulting party based on the results of calculating and aggregating the "Settlement Amounts."

The parties can agree to optional "Closeout Setoffs" in the event the defaulting party would be owed the termination payment.<sup>103</sup> Closeout setoffs are a remedy that allows the non-defaulting party to reduce (setoff) the amounts owed to the defaulting party in the termination payment by amounts the defaulting party owes to the non-defaulting party under other contracts.<sup>104</sup> One option, Option A, allows setoff for amounts owed under other agreements between the parties to the Master Agreement, such as swaps under another master agreement. Another option, Option B, allows for setoff agreements between affiliates of the defaulting party and the non-defaulting party or cross-affiliate agreements.<sup>105</sup> The default option, Option C, does not permit setoff.

#### F. *Other Provisions of Legal Importance*

##### 1. Show Me the Money—Payment and Netting

Article Six (Payment and Netting) in the Master Agreement specifies detailed procedures for settling payments owed for transactions in the ordinary course of business.<sup>106</sup> These standardized payment procedures, including a payment netting provision, are effective risk management tools. Payment netting allows parties to significantly reduce their exposure to a counterparty for transaction payments.<sup>107</sup> There is an optional transaction

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103. See Appendix A, section 5.6.

104. Set-off is a common law remedy "grounded on the absurdity of making A pay B when B owes A." *Studley v. Boylston Nat'l Bank*, 229 U.S. 523, 528 (1913). The 1994 ISDA Credit Annex incorporates a setoff remedy. Many energy marketer credit departments are using the setoff remedy as a way to reduce overall credit exposure to a counterparty. Reducing credit exposure allows an increase in trading limits, which is supported by the traders.

105. The Cover Sheet allows one to specify if all affiliates or certain affiliates are excluded from setoff. Affiliate setoff is particularly sensitive for utility companies or affiliates of utility companies who are concerned about cross subsidization requirements. Some working group members have raised questions about the enforceability of affiliate setoff. But others maintain it is "better to sit on the money and let them pry it out of your hand."

106. Article Six does not address these extraordinary payments: (1) optional accelerated damages under Article Four and (2) termination payment's owed under Article Five.

107. See Appendix A, section 6.4. Payment netting involves discharging the offsetting payment obligations or credits due each party on the same date for transactions executed or cover damages computed during a calendar month. One party will pay only the net "set off" amount due the other party.



netting procedure allowing the parties, by supplemental agreement, to net offsetting transaction quantities.<sup>108</sup> A standardized billing and payment procedure helps implement payment netting and allows withholding of disputed amounts.<sup>109</sup>

## 2. Governmental Charges

Section 9.1 imposes a duty on each party to administer the Master Agreement so as to minimize all taxes. In addition, section 9.2 assigns the Seller responsibility for payment of all applicable governmental charges (i.e., taxes, with respect to getting product to the delivery point specified in a transaction). The Buyer is responsible for paying similar charges with respect to taking product at and from the delivery point.

## 3. Bankruptcy Code and Commodities Exchange Act Implications

The Master Agreement includes numerous representations and warranties in section 10.2. Of particular interest are representations that each party is acting on its own account and is capable of assessing the merits and risks of entering into transactions under the Master Agreement.<sup>110</sup> Another representation warrants that each party is a "forward contract merchant" under the United States Bankruptcy Code (Code).<sup>111</sup> Additionally, in section 10.10 the parties stipulate that all transactions executed under the Master Agreement are "forward contracts" under the Code.

The Code has special provisions that apply to commodity forward contracts and commodity swaps. These provisions allow a party to exercise its liquidation and setoff rights under a contract meeting the Code's definitions of forward contract and swap agreement in the event of the insolvency or bankruptcy of a counterparty. These are important statutory exceptions to the restrictions that the Code generally imposes on actions taken against a debtor and its property.<sup>112</sup>

The Master Agreement's "forward merchant" recitals also serve to avoid the legal risk of having transactions under the Master Agreement be-

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108. The party obligated to deliver the greater amount of energy only delivers the difference between its total obligation and the amount of offsetting quantities owed by its counterparty. The party owing the greater aggregate payment will pay the net difference owed between the parties. See Appendix A, section 6.7. Transaction netting is not the same as a book-out because only bilateral transactions occurring at the same time and delivery point may be netted. *See infra* note 77.

109. Appendix A, section 6.1 makes the calendar month the billing period with bills rendered as soon as practicable after the end of the month, unless otherwise agreed. Appendix A, section 6.2 requires invoice payment by the later of the 20th day of the month or ten days after receiving an invoice. Appendix A, section 6.3 establishes procedures for disputes and adjustments of invoices. A party may dispute the accuracy of or make an adjustment for computational errors in an invoice, in good faith, within 12 months of its receipt.

110. See Appendix A, section 10.2(viii).

111. See Appendix A, section 10.2(ix).

112. Marvin J. Goldstein, *Commodity & Derivative Trading and the Bankruptcy Code*, originally presented at *Power Marketing: A Blueprint for Managing Risks in the Restructured Electric Industry*, (Baltimore, MD, May 3-4, 1999) (sponsored by Public Utilities Reports, on file with the Energy Law Journal and the author).

ing subject to the Commodities Futures Trade Commission (CFTC) under the Commodities Exchange Act (CEA).<sup>113</sup> The CEA requires futures contracts, which can be financially settled without taking physical delivery, to be traded on a recognized exchange regulated by the CFTC. Forward contracts, which require physical delivery, are exempt from CFTC regulation.<sup>114</sup>

#### 4. Governing Law

The law of the State of New York was selected as the governing law for the Master Agreement.<sup>115</sup> The working group selected New York for a variety of reasons, but generally because it is a very pro-commercial transactions state. As previously discussed, New York has a Statute of Frauds provision that permits binding oral commercial transactions.<sup>116</sup> Further, New York has a choice of law provision that allows parties with no nexus to the state to select New York law for commercial transactions in excess of a *de minimis* amount.

Utility members of the working group supported New York because of favorable rulings on the status of electricity regarding strict products tort liability and implied warranties under the UCC. New York does not recognize electricity as a dangerous "product" that would support a cause of action for strict products liability related to accidents involving utility electric distribution and transmission lines.<sup>117</sup> Moreover, New York law does not consider electricity a "good" for purposes of the sale of goods provisions in Article 2 of the UCC.<sup>118</sup>

### V. FERC TARIFF AND FILING REQUIREMENTS

The working group also addressed how to use the Master Agreement under the FERC's tariff and filing requirements for market-based Sellers. With guidance from the FERC Staff, the drafting committee developed a tariff and service agreement structure that allows the maximum flexibility to use the Master Agreement under the restrictions imposed by the current law for market-based transactions. Today, competitive bulk power transactions are "quasi-regulated" by the FERC, because the 1935 Federal Power Act (FPA) still requires it to protect captive customers from undue discrimination and abuse of market power. The FERC's acceptance of minimal market-based tariffs and quarterly short-term transaction report-

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113. 7 U.S.C. § 1 (2000).

114. See Paul J. Pantano, Jr., *Electric Power: Managing Legal Risk in a New Commodity Market*, FUTURES & DERIVATIVES L. REP. (Apr. 1999).

115. See Appendix A, section 10.6.

116. *Supra* note 35.

117. *Farina v. Niagara Mohawk Power Corp.*, 438 N.Y.S.2d 645 (N.Y. App. Div. 1981). In this case, the court held: "there is the implicit suggestion that electricity, '[A] subtle agency that pervades all space and evades successful definition' (Ballantine's Law Dictionary), is not a product within the contemplation of the doctrine's authors. Additionally, we note the inapplicability of the strict liability doctrine."

118. *Id.*

ing reflects a compromise with the practical realities of doing business in the competitive wholesale electricity market that emerged after the Energy Policy Act of 1992. Under traditional regulation, the filed rate doctrine as embodied in FPA section 205 and mirrored in Part 35 of the FERC's regulations, requires cost-based jurisdictional Sellers to file in advance all documentation related to transactions under the Master Agreement, as well as, all subsequent changes to the documentation.<sup>119</sup>

The FERC's market-based tariff and filing requirements, however, are not embodied in generic regulations. Instead, they exist in a continuously evolving series of case specific decisions with differing results depending on a Seller's perceived level of market power.<sup>120</sup> Nevertheless, these decisions have followed a somewhat discernable set of policies in matching traditional utility regulation with today's competitive commercial transactions based on whether the Sellers own generation or have captive customers.<sup>121</sup>

To make sales at market-based rates, an asset-based utility that owns generating assets must file a market-based tariff in advance. Furthermore, all contracts for a term that is longer than a year must be filed thirty days after service begins. For shorter-term sales, the asset-based utility must file an "umbrella" (general) service agreement identifying the customer within thirty days after service begins, but specific transactions and rates need not be filed at that time. Instead, the asset-based utility must file quarterly reports summarizing the previous quarter's transactions to satisfy the filed rate doctrine.<sup>122</sup>

Although the asset-based Sellers' responses to these requirements vary, many vertically integrated investor owned utilities have filed "fat" market-based tariffs with the detailed terms and conditions they wish to apply to all transactions, because of their long history of filing extensive

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119. 16 U.S.C. § 824(c) (1994), requires all jurisdictional utilities to file, and keep open for public inspection, schedules showing "all rates and charges . . . and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect" rates for wholesale sales or transmission. See also *Arkansas La. Gas Co. v. Hall*, 453 U.S. 571, 577-578 (1981), where the court explained that the filed rate doctrine makes it unlawful to charge a rate other than the one on file with the Commission; and Filing of Rate Schedules, 18 C.F.R. § 35 (2000).

120. See also Sam Behrends, *EEL's Master Contract: OK by FERC?*, PUB. UTILS. FORT., Jan. 1, 2000, at 41. "With consistency being the hobgoblin of small minds, the FERC has recognized that the old statute ought to be applied differently to Sellers with different levels of market power, leading to a mish-mash of confusing rules and policy for various types of transactions." Indeed, the most comprehensive guidance the FERC provides is through its website wherein potential applicants are advised to review recent applications and decisions before preparing their own requests for market-based rate authority. See also FERC, *How to Get Market-Based Rate Approval*, (visited Oct. 1, 2000) <<http://www.ferc.fed.us/electric/PwrMkt/Pmhow.htm>>.

121. *Consolidated Edison Energy, Inc.*, 83 F.E.R.C. ¶ 61,236, 62,033 (1998). In this case, the Commission stated: "The Commission allows power sales at market-based rates if the Seller and its affiliates do not have, or have adequately mitigated, market power in generation and transmission and cannot erect other barriers to entry."

122. *Kincaid Generation, L.L.C.*, 78 F.E.R.C. ¶ 61,082, 61,300-01 (1997). Transactions between an asset-based utility and its unregulated affiliate are subject to a code of conduct that must be filed in advance along with the tariff.

documentation under cost-based regulation. Another reason utilities file "fat" tariffs is that they believe they will have the legal certainty that important terms will be enforceable in individual transactions. However, the "fat" tariff severely limits counterparty flexibility to vary specific transaction terms, because filed tariff terms will trump both filed and unfiled inconsistent contract terms.<sup>123</sup> Also, tariffs are seldom read in the commercial setting of competitive electricity marketing.

Pure marketers, those without generating assets, have more lenient filing requirements under the FERC's policies. They must file a market-based tariff in advance, but specific sales contracts or service agreements need not be filed, regardless of their duration. Instead, pure marketers are required to file only quarterly transaction reports. They file "thin" streamlined tariffs which permit maximum flexibility to craft individual competitive transactions.

Today's law may change due to a May 27, 1999 decision in *Southern Company Services, Inc. (Southern)*.<sup>124</sup> In *Southern*, the FERC required all power marketers to file long-term contracts, whether they owned generation or not, based on its perception of the differences between short-term and long-term transactions. The Commission stayed the effectiveness of *Southern*, made all affected power marketers part of the proceeding, and invited comments on a second rehearing. Many parties, including members of the working group, commented because the decision focused attention on the information that should be disclosed publicly by the participants in competitive electricity markets.<sup>125</sup> For instance, the potential for public disclosure of sensitive credit information from the Cover Sheet of the Master Agreement is viewed by many working group members as a significant impediment to its widespread use. In today's competitive commercial setting, market participants are very concerned with publicly disclosing the information that would give their competitors an advantage.<sup>126</sup> The FERC currently almost always denies requests for confidential treatment of the information that is required to be on file.<sup>127</sup>

Another potential change in the law might come from an appeal to the United States Circuit Court of Appeals for the District of Columbia

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123. One solution is to ensure that upstream Sellers use a generic enabling clause in the tariff.

124. *Southern Company Services, Inc.*, 87 F.E.R.C. ¶ 61,214 (1999).

125. See also Donald F. Santa, Jr., *Who Needs What, and Why? Reporting and Disclosure Obligations in Emerging Competitive Electricity Markets*, 21 ENERGY L.J. 1 (2000), which discusses the need for regulators to reassess the information and reporting requirements imposed on the electric power industry.

126. The courts or alternative dispute resolution are effective ways to resolve contract disputes. Under the *Arkansas Louisiana*, 453 U.S. 571, abstention doctrine, a court has the perfect right to review a document related to the FERC's jurisdictional transactions, unless there are issues of national importance or issues within the FERC's special area of expertise. A party in court litigation faces a more serious risk that an unfiled document is unenforceable because it conflicts with another document that is on file, than if the court were to declare that the document is unenforceable simply because it is not on file. The Master Agreement contains a covenant that parties will not raise as a defense to a contract action any inconsistency with tariff terms on file. See also Appendix A, Article 10.8.

127. *Enron Power Marketing, Inc.*, 65 F.E.R.C. ¶ 61,305 (1993).

from a series of cases involving the FERC's authority under the FPA to allow parties to *not* file certain market-based transaction documents. In *Southern Company Energy Marketing, L.P.*, (a.k.a. the PCA case), the FERC ruled that the sixty day advance notice required by FPA section 205 and section 35.15 of its regulations is not needed to terminate market-based sales enabled by an umbrella sales agreement when the specific transaction terms are not required to be on file.<sup>128</sup> Thus, not having to file specific contract terms with the FERC allows parties to respond quickly to counterparty defaults through exercising the liquidation and termination provisions of the Master Agreement. Some FERC counsel are concerned that the appeal has gone beyond the narrow issue of the case to the broader issue of whether the FERC has authority to allow companies subject to its jurisdiction to not file contracts and to raise the FPA as fundamental law that cannot be waived. Such a result would be a major setback to emerging competitive electricity markets.

Thus, the drafting committee faced uncertainty in the law, asymmetric filing requirements, and diverse industry compliance practices when it began to develop a FERC compliance strategy for using the Master Agreement. Many utilities were particularly concerned that the detailed terms in their market-based tariffs would conflict with the terms of the Master Agreement. To sort out these issues, members of the drafting committee and public power representatives met with the Commission Staff on February 1, 2000 to explain the Master Agreement. The Commission Staff reacted favorably to the master contract and offered helpful suggestions for its implementation under their policies and regulations.

These are the key points raised in the meeting. Consistent with the FERC's *Toledo Edison* decision,<sup>129</sup> the Commission Staff's expectation and preference is to avoid the repetitive filing of lengthy terms and conditions for market-based transactions. The Commission Staff is comfortable if traditional (generation owning) utilities with market-based authority filed a "thin" streamlined market-based tariff to implement the Master Agreement. The streamlined tariff could coexist with more detailed tariffs already on file. The detailed tariffs could later be withdrawn if the transactions under them expire or are transferred by agreement of the parties to the governing terms of a streamlined tariff and Master Agreement.

In addition to the streamlined tariff, traditional utilities entering into short term transactions of one year or less can submit a streamlined service agreement that designates a counterparty with whom they conduct transactions under the master contract within thirty days of commencement of

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128. *Southern Co. Energy Mktg., L.P.*, 84 F.E.R.C. ¶ 61,199 (1998), *reh'g denied*, 86 F.E.R.C. ¶ 61,131 (1999), *appeal sub nom.*, *Power Co. of America v. FERC*, Nos. 99-1263, 99-1333 (1999). The transactions at issue in this proceeding involved the Power Company of America which had declared bankruptcy and defaulted on its obligations to several parties. *See also supra* notes 7 and 102. The FERC specifically overturned its policy that prior notice was required to terminate contracts that were not on file. *See also Portland Gen. Elec. Co.*, 75 F.E.R.C. ¶ 61,310 (1996), *reh'g denied*, 77 F.E.R.C. ¶ 61,171 (1996).

129. *Toledo Edison Co.*, 79 F.E.R.C. ¶ 61,088, 61,420 (1997).

service. The service agreement can be in the form of a short document that identifies the counterparties, and that can be executed and filed with the Commission. Particular short-term transactions must be included in the quarterly transaction reports submitted to the FERC.

For long term transactions of over one year, the Commission will continue to require traditional utilities to file the entire master contract, including: the executed Cover Sheet, the General Terms and Conditions, and the Confirmation Letter related to the transaction. At least for now, non-asset-based marketers only need to report their long and short-term transactions under the Master Agreement in the quarterly report. There is interest among the drafting committee to have follow up discussions with the staff regarding how the filing of long term transactions could still permit a single timely liquidation and termination under the procedures specified in the Master Agreement upon an event of default.

The FERC compliance effort culminated in the creation of a model short-form utility market-based tariff and umbrella service agreement.<sup>130</sup> These documents are intended for use by traditional (generation owning) utilities in conjunction with the master contract to comply with the FERC's market-based tariff filing requirements. The short-form tariff also can be adapted for use by other competitive wholesale market participants.<sup>131</sup>

#### VI. CURRENT STATUS AND FUTURE OF THE EEI-NEM MASTER AGREEMENT

Since its rollout, some of the key players in the wholesale power market are using the Master Agreement, including: Constellation Power Source, Duke Energy Trading, Enron Power Marketing, Incorporated, Entergy Marketing, Reliant Energy, and Southern Energy, Incorporated. In general, power marketers are adopting the Master Agreement faster than traditional utilities, because of their relative comfort level with how the document's terms address performance and financial risks. Another factor is the willingness or need to change trading floor operations, and mid and back office operations to accommodate the use of the Master Agreement. As mentioned, however, three utilities have made tariff filings at the FERC specifically to use the Master Agreement. Many market participants are undertaking internal reviews to determine whether to use the document. In addition, the Mid-Continent Area Power Pool is preparing

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130. These documents were prepared by Antonia Frost and Thomas Blackburn of the law firm of Bruder, Gentile & Marcoux, L.L.P., who worked with a coalition of utilities involved with the master contract working group. The Model Tariff and Service Agreement may be obtained at EEI's website. See also *supra* note 24.

131. Many utilities have begun using the Master Agreement under their existing market-based tariff structures. In addition, "[t]he following EEI-member utilities have received FERC approval to implement the Master [Agreement] . . . using the [new] document structure described above; *Northern Illinois Public Service Company*, Docket No. ER00-2173-000; *Consumers Energy Company*, Docket No. ER00-2299-000; and *Virginia Electric and Power Company*, Docket No. ER00-2839-000." *Market-Based Tariff and Umbrella Service Agreement* (visited Oct. 1, 2000) <<http://www.eei.org/issues/contract/tariff/index.htm>>.

to adopt the Master Agreement as the standard agreement for its members' market-based transactions. Ultimately, the developers feel that the Master Agreement's superiority to other master agreements to mitigate business and legal risks will increase its use.

The working group intends to meet periodically to keep the Master Agreement current. This fall, it will assess the market's experience with the Master Agreement after the summer of 2000 peak demand period. One area of particular interest is the types of customized amendments that the parties have attached to the Master Agreement. The working group plans to review parties' Cover Sheets to consider what standard language for frequently used customized provisions might be developed in the future. To date, the working group has identified the following areas that are frequently customized in parties' cover sheets: (1) the incorporation of prior transactions as being governed by the Master Agreement; (2) the use of the Master Agreement for electronic trading; (3) alternative dispute resolution mechanisms; (4) treatment of new taxes or changes in regulatory policy; (5) additional products (e.g., Western firm or CAISO energy). These provisions will be addressed in future efforts by the working group.

Notwithstanding some unresolved issues, the drafting committee does not want to make significant revisions to the General Terms and Conditions of the Master Agreement until it has been in use longer. Undoubtedly, disputes over contract interpretation will arise, necessitating ironing out ambiguities. Nevertheless, the current version of the Master Agreement represents a significant step forward in power trading documentation.





## APPENDIX A

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# Master Power Purchase & Sale Agreement

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Version 2.1 (modified 4/25/00)

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## MASTER POWER PURCHASE AND SALES AGREEMENT

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**MASTER POWER PURCHASE AND SALE AGREEMENT**

**COVER SHEET**

This *Master Power Purchase and Sale Agreement* (“*Master Agreement*” ) is made as of the following date: \_\_\_\_\_ (“Effective Date”). The *Master Agreement*, together with the exhibits, schedules and any written supplements hereto, the Party A Tariff, if any, the Party B Tariff, if any, any designated collateral, credit support or margin agreement or similar arrangement between the Parties and all Transactions (including any confirmations accepted in accordance with Section 2.3 hereto) shall be referred to as the “Agreement.” The Parties to this *Master Agreement* are the following:

Name (“\_\_\_\_\_” or “Party A”)      Name (“Counterparty” or “Party B”)

All Notices: \_\_\_\_\_      All Notices: \_\_\_\_\_

Street: \_\_\_\_\_      Street: \_\_\_\_\_

City: \_\_\_\_\_ Zip: \_\_\_\_\_      City: \_\_\_\_\_ Zip: \_\_\_\_\_

Attn: Contract Administration      Attn: Contract Administration

Phone: \_\_\_\_\_      Phone: \_\_\_\_\_

Facsimile: \_\_\_\_\_      Facsimile: \_\_\_\_\_

Duns: \_\_\_\_\_      Duns: \_\_\_\_\_

Federal Tax ID Number: \_\_\_\_\_      Federal Tax ID Number: \_\_\_\_\_

**Invoices:**  
Attn: \_\_\_\_\_  
Phone: \_\_\_\_\_  
Facsimile: \_\_\_\_\_

**Invoices:**  
Attn: \_\_\_\_\_  
Phone: \_\_\_\_\_  
Facsimile: \_\_\_\_\_

**Scheduling:**  
Attn: \_\_\_\_\_  
Phone: \_\_\_\_\_  
Facsimile: \_\_\_\_\_

**Scheduling:**  
Attn: \_\_\_\_\_  
Phone: \_\_\_\_\_  
Facsimile: \_\_\_\_\_

**Payments:**  
Attn: \_\_\_\_\_  
Phone: \_\_\_\_\_  
Facsimile: \_\_\_\_\_

**Payments:**  
Attn: \_\_\_\_\_  
Phone: \_\_\_\_\_  
Facsimile: \_\_\_\_\_

**Wire Transfer:**  
BNK: \_\_\_\_\_  
ABA: \_\_\_\_\_  
ACCT: \_\_\_\_\_

**Wire Transfer:**  
BNK: \_\_\_\_\_  
ABA: \_\_\_\_\_  
ACCT: \_\_\_\_\_

**Credit and Collections:**  
Attn: \_\_\_\_\_  
Phone: \_\_\_\_\_  
Facsimile: \_\_\_\_\_

**Credit and Collections:**  
Attn: \_\_\_\_\_  
Phone: \_\_\_\_\_  
Facsimile: \_\_\_\_\_

With additional Notices of an Event of Default or Potential Event of Default to:

Attn: \_\_\_\_\_  
Phone: \_\_\_\_\_  
Facsimile: \_\_\_\_\_

With additional Notices of an Event of Default or Potential Event of Default to:

Attn: \_\_\_\_\_  
Phone: \_\_\_\_\_  
Facsimile: \_\_\_\_\_

The Parties hereby agree that the General Terms and Conditions are incorporated herein, and to the following provisions as provided for in the General Terms and Conditions:

Party A Tariff Tariff \_\_\_\_\_ Dated \_\_\_\_\_  
Docket Number \_\_\_\_\_

Party B Tariff Tariff \_\_\_\_\_ Dated \_\_\_\_\_  
Docket Number \_\_\_\_\_

**Article Two**

Transaction Terms and Conditions  Optional provision in Section 2.4. If not checked, inapplicable.

**Article Four**

Remedies for Failure to Deliver or Receive  Accelerated Payment of Damages. If not checked, inapplicable.

**Article Five**

Events of Default; Remedies  Cross Default for Party A:  
 Party A: \_\_\_\_\_ Cross Default Amount \$ \_\_\_\_\_  
 Other Entity: \_\_\_\_\_ Cross Default Amount \$ \_\_\_\_\_  
 Cross Default for Party B:  
 Party B: \_\_\_\_\_ Cross Default Amount \$ \_\_\_\_\_  
 Other Entity: \_\_\_\_\_ Cross Default Amount \$ \_\_\_\_\_

5.6 Closeout Setoff

Option A (Applicable if no other selection is made.)

Option B - Affiliates shall have the meaning set forth in the Agreement unless otherwise specified as follows: \_\_\_\_\_

Option C (No Setoff)

**Article 8**

Credit and Collateral Requirements

8.1 Party A Credit Protection:

(a) Financial Information:

Option A  
 Option B Specify: \_\_\_\_\_  
 Option C Specify: \_\_\_\_\_

(b) Credit Assurances:

Not Applicable  
 Applicable

(c) Collateral Threshold:

Not Applicable  
 Applicable

If applicable, complete the following:

Party B Collateral Threshold: \$ \_\_\_\_\_; provided, however, that Party B's Collateral Threshold shall be zero if an Event of Default or Potential Event of Default with respect to Party B has occurred and is continuing.

Party B Independent Amount: \$ \_\_\_\_\_

Party B Rounding Amount: \$ \_\_\_\_\_

(d) Downgrade Event:

Not Applicable  
 Applicable

If applicable, complete the following:

It shall be a Downgrade Event for Party B if Party B's Credit Rating falls below \_\_\_\_\_ from S&P or \_\_\_\_\_ from Moody's or if Party B is not rated by either S&P or Moody's

Other:  
Specify: \_\_\_\_\_

(e) Guarantor for Party B: \_\_\_\_\_

Guarantee Amount: \_\_\_\_\_

8.2 Party B Credit Protection:

(a) Financial Information:

- Option A
- Option B Specify: \_\_\_\_\_
- Option C Specify: \_\_\_\_\_

(b) Credit Assurances:

- Not Applicable
- Applicable

(c) Collateral Threshold:

- Not Applicable
- Applicable

If applicable, complete the following:

Party A Collateral Threshold: \$ \_\_\_\_\_;  
provided, however, that Party A's Collateral  
Threshold shall be zero if an Event of Default  
or Potential Event of Default with respect to  
Party A has occurred and is continuing.

Party A Independent Amount: \$ \_\_\_\_\_

Party A Rounding Amount: \$ \_\_\_\_\_

(d) Downgrade Event:

- Not Applicable
- Applicable

If applicable, complete the following:

- It shall be a Downgrade Event for Party  
A if Party A's Credit Rating falls below  
\_\_\_\_\_ from S&P or \_\_\_\_\_  
from Moody's or if Party A is not rated  
by either S&P or Moody's

Other:  
Specify: \_\_\_\_\_

(e) Guarantor for Party A: \_\_\_\_\_

Guarantee Amount: \_\_\_\_\_

**Article 10**

Confidentiality  Confidentiality Applicable If not checked, in-applicable.

**Schedule M**

- Party A is a Governmental Entity or Public Power System
- Party B is a Governmental Entity or Public Power System
- Add Section 3.6. If not checked, inapplicable
- Add Section 8.6. If not checked, inapplicable

**Other Changes** Specify, if any: \_\_\_\_\_

IN WITNESS WHEREOF, the Parties have caused this Master Agreement to be duly executed as of the date first above written.

Party A Name

Party B Name

By: \_\_\_\_\_

By: \_\_\_\_\_

Name: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Title: \_\_\_\_\_

**DISCLAIMER: This Master Power Purchase and Sale Agreement was prepared by a committee of representatives of Edison Electric Institute (“EEI”) and National Energy Marketers Association (“NEM”) member companies to facilitate orderly trading in and development of wholesale power markets. Neither EEI nor NEM nor any member company nor any of their agents, representatives or attorneys shall be responsible for its use, or any damages resulting therefrom. By providing this Agreement EEI and NEM do not offer legal advice and all users are urged to consult their own legal counsel to ensure that their commercial objectives will be achieved and their legal interests are adequately protected.**



## **GENERAL TERMS AND CONDITIONS**

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### **ARTICLE ONE: GENERAL DEFINITIONS**

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1.1 "Affiliate" means, with respect to any person, any other person (other than an individual) that, directly or indirectly, through one or more intermediaries, controls, or is controlled by, or is under common control with, such person. For this purpose, "control" means the direct or indirect ownership of fifty percent (50%) or more of the outstanding capital stock or other equity interests having ordinary voting power.

1.2 "Agreement" has the meaning set forth in the Cover Sheet.

1.3 "Bankrupt" means with respect to any entity, such entity (i) files a petition or otherwise commences, authorizes or acquiesces in the commencement of a proceeding or cause of action under any bankruptcy, insolvency, reorganization or similar law, or has any such petition filed or commenced against it, (ii) makes an assignment or any general arrangement for the benefit of creditors, (iii) otherwise becomes bankrupt or insolvent (however evidenced), (iv) has a liquidator, administrator, receiver, trustee, conservator or similar official appointed with respect to it or any substantial portion of its property or assets, or (v) is generally unable to pay its debts as they fall due.

1.4 "Business Day" means any day except a Saturday, Sunday, or a Federal Reserve Bank holiday. A Business Day shall open at 8:00 a.m. and close at 5:00 p.m. local time for the relevant Party's principal place of business. The relevant Party, in each instance unless otherwise specified, shall be the Party from whom the notice, payment or delivery is being sent and by whom the notice or payment or delivery is to be received.

1.5 "Buyer" means the Party to a Transaction that is obligated to purchase and receive, or cause to be received, the Product, as specified in the Transaction.

1.6 "Call Option" means an Option entitling, but not obligating, the Option Buyer to purchase and receive the Product from the Option Seller at a price equal to the Strike Price for the Delivery Period for which the Option may be exercised, all as specified in the Transaction. Upon proper exercise of the Option by the Option Buyer, the Option Seller will be obligated to sell and deliver the Product for the Delivery Period for which the Option has been exercised.

1.7 “Claiming Party” has the meaning set forth in Section 3.3.

1.8 “Claims” means all third party claims or actions, threatened or filed and, whether groundless, false, fraudulent or otherwise, that directly or indirectly relate to the subject matter of an indemnity, and the resulting losses, damages, expenses, attorneys’ fees and court costs, whether incurred by settlement or otherwise, and whether such claims or actions are threatened or filed prior to or after the termination of this Agreement.

1.9 “Confirmation” has the meaning set forth in Section 2.3.

1.10 “Contract Price” means the price in \$U.S. (unless otherwise provided for) to be paid by Buyer to Seller for the purchase of the Product, as specified in the Transaction.

1.11 “Costs” means, with respect to the Non-Defaulting Party, brokerage fees, commissions and other similar third party transaction costs and expenses reasonably incurred by such Party either in terminating any arrangement pursuant to which it has hedged its obligations or entering into new arrangements which replace a Terminated Transaction; and all reasonable attorneys’ fees and expenses incurred by the Non-Defaulting Party in connection with the termination of a Transaction.

1.12 “Credit Rating” means, with respect to any entity, the rating then assigned to such entity’s unsecured, senior long-term debt obligations (not supported by third party credit enhancements) or if such entity does not have a rating for its senior unsecured long-term debt, then the rating then assigned to such entity as an issues rating by S&P, Moody’s or any other rating agency agreed by the Parties as set forth in the Cover Sheet.

1.13 “Cross Default Amount” means the cross default amount, if any, set forth in the Cover Sheet for a Party.

1.14 “Defaulting Party” has the meaning set forth in Section 5.1.

1.15 “Delivery Period” means the period of delivery for a Transaction, as specified in the Transaction.

1.16 “Delivery Point” means the point at which the Product will be delivered and received, as specified in the Transaction.

1.17 “Downgrade Event” has the meaning set forth on the Cover Sheet.

1.18 “Early Termination Date” has the meaning set forth in Section 5.2.

1.19 “Effective Date” has the meaning set forth on the Cover Sheet.

1.20 “Equitable Defenses” means any bankruptcy, insolvency, reorganization and other laws affecting creditors’ rights generally, and with regard to equitable remedies, the discretion of the court before which proceedings to obtain same may be pending.

1.21 “Event of Default” has the meaning set forth in Section 5.1.

1.22 “FERC” means the Federal Energy Regulatory Commission or any successor government agency.

1.23 “Force Majeure” means an event or circumstance which prevents one Party from performing its obligations under one or more Transactions, which event or circumstance was not anticipated as of the date the Transaction was agreed to, which is not within the reasonable control of, or the result of the negligence of, the Claiming Party, and which, by the exercise of due diligence, the Claiming Party is unable to overcome or avoid or cause to be avoided. Force Majeure shall not be based on (i) the loss of Buyer’s markets; (ii) Buyer’s inability economically to use or resell the Product purchased hereunder; (iii) the loss or failure of Seller’s supply; or (iv) Seller’s ability to sell the Product at a price greater than the Contract Price. Neither Party may raise a claim of Force Majeure based in whole or in part on curtailment by a Transmission Provider unless (i) such Party has contracted for firm transmission with a Transmission Provider for the Product to be delivered to or received at the Delivery Point and (ii) such curtailment is due to “force majeure” or “uncontrollable force” or a similar term as defined under the Transmission Provider’s tariff; provided, however, that existence of the foregoing factors shall not be sufficient to conclusively or presumptively prove the existence of a Force Majeure absent a showing of other facts and circumstances which in the aggregate with such factors establish that a Force Majeure as defined in the first sentence hereof has occurred. The applicability of Force Majeure to the Transaction is governed by the terms of the Products and Related Definitions contained in Schedule P.

1.24 “Gains” means, with respect to any Party, an amount equal to the present value of the economic benefit to it, if any (exclusive of Costs), resulting from the termination of a Terminated Transaction, determined in a commercially reasonable manner.

1.25 “Guarantor” means, with respect to a Party, the guarantor, if any, specified for such Party on the Cover Sheet.

1.26 “Interest Rate” means, for any date, the lesser of (a) the per annum rate of interest equal to the prime lending rate as may from time to time be published in *The Wall Street Journal* under “Money Rates” on such day (or if not published on such day on the most recent preceding day on which published), plus two percent (2%) and (b) the maximum rate permitted by applicable law.

1.27 “Letter(s) of Credit” means one or more irrevocable, transferable standby letters of credit issued by a U.S. commercial bank or a foreign bank with a U.S. branch with such bank having a credit rating of at least A- from S&P or A3 from Moody’s, in a form acceptable to the Party in whose favor the letter of credit is issued. Costs of a Letter of Credit shall be borne by the applicant for such Letter of Credit.

1.28 “Losses” means, with respect to any Party, an amount equal to the present value of the economic loss to it, if any (exclusive of Costs), resulting from termination of a Terminated Transaction, determined in a commercially reasonable manner.

1.29 “Master Agreement” has the meaning set forth on the Cover Sheet.

1.30 “Moody’s” means Moody’s Investor Services, Inc. or its successor.

1.31 “NERC Business Day” means any day except a Saturday, Sunday or a holiday as defined by the North American Electric Reliability Council or any successor organization thereto. A NERC Business Day shall open at 8:00 a.m. and close at 5:00 p.m. local time for the relevant Party’s principal place of business. The relevant Party, in each instance unless otherwise specified, shall be the Party from whom the notice, payment or delivery is being sent and by whom the notice or payment or delivery is to be received.

1.32 “Non-Defaulting Party” has the meaning set forth in Section 5.2.

1.33 “Offsetting Transactions” mean any two or more outstanding Transactions, having the same or overlapping Delivery Period(s), Delivery Point and payment date, where under one or more of such Transactions, one Party is the Seller, and under the other such Transaction(s), the same Party is the Buyer.

1.34 “Option” means the right but not the obligation to purchase or sell a Product as specified in a Transaction.

- 1.35 "Option Buyer" means the Party specified in a Transaction as the purchaser of an option, as defined in Schedule P.
- 1.36 "Option Seller" means the Party specified in a Transaction as the seller of an option, as defined in Schedule P.
- 1.37 "Party A Collateral Threshold" means the collateral threshold, if any, set forth in the Cover Sheet for Party A.
- 1.38 "Party B Collateral Threshold" means the collateral threshold, if any, set forth in the Cover Sheet for Party B.
- 1.39 "Party A Independent Amount" means the amount, if any, set forth in the Cover Sheet for Party A.
- 1.40 "Party B Independent Amount" means the amount, if any, set forth in the Cover Sheet for Party B.
- 1.41 "Party A Rounding Amount" means the amount, if any, set forth in the Cover Sheet for Party A.
- 1.42 "Party B Rounding Amount" means the amount, if any, set forth in the Cover Sheet for Party B.
- 1.43 "Party A Tariff" means the tariff, if any, specified in the Cover Sheet for Party A.
- 1.44 "Party B Tariff" means the tariff, if any, specified in the Cover Sheet for Party B.
- 1.45 "Performance Assurance" means collateral in the form of either cash, Letter(s) of Credit, or other security acceptable to the Requesting Party.
- 1.46 "Potential Event of Default" means an event which, with notice or passage of time or both, would constitute an Event of Default.
- 1.47 "Product" means electric capacity, energy or other product(s) related thereto as specified in a Transaction by reference to a Product listed in Schedule P hereto or as otherwise specified by the Parties in the Transaction.
- 1.48 "Put Option" means an Option entitling, but not obligating, the Option Buyer to sell and deliver the Product to the Option Seller at a price equal to the Strike Price for the Delivery Period for which the option may

be exercised, all as specified in a Transaction. Upon proper exercise of the Option by the Option Buyer, the Option Seller will be obligated to purchase and receive the Product.

1.49 "Quantity" means that quantity of the Product that Seller agrees to make available or sell and deliver, or cause to be delivered, to Buyer, and that Buyer agrees to purchase and receive, or cause to be received, from Seller as specified in the Transaction.

1.50 "Recording" has the meaning set forth in Section 2.4.

1.51 "Replacement Price" means the price at which Buyer, acting in a commercially reasonable manner, purchases at the Delivery Point a replacement for any Product specified in a Transaction but not delivered by Seller, plus (i) costs reasonably incurred by Buyer in purchasing such substitute Product and (ii) additional transmission charges, if any, reasonably incurred by Buyer to the Delivery Point, or at Buyer's option, the market price at the Delivery Point for such Product not delivered as determined by Buyer in a commercially reasonable manner; provided, however, in no event shall such price include any penalties, ratcheted demand or similar charges, nor shall Buyer be required to utilize or change its utilization of its owned or controlled assets or market positions to minimize Seller's liability. For the purposes of this definition, Buyer shall be considered to have purchased replacement Product to the extent Buyer shall have entered into one or more arrangements in a commercially reasonable manner whereby Buyer repurchases its obligation to sell and deliver the Product to another party at the Delivery Point.

1.52 "S&P" means the Standard & Poor's Rating Group (a division of McGraw-Hill, Inc.) or its successor.

1.53 "Sales Price" means the price at which Seller, acting in a commercially reasonable manner, resells at the Delivery Point any Product not received by Buyer, deducting from such proceeds any (i) costs reasonably incurred by Seller in reselling such Product and (ii) additional transmission charges, if any, reasonably incurred by Seller in delivering such Product to the third party purchasers, or at Seller's option, the market price at the Delivery Point for such Product not received as determined by Seller in a commercially reasonable manner; provided, however, in no event shall such price include any penalties, ratcheted demand or similar charges, nor shall Seller be required to utilize or change its utilization of its owned or controlled assets, including contractual assets, or market positions to minimize Buyer's liability. For purposes of this definition, Seller shall be considered to have resold such Product to the extent Seller shall have en-

tered into one or more arrangements in a commercially reasonable manner whereby Seller repurchases its obligation to purchase and receive the Product from another party at the Delivery Point.

1.54 “Schedule” or “Scheduling” means the actions of Seller, Buyer and/or their designated representatives, including each Party’s Transmission Providers, if applicable, of notifying, requesting and confirming to each other the quantity and type of Product to be delivered on any given day or days during the Delivery Period at a specified Delivery Point.

1.55 “Seller” means the Party to a Transaction that is obligated to sell and deliver, or cause to be delivered, the Product, as specified in the Transaction.

1.56 “Settlement Amount” means, with respect to a Transaction and the Non-Defaulting Party, the Losses or Gains, and Costs, expressed in U.S. Dollars, which such party incurs as a result of the liquidation of a Terminated Transaction pursuant to Section 5.2.

1.57 “Strike Price” means the price to be paid for the purchase of the Product pursuant to an Option.

1.58 “Terminated Transaction” has the meaning set forth in Section 5.2.

1.59 “Termination Payment” has the meaning set forth in Section 5.3.

1.60 “Transaction” means a particular transaction agreed to by the Parties relating to the sale and purchase of a Product pursuant to this Master Agreement.

1.61 “Transmission Provider” means any entity or entities transmitting or transporting the Product on behalf of Seller or Buyer to or from the Delivery Point in a particular Transaction.

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## ARTICLE TWO: TRANSACTION TERMS AND CONDITIONS

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2.1 **Transactions.** A Transaction shall be entered into upon agreement of the Parties orally or, if expressly required by either Party with respect to a particular Transaction, in writing, including an electronic means of communication. Each Party agrees not to contest, or assert any defense to, the validity or enforceability of the Transaction entered into in accordance with this Master Agreement (i) based on any law requiring agreements to

be in writing or to be signed by the parties, or (ii) based on any lack of authority of the Party or any lack of authority of any employee of the Party to enter into a Transaction.

2.2 Governing Terms. Unless otherwise specifically agreed, each Transaction between the Parties shall be governed by this Master Agreement. This Master Agreement (including all exhibits, schedules and any written supplements hereto), , the Party A Tariff, if any, and the Party B Tariff, if any, any designated collateral, credit support or margin agreement or similar arrangement between the Parties and all Transactions (including any Confirmations accepted in accordance with Section 2.3) shall form a single integrated agreement between the Parties. Any inconsistency between any terms of this Master Agreement and any terms of the Transaction shall be resolved in favor of the terms of such Transaction.

2.3 Confirmation. Seller may confirm a Transaction by forwarding to Buyer by facsimile within three (3) Business Days after the Transaction is entered into a confirmation (“Confirmation”) substantially in the form of Exhibit A. If Buyer objects to any term(s) of such Confirmation, Buyer shall notify Seller in writing of such objections within two (2) Business Days of Buyer’s receipt thereof, failing which Buyer shall be deemed to have accepted the terms as sent. If Seller fails to send a Confirmation within three (3) Business Days after the Transaction is entered into, a Confirmation substantially in the form of Exhibit A, may be forwarded by Buyer to Seller. If Seller objects to any term(s) of such Confirmation, Seller shall notify Buyer of such objections within two (2) Business Days of Seller’s receipt thereof, failing which Seller shall be deemed to have accepted the terms as sent. If Seller and Buyer each send a Confirmation and neither Party objects to the other Party’s Confirmation within two (2) Business Days of receipt, Seller’s Confirmation shall be deemed to be accepted and shall be the controlling Confirmation, unless (i) Seller’s Confirmation was sent more than three (3) Business Days after the Transaction was entered into and (ii) Buyer’s Confirmation was sent prior to Seller’s Confirmation, in which case Buyer’s Confirmation shall be deemed to be accepted and shall be the controlling Confirmation. Failure by either Party to send or either Party to return an executed Confirmation or any objection by either Party shall not invalidate the Transaction agreed to by the Parties.

2.4 Additional Confirmation Terms. If the Parties have elected on the Cover Sheet to make this Section 2.4 applicable to this Master Agreement, when a Confirmation contains provisions, other than those provisions relating to the commercial terms of the Transaction (e.g., price or special transmission conditions), which modify or supplement the general terms



and conditions of this Master Agreement (e.g., arbitration provisions or additional representations and warranties), such provisions shall not be deemed to be accepted pursuant to Section 2.3 unless agreed to either orally or in writing by the Parties; provided that the foregoing shall not invalidate any Transaction agreed to by the Parties.

**2.5 Recording.** Unless a Party expressly objects to a Recording (defined below) at the beginning of a telephone conversation, each Party consents to the creation of a tape or electronic recording ("Recording") of all telephone conversations between the Parties to this Master Agreement, and that any such Recordings will be retained in confidence, secured from improper access, and may be submitted in evidence in any proceeding or action relating to this Agreement. Each Party waives any further notice of such monitoring or recording, and agrees to notify its officers and employees of such monitoring or recording and to obtain any necessary consent of such officers and employees. The Recording, and the terms and conditions described therein, if admissible, shall be the controlling evidence for the Parties' agreement with respect to a particular Transaction in the event a Confirmation is not fully executed (or deemed accepted) by both Parties. Upon full execution (or deemed acceptance) of a Confirmation, such Confirmation shall control in the event of any conflict with the terms of a Recording, or in the event of any conflict with the terms of this Master Agreement.

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### ARTICLE THREE: OBLIGATIONS AND DELIVERIES

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**3.1 Seller's and Buyer's Obligations.** With respect to each Transaction, Seller shall sell and deliver, or cause to be delivered, and Buyer shall purchase and receive, or cause to be received, the Quantity of the Product at the Delivery Point, and Buyer shall pay Seller the Contract Price; provided, however, with respect to Options, the obligations set forth in the preceding sentence shall only arise if the Option Buyer exercises its Option in accordance with its terms. Seller shall be responsible for any costs or charges imposed on or associated with the Product or its delivery of the Product up to the Delivery Point. Buyer shall be responsible for any costs or charges imposed on or associated with the Product or its receipt at and from the Delivery Point.

**3.2 Transmission and Scheduling.** Seller shall arrange and be responsible for transmission service to the Delivery Point and shall Schedule or arrange for Scheduling services with its Transmission Providers, as specified by the Parties in the Transaction, or in the absence thereof, in accordance with the practice of the Transmission Providers, to deliver the Product to

the Delivery Point. Buyer shall arrange and be responsible for transmission service at and from the Delivery Point and shall Schedule or arrange for Scheduling services with its Transmission Providers to receive the Product at the Delivery Point.

3.3 Force Majeure. To the extent either Party is prevented by Force Majeure from carrying out, in whole or part, its obligations under the Transaction and such Party (the "Claiming Party") gives notice and details of the Force Majeure to the other Party as soon as practicable, then, unless the terms of the Product specify otherwise, the Claiming Party shall be excused from the performance of its obligations with respect to such Transaction (other than the obligation to make payments then due or becoming due with respect to performance prior to the Force Majeure). The Claiming Party shall remedy the Force Majeure with all reasonable dispatch. The non-Claiming Party shall not be required to perform or resume performance of its obligations to the Claiming Party corresponding to the obligations of the Claiming Party excused by Force Majeure.

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#### ARTICLE FOUR: REMEDIES FOR FAILURE TO DELIVER/RECEIVE

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4.1 Seller Failure. If Seller fails to schedule and/or deliver all or part of the Product pursuant to a Transaction, and such failure is not excused under the terms of the Product or by Buyer's failure to perform, then Seller shall pay Buyer, on the date payment would otherwise be due in respect of the month in which the failure occurred or, if "Accelerated Payment of Damages" is specified on the Cover Sheet, within five (5) Business Days of invoice receipt, an amount for such deficiency equal to the positive difference, if any, obtained by subtracting the Contract Price from the Replacement Price. The invoice for such amount shall include a written statement explaining in reasonable detail the calculation of such amount.

4.2 Buyer Failure. If Buyer fails to schedule and/or receive all or part of the Product pursuant to a Transaction and such failure is not excused under the terms of the Product or by Seller's failure to perform, then Buyer shall pay Seller, on the date payment would otherwise be due in respect of the month in which the failure occurred or, if "Accelerated Payment of Damages" is specified on the Cover Sheet, within five (5) Business Days of invoice receipt, an amount for such deficiency equal to the positive difference, if any, obtained by subtracting the Sales Price from the Contract Price. The invoice for such amount shall include a written statement explaining in reasonable detail the calculation of such amount.

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**ARTICLE FIVE: EVENTS OF DEFAULT;  
REMEDIES**

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5.1 Events of Default. An “Event of Default” shall mean, with respect to a Party (a “Defaulting Party”), the occurrence of any of the following:

(a) the failure to make, when due, any payment required pursuant to this Agreement if such failure is not remedied within three (3) Business Days after written notice;

(b) any representation or warranty made by such Party herein is false or misleading in any material respect when made or when deemed made or repeated;

(c) the failure to perform any material covenant or obligation set forth in this Agreement (except to the extent constituting a separate Event of Default, and except for such Party’s obligations to deliver or receive the Product, the exclusive remedy for which is provided in Article Four) if such failure is not remedied within three (3) Business Days after written notice;

(d) such Party becomes Bankrupt;

(e) the failure of such Party to satisfy the creditworthiness/collateral requirements agreed to pursuant to Article Eight hereof;

(f) such Party consolidates or amalgamates with, or merges with or into, or transfers all or substantially all of its assets to, another entity and, at the time of such consolidation, amalgamation, merger or transfer, the resulting, surviving or transferee entity fails to assume all the obligations of such Party under this Agreement to which it or its predecessor was a party by operation of law or pursuant to an agreement reasonably satisfactory to the other Party;

(g) if the applicable cross default section in the Cover Sheet is indicated for such Party, the occurrence and continuation of (i) a default, event of default or other similar condition or event in respect of such Party or any other party specified in the Cover Sheet for such Party under one or more agreements or instruments, individually or collectively, relating to indebtedness for borrowed money in an aggregate amount of not less than the applicable Cross Default Amount (as specified in the Cover Sheet), which results in such indebtedness becoming, or becoming capable at such

time of being declared, immediately due and payable or (ii) a default by such Party or any other party specified in the Cover Sheet for such Party in making on the due date therefor one or more payments, individually or collectively, in an aggregate amount of not less than the applicable Cross Default Amount (as specified in the Cover Sheet);

(h) with respect to such Party's Guarantor, if any:

(i) if any representation or warranty made by a Guarantor in connection with this Agreement is false or misleading in any material respect when made or when deemed made or repeated;

(ii) the failure of a Guarantor to make any payment required or to perform any other material covenant or obligation in any guaranty made in connection with this Agreement and such failure shall not be remedied within three (3) Business Days after written notice;

(iii) a Guarantor becomes Bankrupt;

(iv) the failure of a Guarantor's guaranty to be in full force and effect for purposes of this Agreement (other than in accordance with its terms) prior to the satisfaction of all obligations of such Party under each Transaction to which such guaranty shall relate without the written consent of the other Party; or

(v) a Guarantor shall repudiate, disaffirm, disclaim, or reject, in whole or in part, or challenge the validity of any guaranty.

**5.2 Declaration of an Early Termination Date and Calculation of Settlement Amounts.** If an Event of Default with respect to a Defaulting Party shall have occurred and be continuing, the other Party (the "Non-Defaulting Party") shall have the right (i) to designate a day, no earlier than the day such notice is effective and no later than 20 days after such notice is effective, as an early termination date ("Early Termination Date") to accelerate all amounts owing between the Parties and to liquidate and terminate all, but not less than all, Transactions (each referred to as a "Terminated Transaction") between the Parties, (ii) withhold any payments due to the Defaulting Party under this Agreement and (iii) suspend performance. The Non-Defaulting Party shall calculate, in a commercially reasonable manner, a Settlement Amount for each such Terminated Transaction as of the Early Termination Date (or, to the extent that in the reasonable opinion of the Non-Defaulting Party certain of such Terminated Transactions are commercially impracticable to liquidate and terminate or may not be liquidated and terminated under applicable law

on the Early Termination Date, as soon thereafter as is reasonably practicable).

5.3 Net Out of Settlement Amounts. The Non-Defaulting Party shall aggregate all Settlement Amounts into a single amount by: netting out (a) all Settlement Amounts that are due to the Defaulting Party, plus, at the option of the Non-Defaulting Party, any cash or other form of security then available to the Non-Defaulting Party pursuant to Article Eight, plus any or all other amounts due to the Defaulting Party under this Agreement against (b) all Settlement Amounts that are due to the Non-Defaulting Party, plus any or all other amounts due to the Non-Defaulting Party under this Agreement, so that all such amounts shall be netted out to a single liquidated amount (the "Termination Payment") payable by one Party to the other. The Termination Payment shall be due to or due from the Non-Defaulting Party as appropriate.

5.4 Notice of Payment of Termination Payment. As soon as practicable after a liquidation, notice shall be given by the Non-Defaulting Party to the Defaulting Party of the amount of the Termination Payment and whether the Termination Payment 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. The Termination Payment shall be made by the Party that owes it within two (2) Business Days after such notice is effective.

5.5 Disputes With Respect to Termination Payment. If the Defaulting Party disputes the Non-Defaulting Party's calculation of the Termination Payment, in whole or in part, the Defaulting Party shall, within two (2) Business Days of receipt of Non-Defaulting Party's calculation of the Termination Payment, provide to the Non-Defaulting Party a detailed written explanation of the basis for such dispute; provided, however, that if the Termination Payment is due from the Defaulting Party, the Defaulting Party shall first transfer Performance Assurance to the Non-Defaulting Party in an amount equal to the Termination Payment.

5.6 Closeout Setoffs.

Option A: After calculation of a Termination Payment in accordance with Section 5.3, if the Defaulting Party would be owed the Termination Payment, the Non-Defaulting Party shall be entitled, at its option and in its discretion, to (i) set off against such Termination Payment any amounts due and owing by the Defaulting Party to the Non-Defaulting Party under any other agreements, instruments or undertakings between the Defaulting Party and the Non-Defaulting Party and/or (ii) to the extent

the Transactions are not yet liquidated in accordance with Section 5.2, withhold payment of the Termination Payment to the Defaulting Party. The remedy provided for in this Section shall be without prejudice and in addition to any right of setoff, combination of accounts, lien or other right to which any Party is at any time otherwise entitled (whether by operation of law, contract or otherwise).

Option B: After calculation of a Termination Payment in accordance with Section 5.3, if the Defaulting Party would be owed the Termination Payment, the Non-Defaulting Party shall be entitled, at its option and in its discretion, to (i) set off against such Termination Payment any amounts due and owing by the Defaulting Party or any of its Affiliates to the Non-Defaulting Party or any of its Affiliates under any other agreements, instruments or undertakings between the Defaulting Party or any of its Affiliates and the Non-Defaulting Party or any of its Affiliates and/or (ii) to the extent the Transactions are not yet liquidated in accordance with Section 5.2, withhold payment of the Termination Payment to the Defaulting Party. The remedy provided for in this Section shall be without prejudice and in addition to any right of setoff, combination of accounts, lien or other right to which any Party is at any time otherwise entitled (whether by operation of law, contract or otherwise).

Option C: Neither Option A nor B shall apply.

5.7 Suspension of Performance. Notwithstanding any other provision of this Master Agreement, if (a) an Event of Default or (b) a Potential Event of Default shall have occurred and be continuing, the Non-Defaulting Party, upon written notice to the Defaulting Party, shall have the right (i) to suspend performance under any or all Transactions; provided, however, in no event shall any such suspension continue for longer than ten (10) NERC Business Days with respect to any single Transaction unless an early Termination Date shall have been declared and notice thereof pursuant to Section 5.2 given, and (ii) to the extent an Event of Default shall have occurred and be continuing to exercise any remedy available at law or in equity.

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## ARTICLE SIX: PAYMENT AND NETTING

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6.1 Billing Period. Unless otherwise specifically agreed upon by the Parties in a Transaction, the calendar month shall be the standard period for all payments under this Agreement (other than Termination Payments and, if "Accelerated Payment of Damages" is specified by the Parties in the Cover Sheet, payments pursuant to Section 4.1 or 4.2 and Option pre-

mium payments pursuant to Section 6.7). As soon as practicable after the end of each month, each Party will render to the other Party an invoice for the payment obligations, if any, incurred hereunder during the preceding month.

6.2 Timeliness of Payment. Unless otherwise agreed by the Parties in a Transaction, all invoices under this Master Agreement shall be due and payable in accordance with each Party's invoice instructions on or before the later of the twentieth (20th) day of each month, or tenth (10th) day after receipt of the invoice or, if such day is not a Business Day, then on the next Business Day. Each Party will make payments by electronic funds transfer, or by other mutually agreeable method(s), to the account designated by the other Party. Any amounts not paid by the due date will be deemed delinquent and will accrue interest at the Interest Rate, such interest to be calculated from and including the due date to but excluding the date the delinquent amount is paid in full.

6.3 Disputes and Adjustments of Invoices. A Party may, in good faith, dispute the correctness of any invoice or any adjustment to an invoice, rendered under this Agreement or adjust any invoice for any arithmetic or computational error within twelve (12) months of the date the invoice, or adjustment to an invoice, was rendered. In the event an invoice or portion thereof, or any other claim or adjustment arising hereunder, is disputed, payment of the undisputed portion of the invoice shall be required to be made when due, with notice of the objection given to the other Party. Any invoice dispute or invoice adjustment shall be in writing and shall state the basis for the dispute or adjustment. Payment of the disputed amount shall not be required until the dispute is resolved. Upon resolution of the dispute, any required payment shall be made within two (2) Business Days of such resolution along with interest accrued at the Interest Rate from and including the due date to but excluding the date paid. Inadvertent overpayments shall be returned upon request or deducted by the Party receiving such overpayment from subsequent payments, with interest accrued at the Interest Rate from and including the date of such overpayment to but excluding the date repaid or deducted by the Party receiving such overpayment. Any dispute with respect to an invoice is waived unless the other Party is notified in accordance with this Section 6.3 within twelve (12) months after the invoice is rendered or any specific adjustment to the invoice is made. If an invoice is not rendered within twelve (12) months after the close of the month during which performance of a Transaction occurred, the right to payment for such performance is waived.

6.4 Netting of Payments. The Parties hereby agree that they shall discharge mutual debts and payment obligations due and owing to each other

on the same date pursuant to all Transactions through netting, in which case all amounts owed by each Party to the other Party for the purchase and sale of Products during the monthly billing period under this Master Agreement, including any related damages calculated pursuant to Article Four (unless one of the Parties elects to accelerate payment of such amounts as permitted by Article Four), interest, and payments or credits, shall be netted so that only the excess amount remaining due shall be paid by the Party who owes it.

6.5 Payment Obligation Absent Netting. If no mutual debts or payment obligations exist and only one Party owes a debt or obligation to the other during the monthly billing period, including, but not limited to, any related damage amounts calculated pursuant to Article Four, interest, and payments or credits, that Party shall pay such sum in full when due.

6.6 Security. Unless the Party benefiting from Performance Assurance or a guaranty notifies the other Party in writing, and except in connection with a liquidation and termination in accordance with Article Five, all amounts netted pursuant to this Article Six shall not take into account or include any Performance Assurance or guaranty which may be in effect to secure a Party's performance under this Agreement.

6.7 Payment for Options. The premium amount for the purchase of an Option shall be paid within two (2) Business Days of receipt of an invoice from the Option Seller. Upon exercise of an Option, payment for the Product underlying such Option shall be due in accordance with Section 6.1.

6.8 Transaction Netting. If the Parties enter into one or more Transactions, which in conjunction with one or more other outstanding Transactions, constitute Offsetting Transactions, then all such Offsetting Transactions may by agreement of the Parties, be netted into a single Transaction under which:

(a) the Party obligated to deliver the greater amount of Energy will deliver the difference between the total amount it is obligated to deliver and the total amount to be delivered to it under the Offsetting Transactions, and

(b) the Party owing the greater aggregate payment will pay the net difference owed between the Parties.

Each single Transaction resulting under this Section shall be deemed part of the single, indivisible contractual arrangement between the parties, and



once such resulting Transaction occurs, outstanding obligations under the Offsetting Transactions which are satisfied by such offset shall terminate.

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## ARTICLE SEVEN: LIMITATIONS

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7.1 Limitation of Remedies, Liability and Damages. EXCEPT AS SET FORTH HEREIN, THERE IS NO WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE, AND ANY AND ALL IMPLIED WARRANTIES ARE DISCLAIMED. THE PARTIES CONFIRM THAT THE EXPRESS REMEDIES AND MEASURES OF DAMAGES PROVIDED IN THIS AGREEMENT SATISFY THE ESSENTIAL PURPOSES HEREOF. 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, THE OBLIGOR'S LIABILITY 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, THE OBLIGOR'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.

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**ARTICLE EIGHT: CREDIT AND COLLATERAL REQUIREMENTS**

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8.1 **Party A Credit Protection.** The applicable credit and collateral requirements shall be as specified on the Cover Sheet. If no option in Section 8.1(a) is specified on the Cover Sheet, Section 8.1(a) Option C shall apply exclusively. If none of Sections 8.1(b), 8.1(c) or 8.1(d) are specified on the Cover Sheet, Section 8.1(b) shall apply exclusively.

(a) **Financial Information.** Option A: If requested by Party A, Party B shall deliver (i) within 120 days following the end of each fiscal year, a copy of Party B's annual report containing audited consolidated financial statements for such fiscal year and (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of Party B's quarterly report containing unaudited consolidated financial statements for such fiscal quarter. In all cases the statements shall be for the most recent accounting period and prepared in accordance with generally accepted accounting principles; provided, however, that should any such statements not be available on a timely basis due to a delay in preparation or certification, such delay shall not be an Event of Default so long as Party B diligently pursues the preparation, certification and delivery of the statements.

Option B: If requested by Party A, Party B shall deliver (i) within 120 days following the end of each fiscal year, a copy of the annual report containing audited consolidated financial statements for such fiscal year for the party(s) specified on the Cover Sheet and (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of quarterly report containing unaudited consolidated financial statements for such fiscal quarter for the party(s) specified on the Cover Sheet. In all cases the statements shall be for the most recent accounting period and shall be prepared in accordance with generally accepted accounting principles; provided, however, that should any such statements not be available on a timely basis due to a delay in preparation or certification, such delay shall not be an Event of Default so long as the relevant entity diligently pursues the preparation, certification and delivery of the statements.

Option C: Party A may request from Party B the information specified in the Cover Sheet.

(b) **Credit Assurances.** If Party A has reasonable grounds to believe that Party B's creditworthiness or performance under this Agreement has become unsatisfactory, Party A will provide Party B with written notice requesting Performance Assurance in an amount determined by Party A in

a commercially reasonable manner. Upon receipt of such notice Party B shall have three (3) Business Days to remedy the situation by providing such Performance Assurance to Party A. In the event that Party B fails to provide such Performance Assurance, or a guaranty or other credit assurance acceptable to Party A within three (3) Business Days of receipt of notice, then an Event of Default under Article Five will be deemed to have occurred and Party A will be entitled to the remedies set forth in Article Five of this Master Agreement.

(c) Collateral Threshold. If at any time and from time to time during the term of this Agreement (and notwithstanding whether an Event of Default has occurred), the Termination Payment that would be owed to Party A plus Party B's Independent Amount, if any, exceeds the Party B Collateral Threshold, then Party A, on any Business Day, may request that Party B provide Performance Assurance in an amount equal to the amount by which the Termination Payment plus Party B's Independent Amount, if any, exceeds the Party B Collateral Threshold (rounding upwards for any fractional amount to the next Party B Rounding Amount) ("Party B Performance Assurance"), less any Party B Performance Assurance already posted with Party A. Such Party B Performance Assurance shall be delivered to Party A within three (3) Business Days of the date of such request. On any Business Day (but no more frequently than weekly with respect to Letters of Credit and daily with respect to cash), Party B, at its sole cost, may request that such Party B Performance Assurance be reduced correspondingly to the amount of such excess Termination Payment plus Party B's Independent Amount, if any, (rounding upwards for any fractional amount to the next Party B Rounding Amount). In the event that Party B fails to provide Party B Performance Assurance pursuant to the terms of this Article Eight within three (3) Business Days, then an Event of Default under Article Five shall be deemed to have occurred and Party A will be entitled to the remedies set forth in Article Five of this Master Agreement.

For purposes of this Section 8.1(c), the calculation of the Termination Payment shall be calculated pursuant to Section 5.3 by Party A as if all outstanding Transactions had been liquidated, and in addition thereto, shall include all amounts owed but not yet paid by Party B to Party A, whether or not such amounts are due, for performance already provided pursuant to any and all Transactions.

(d) Downgrade Event. If at any time there shall occur a Downgrade Event in respect of Party B, then Party A may require Party B to provide Performance Assurance in an amount determined by Party A in a commercially reasonable manner. In the event Party B shall fail to provide such Performance Assurance or a guaranty or other credit assurance ac-

ceptable to Party A within three (3) Business Days of receipt of notice, then an Event of Default shall be deemed to have occurred and Party A will be entitled to the remedies set forth in Article Five of this Master Agreement.

If specified on the Cover Sheet, Party B shall deliver to Party A, prior to or concurrently with the execution and delivery of this Master Agreement a guarantee in an amount not less than the Guarantee Amount specified on the Cover Sheet and in a form reasonably acceptable to Party A.

**8.2 Party B Credit Protection.** The applicable credit and collateral requirements shall be as specified on the Cover Sheet. If no option in Section 8.2(a) is specified on the Cover Sheet, Section 8.2(a) Option C shall apply exclusively. If none of Sections 8.2(b), 8.2(c) or 8.2(d) are specified on the Cover Sheet, Section 8.2(b) shall apply exclusively.

(a) **Financial Information.** Option A: If requested by Party B, Party A shall deliver (i) within 120 days following the end of each fiscal year, a copy of Party A's annual report containing audited consolidated financial statements for such fiscal year and (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of such Party's quarterly report containing unaudited consolidated financial statements for such fiscal quarter. In all cases the statements shall be for the most recent accounting period and prepared in accordance with generally accepted accounting principles; provided, however, that should any such statements not be available on a timely basis due to a delay in preparation or certification, such delay shall not be an Event of Default so long as such Party diligently pursues the preparation, certification and delivery of the statements.

Option B: If requested by Party B, Party A shall deliver (i) within 120 days following the end of each fiscal year, a copy of the annual report containing audited consolidated financial statements for such fiscal year for the party(s) specified on the Cover Sheet and (ii) within 60 days after the end of each of its first three fiscal quarters of each fiscal year, a copy of quarterly report containing unaudited consolidated financial statements for such fiscal quarter for the party(s) specified on the Cover Sheet. In all cases the statements shall be for the most recent accounting period and shall be prepared in accordance with generally accepted accounting principles; provided, however, that should any such statements not be available on a timely basis due to a delay in preparation or certification, such delay shall not be an Event of Default so long as the relevant entity diligently pursues the preparation, certification and delivery of the statements.

Option C: Party B may request from Party A the information specified in the Cover Sheet.

(b) Credit Assurances. If Party B has reasonable grounds to believe that Party A's creditworthiness or performance under this Agreement has become unsatisfactory, Party B will provide Party A with written notice requesting Performance Assurance in an amount determined by Party B in a commercially reasonable manner. Upon receipt of such notice Party A shall have three (3) Business Days to remedy the situation by providing such Performance Assurance to Party B. In the event that Party A fails to provide such Performance Assurance, or a guaranty or other credit assurance acceptable to Party B within three (3) Business Days of receipt of notice, then an Event of Default under Article Five will be deemed to have occurred and Party B will be entitled to the remedies set forth in Article Five of this Master Agreement.

(c) Collateral Threshold. If at any time and from time to time during the term of this Agreement (and notwithstanding whether an Event of Default has occurred), the Termination Payment that would be owed to Party B plus Party A's Independent Amount, if any, exceeds the Party A Collateral Threshold, then Party B, on any Business Day, may request that Party A provide Performance Assurance in an amount equal to the amount by which the Termination Payment plus Party A's Independent Amount, if any, exceeds the Party A Collateral Threshold (rounding upwards for any fractional amount to the next Party A Rounding Amount) ("Party A Performance Assurance"), less any Party A Performance Assurance already posted with Party B. Such Party A Performance Assurance shall be delivered to Party B within three (3) Business Days of the date of such request. On any Business Day (but no more frequently than weekly with respect to Letters of Credit and daily with respect to cash), Party A, at its sole cost, may request that such Party A Performance Assurance be reduced correspondingly to the amount of such excess Termination Payment plus Party A's Independent Amount, if any, (rounding upwards for any fractional amount to the next Party A Rounding Amount). In the event that Party A fails to provide Party A Performance Assurance pursuant to the terms of this Article Eight within three (3) Business Days, then an Event of Default under Article Five shall be deemed to have occurred and Party B will be entitled to the remedies set forth in Article Five of this Master Agreement.

For purposes of this Section 8.2(c), the calculation of the Termination Payment shall be calculated pursuant to Section 5.3 by Party B as if all outstanding Transactions had been liquidated, and in addition thereto, shall include all amounts owed but not yet paid by Party A to Party B,

whether or not such amounts are due, for performance already provided pursuant to any and all Transactions.

(d) Downgrade Event. If at any time there shall occur a Downgrade Event in respect of Party A, then Party B may require Party A to provide Performance Assurance in an amount determined by Party B in a commercially reasonable manner. In the event Party A shall fail to provide such Performance Assurance or a guaranty or other credit assurance acceptable to Party B within three (3) Business Days of receipt of notice, then an Event of Default shall be deemed to have occurred and Party B will be entitled to the remedies set forth in Article Five of this Master Agreement.

(e) If specified on the Cover Sheet, Party A shall deliver to Party B, prior to or concurrently with the execution and delivery of this Master Agreement a guarantee in an amount not less than the Guarantee Amount specified on the Cover Sheet and in a form reasonably acceptable to Party B.

8.3 Grant of Security Interest/Remedies. To secure its obligations under this Agreement and to the extent either or both Parties deliver Performance Assurance hereunder, each Party (a "Pledgor") hereby grants to the other Party (the "Secured Party") a present and continuing security interest in, and lien on (and right of setoff against), and assignment of, all cash collateral and cash equivalent collateral and any and all proceeds resulting therefrom or the liquidation thereof, whether now or hereafter held by, on behalf of, or for the benefit of, such Secured Party, and each Party agrees to take such action as the other Party reasonably requires in order to perfect the Secured Party's first-priority security interest in, and lien on (and right of setoff against), such collateral and any and all proceeds resulting therefrom or from the liquidation thereof. Upon or any time after the occurrence or deemed occurrence and during the continuation of an Event of Default or an Early Termination Date, the Non-Defaulting Party may do any one or more of the following: (i) exercise any of the rights and remedies of a Secured Party with respect to all Performance Assurance, including any such rights and remedies under law then in effect; (ii) exercise its rights of setoff against any and all property of the Defaulting Party in the possession of the Non-Defaulting Party or its agent; (iii) draw on any outstanding Letter of Credit issued for its benefit; and (iv) liquidate all Performance Assurance then held by or for the benefit of the Secured Party free from any claim or right of any nature whatsoever of the Defaulting Party, including any equity or right of purchase or redemption by the Defaulting Party. The Secured Party shall apply the proceeds of the collateral realized upon the exercise of any such rights or remedies to reduce the

Pledgor's obligations under the Agreement (the Pledgor remaining liable for any amounts owing to the Secured Party after such application), subject to the Secured Party's obligation to return any surplus proceeds remaining after such obligations are satisfied in full.

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## ARTICLE NINE: GOVERNMENTAL CHARGES

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9.1 Cooperation. Each Party shall use reasonable efforts to implement the provisions of and to administer this Master Agreement in accordance with the intent of the parties to minimize all taxes, so long as neither Party is materially adversely affected by such efforts.

9.2 Governmental Charges. Seller shall pay or cause to be paid all taxes imposed by any government authority ("Governmental Charges") on or with respect to the Product or a Transaction arising prior to the Delivery Point. Buyer shall pay or cause to be paid all Governmental Charges on or with respect to the Product or a Transaction at and from the Delivery Point (other than ad valorem, franchise or income taxes which are related to the sale of the Product and are, therefore, the responsibility of the Seller). In the event Seller is required by law or regulation to remit or pay Governmental Charges which are Buyer's responsibility hereunder, Buyer shall promptly reimburse Seller for such Governmental Charges. If Buyer is required by law or regulation to remit or pay Governmental Charges which are Seller's responsibility hereunder, Buyer may deduct the amount of any such Governmental Charges from the sums due to Seller under Article 6 of this Agreement. Nothing shall obligate or cause a Party to pay or be liable to pay any Governmental Charges for which it is exempt under the law.

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## ARTICLE TEN: MISCELLANEOUS

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10.1 Term of Master Agreement. The term of this Master Agreement shall commence on the Effective Date and shall remain in effect until terminated by either Party upon (thirty) 30 days' prior written notice; provided, however, that such termination shall not affect or excuse the performance of either Party under any provision of this Master Agreement that by its terms survives any such termination and, provided further, that this Master Agreement and any other documents executed and delivered hereunder shall remain in effect with respect to the Transaction(s) entered into prior to the effective date of such termination until both Parties have fulfilled all of their obligations with respect to such Transaction(s), or such

Transaction(s) that have been terminated under Section 5.2 of this Agreement.

10.2 Representations and Warranties. On the Effective Date and the date of entering into each Transaction, each Party represents and warrants to the other Party that:

(i) it is duly organized, validly existing and in good standing under the laws of the jurisdiction of its formation;

(ii) it has all regulatory authorizations necessary for it to legally perform its obligations under this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3);

(iii) the execution, delivery and performance of this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3) are within its powers, have been duly authorized by all necessary action and do not violate any of the terms and conditions in its governing documents, any contracts to which it is a party or any law, rule, regulation, order or the like applicable to it;

(iv) this Master Agreement, each Transaction (including any Confirmation accepted in accordance with Section 2.3), and each other document executed and delivered in accordance with this Master Agreement constitutes its legally valid and binding obligation enforceable against it in accordance with its terms; subject to any Equitable Defenses.

(v) it is not Bankrupt and there are no proceedings pending or being contemplated by it or, to its knowledge, threatened against it which would result in it being or becoming Bankrupt;

(vi) there is not pending or, to its knowledge, threatened against it or any of its Affiliates any legal proceedings that could materially adversely affect its ability to perform its obligations under this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3);

(vii) no Event of Default or Potential Event of Default with respect to it has occurred and is continuing and no such event or circumstance would occur as a result of its entering into or performing its obligations under this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3);



(viii) it is acting for its own account, has made its own independent decision to enter into this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3) and as to whether this Master Agreement and each such Transaction (including any Confirmation accepted in accordance with Section 2.3) is appropriate or proper for it based upon its own judgment, is not relying upon the advice or recommendations of the other Party in so doing, and is capable of assessing the merits of and understanding, and understands and accepts, the terms, conditions and risks of this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3);

(ix) it is a "forward contract merchant" within the meaning of the United States Bankruptcy Code;

(x) it has entered into this Master Agreement and each Transaction (including any Confirmation accepted in accordance with Section 2.3) in connection with the conduct of its business and it has the capacity or ability to make or take delivery of all Products referred to in the Transaction to which it is a Party;

(xi) with respect to each Transaction (including any Confirmation accepted in accordance with Section 2.3) involving the purchase or sale of a Product or an Option, it is a producer, processor, commercial user or merchant handling the Product, and it is entering into such Transaction for purposes related to its business as such; and

(xii) the material economic terms of each Transaction are subject to individual negotiation by the Parties.

10.3 Title and Risk of Loss. Title to and risk of loss related to the Product shall transfer from Seller to Buyer at the Delivery Point. Seller warrants that it will deliver to Buyer the Quantity of the Product free and clear of all liens, security interests, claims and encumbrances or any interest therein or thereto by any person arising prior to the Delivery Point.

10.4 Indemnity. Each Party shall indemnify, defend and hold harmless the other Party from and against any Claims arising from or out of any event, circumstance, act or incident first occurring or existing during the period when control and title to Product is vested in such Party as provided in Section 10.3. Each Party shall indemnify, defend and hold harmless the other Party against any Governmental Charges for which such Party is responsible under Article Nine.

10.5 **Assignment.** Neither Party shall assign this Agreement or its rights hereunder without the prior written consent of the other Party, which consent may be withheld in the exercise of its sole discretion; provided, however, either Party may, without the consent of the other Party (and without relieving itself from liability hereunder), (i) transfer, sell, pledge, encumber or assign this Agreement or the accounts, revenues or proceeds hereof in connection with any financing or other financial arrangements, (ii) transfer or assign this Agreement to an affiliate of such Party which affiliate's creditworthiness is equal to or higher than that of such Party, or (iii) transfer or assign this Agreement to any person or entity succeeding to all or substantially all of the assets whose creditworthiness is equal to or higher than that of such Party; provided, however, that in each such case, any such assignee shall agree in writing to be bound by the terms and conditions hereof and so long as the transferring Party delivers such tax and enforceability assurance as the non-transferring Party may reasonably request.

10.6 **Governing Law.** THIS AGREEMENT AND THE RIGHTS AND DUTIES OF THE PARTIES HEREUNDER SHALL BE GOVERNED BY AND CONSTRUED, ENFORCED AND PERFORMED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK, WITHOUT REGARD TO PRINCIPLES OF CONFLICTS OF LAW. EACH PARTY WAIVES ITS RESPECTIVE RIGHT TO ANY JURY TRIAL WITH RESPECT TO ANY LITIGATION ARISING UNDER OR IN CONNECTION WITH THIS AGREEMENT.

10.7 **Notices.** All notices, requests, statements or payments shall be made as specified in the Cover Sheet. Notices (other than scheduling requests) shall, unless otherwise specified herein, be in writing and may be delivered by hand delivery, United States mail, overnight courier service or facsimile. Notice by facsimile or hand delivery shall be effective at the close of business on the day actually received, if received during business hours on a Business Day, and otherwise shall be effective at the close of business on the next Business Day. Notice by overnight United States mail or courier shall be effective on the next Business Day after it was sent. A Party may change its addresses by providing notice of same in accordance herewith.

10.8 **General.** This Master Agreement (including the exhibits, schedules and any written supplements hereto), the Party A Tariff, if any, the Party B Tariff, if any, any designated collateral, credit support or margin agreement or similar arrangement between the Parties and all Transactions (including any Confirmation accepted in accordance with Section 2.3) constitute the entire agreement between the Parties relating to the subject matter. Notwithstanding the foregoing, any collateral, credit support or margin agreement or similar arrangement between the Parties shall, upon

designation by the Parties, be deemed part of this Agreement and shall be incorporated herein by reference. This Agreement shall be considered for all purposes as prepared through the joint efforts of the parties and shall not be construed against one party or the other as a result of the preparation, substitution, submission or other event of negotiation, drafting or execution hereof. Except to the extent herein provided for, no amendment or modification to this Master Agreement shall be enforceable unless reduced to writing and executed by both Parties. Each Party agrees if it seeks to amend any applicable wholesale power sales tariff during the term of this Agreement, such amendment will not in any way affect outstanding Transactions under this Agreement without the prior written consent of the other Party. Each Party further agrees that it will not assert, or defend itself, on the basis that any applicable tariff is inconsistent with this Agreement. This Agreement shall not impart any rights enforceable by any third party (other than a permitted successor or assignee bound to this Agreement). Waiver by a Party of any default by the other Party shall not be construed as a waiver of any other default. Any provision declared or rendered unlawful by any applicable court of law or regulatory agency or deemed unlawful because of a statutory change (individually or collectively, such events referred to as "Regulatory Event") will not otherwise affect the remaining lawful obligations that arise under this Agreement; and provided, further, that if a Regulatory Event occurs, the Parties shall use their best efforts to reform this Agreement in order to give effect to the original intention of the Parties. The term "including" when used in this Agreement shall be by way of example only and shall not be considered in any way to be in limitation. The headings used herein are for convenience and reference purposes only. All indemnity and audit rights shall survive the termination of this Agreement for twelve (12) months. This Agreement shall be binding on each Party's successors and permitted assigns.

10.9 Audit. Each Party has the right, at its sole expense and during normal working hours, to examine the records of the other Party to the extent reasonably necessary to verify the accuracy of any statement, charge or computation made pursuant to this Master Agreement. If requested, a Party shall provide to the other Party statements evidencing the Quantity delivered at the Delivery Point. If any such examination reveals any inaccuracy in any statement, the necessary adjustments in such statement and the payments thereof will be made promptly and shall bear interest calculated at the Interest Rate from the date the overpayment or underpayment was made until paid; provided, however, that no adjustment for any statement or payment will be made unless objection to the accuracy thereof was made prior to the lapse of twelve (12) months from the rendition thereof, and thereafter any objection shall be deemed waived.

gations to make payments hereunder are unsubordinated obligations and such payments are (a) operating and maintenance costs (or similar designation) which enjoy first priority of payment at all times under any and all bond ordinances or indentures to which it is a party, the Act and all other relevant constitutional, organic or other governing documents and applicable law or (b) otherwise not subject to any prior claim under any and all bond ordinances or indentures to which it is a party, the Act and all other relevant constitutional, organic or other governing documents and applicable law and are available without limitation or deduction to satisfy all Governmental Entity or Public Power System' obligations hereunder and under each Transaction or (c) are to be made solely from a Special Fund, (vi) entry into and performance of this Master Agreement and each Transaction by the Governmental Entity or Public Power System will not adversely affect the exclusion from gross income for federal income tax purposes of interest on any obligation of Governmental Entity or Public Power System otherwise entitled to such exclusion, and (vii) obligations to make payments hereunder do not constitute any kind of indebtedness of Governmental Entity or Public Power System or create any kind of lien on, or security interest in, any property or revenues of Governmental Entity or Public Power System which, in either case, is proscribed by any provision of the Act or any other relevant constitutional, organic or other governing documents and applicable law, any order or judgment of any court or other agency of government applicable to it or its assets, or any contractual restriction binding on or affecting it or any of its assets.

D. The Parties agree to add the following sections to Article Three:

Section 3.4 Public Power System's Deliveries. On the Effective Date and as a condition to the obligations of the other Party under this Agreement, Governmental Entity or Public Power System shall provide the other Party hereto (i) certified

copies of all ordinances, resolutions, public notices and other documents evidencing the necessary authorizations with respect to the execution, delivery and performance by Governmental Entity or Public Power System of this Master Agreement and (ii) an opinion of counsel for Governmental Entity or Public Power System, in form and substance reasonably satisfactory to the Other Party, regarding the validity, binding effect and enforceability of this Master Agreement against Governmental Entity or Public Power System in respect of the Act and all other relevant constitutional organic or other governing documents and applicable law.

Section 3.5 No Immunity Claim. Governmental Entity or Public Power System warrants and covenants that with respect to its contractual obligations hereunder and performance thereof, it will not claim immunity on the grounds of sovereignty or similar grounds with respect to itself or its revenues or assets from (a) suit, (b) jurisdiction of court (including a court located outside the jurisdiction of its organization), (c) relief by way of injunction, order for specific performance or recovery of property, (d) attachment of assets, or (e) execution or enforcement of any judgment.

E. If the appropriate box is checked on the Cover Sheet, as an alternative to selecting one of the options under Section 8.3, the Parties agree to add the following section to Article Three:

Section 3.6 Governmental Entity or Public Power System Security. With respect to each Transaction, Governmental Entity or Public Power System shall either (i) have created and set aside a Special Fund or (ii) upon execution of this Master Agreement and prior to the commencement of each subsequent fiscal year of Governmental Entity or Public Power System during any Delivery Period, have obtained all necessary budgetary approvals and certifications for payment of all of its obligations under this Master Agreement for such fiscal year; any breach of this provision shall be deemed to have arisen during a fiscal period of Governmen-

tal Entity or Public Power System for which budgetary approval or certification of its obligations under this Master Agreement is in effect and, notwithstanding anything to the contrary in Article Four, an Early Termination Date shall automatically and without further notice occur hereunder as of such date wherein Governmental Entity or Public Power System shall be treated as the Defaulting Party. Governmental Entity or Public Power System shall have allocated to the Special Fund or its general funds a revenue base that is adequate to cover Public Power System's payment obligations hereunder throughout the entire Delivery Period.

F. If the appropriate box is checked on the Cover Sheet, the Parties agree to add the following section to Article Eight:

Section 8.4 Governmental Security. As security for payment and performance of Public Power System's obligations hereunder, Public Power System hereby pledges, sets over, assigns and grants to the other Party a security interest in all of Public Power System's right, title and interest in and to [specify collateral].

G. The Parties agree to add the following sentence at the end of Section 10.6 - Governing Law:

NOTWITHSTANDING THE FOREGOING, IN RESPECT OF THE APPLICABILITY OF THE ACT AS HEREIN PROVIDED, THE LAWS OF THE STATE OF \_\_\_\_\_<sup>2</sup> SHALL APPLY.

### **SCHEDULE P: PRODUCTS AND RELATED DEFINITIONS**

"Ancillary Services" means any of the services identified by a Transmission Provider in its transmission tariff as "ancillary services" including, but not limited to, regulation and frequency response, energy imbalance, operating reserve-spinning and operating reserve-supplemental, as may be specified in the Transaction.

<sup>2</sup> Insert relevant state for Governmental Entity or Public Power System.

“Capacity” has the meaning specified in the Transaction.

“Energy” means three-phase, 60-cycle alternating current electric energy, expressed in megawatt hours.

“Firm (LD)” means, with respect to a Transaction, that either Party shall be relieved of its obligations to sell and deliver or purchase and receive without liability only to the extent that, and for the period during which, such performance is prevented by Force Majeure. In the absence of Force Majeure, the Party to which performance is owed shall be entitled to receive from the Party which failed to deliver/receive an amount determined pursuant to Article Four.

“Firm Transmission Contingent - Contract Path” means, with respect to a Transaction, that the performance of either Seller or Buyer (as specified in the Transaction) shall be excused, and no damages shall be payable including any amounts determined pursuant to Article Four, if the transmission for such Transaction is interrupted or curtailed and (i) such Party has provided for firm transmission with the transmission provider(s) for the Product in the case of the Seller from the generation source to the Delivery Point or in the case of the Buyer from the Delivery Point to the ultimate sink, and (ii) such interruption or curtailment is due to “force majeure” or “uncontrollable force” or a similar term as defined under the applicable transmission provider’s tariff. This contingency shall excuse performance for the duration of the interruption or curtailment notwithstanding the provisions of the definition of “Force Majeure” in Section 1.23 to the contrary.

“Firm Transmission Contingent - Delivery Point” means, with respect to a Transaction, that the performance of either Seller or Buyer (as specified in the Transaction) shall be excused, and no damages shall be payable including any amounts determined pursuant to Article Four, if the transmission to the Delivery Point (in the case of Seller) or from the Delivery Point (in the case of Buyer) for such Transaction is interrupted or curtailed and (i) such Party has provided for firm transmission with the transmission provider(s) for the Product, in the case of the Seller, to be delivered to the Delivery Point or, in the case of Buyer, to be received at the Delivery Point and (ii) such interruption or curtailment is due to “force majeure” or “uncontrollable force” or a similar term as defined under the applicable transmission provider’s tariff. This transmission contingency excuses performance for the duration of the interruption or curtailment, notwithstanding the provisions of the definition of “Force Majeure” in Section 1.23 to the contrary. Interruptions or curtailments of transmission

other than the transmission either immediately to or from the Delivery Point shall not excuse performance

“Firm (No Force Majeure)” means, with respect to a Transaction, that if either Party fails to perform its obligation to sell and deliver or purchase and receive the Product, the Party to which performance is owed shall be entitled to receive from the Party which failed to perform an amount determined pursuant to Article Four. Force Majeure shall not excuse performance of a Firm (No Force Majeure) Transaction.

“Into \_\_\_\_\_ (the “Receiving Transmission Provider”), Seller’s Daily Choice” means that, in accordance with the provisions set forth below, (1) the Product shall be scheduled and delivered to an interconnection or interface (“Interface”) either (a) on the Receiving Transmission Provider’s transmission system border or (b) within the control area of the Receiving Transmission Provider if the Product is from a source of generation in that control area, which Interface, in either case, the Receiving Transmission Provider identifies as available for delivery of the Product in or into its control area; and (2) Seller has the right on a daily prescheduled basis to designate the Interface where the Product shall be delivered. An “Into” Product shall be subject to the following provisions:

1. Prescheduling and Notification. Subject to the provisions of Section 6, not later than the prescheduling deadline of 11:00 a.m. CPT on the Business Day before the next delivery day or as otherwise agreed to by Buyer and Seller, Seller shall notify Buyer (“Seller’s Notification”) of Seller’s immediate upstream counterparty and the Interface (the “Designated Interface”) where Seller shall deliver the Product for the next delivery day, and Buyer shall notify Seller of Buyer’s immediate downstream counterparty.

2. Availability of “Firm Transmission” to Buyer at Designated Interface: “Timely Request for Transmission,” “ADI” and “Available Transmission.” In determining availability to Buyer of next-day firm transmission (“Firm Transmission”) from the Designated Interface, a “Timely Request for Transmission” shall mean a properly completed request for Firm Transmission made by Buyer in accordance with the controlling tariff procedures, which request shall be submitted to the Receiving Transmission Provider no later than 30 minutes after delivery of Seller’s Notification, provided, however, if the Receiving Transmission Provider is not accepting requests for Firm Transmission at the time of Seller’s Notification, then such request by Buyer shall be made within 30



minutes of the time when the Receiving Transmission Provider first opens thereafter for purposes of accepting requests for Firm Transmission.

Pursuant to the terms hereof, delivery of the Product may under certain circumstances be redesignated to occur at an Interface other than the Designated Interface (any such alternate designated interface, an "ADI") either (a) on the Receiving Transmission Provider's transmission system border or (b) within the control area of the Receiving Transmission Provider if the Product is from a source of generation in that control area, which ADI, in either case, the Receiving Transmission Provider identifies as available for delivery of the Product in or into its control area using either firm or non-firm transmission, as available on a day-ahead or hourly basis (individually or collectively referred to as "Available Transmission") within the Receiving Transmission Provider's transmission system.

3. Rights of Buyer and Seller Depending Upon Availability of/Timely Request for Firm Transmission.

A. Timely Request for Firm Transmission made by Buyer. Accepted by the Receiving Transmission Provider and Purchased by Buyer. If a Timely Request for Firm Transmission is made by Buyer and is accepted by the Receiving Transmission Provider and Buyer purchases such Firm Transmission, then Seller shall deliver and Buyer shall receive the Product at the Designated Interface.

i. If the Firm Transmission purchased by Buyer within the Receiving Transmission Provider's transmission system from the Designated Interface ceases to be available to Buyer for any reason, or if Seller is unable to deliver the Product at the Designated Interface for any reason except Buyer's non-performance, then at Seller's choice from among the following, Seller shall: (a) to the extent Firm Transmission is available to Buyer from an ADI on a day-ahead basis, require Buyer to purchase such Firm Transmission from such ADI, and schedule and deliver the affected portion of the Product to such ADI on the basis of Buyer's purchase of Firm Transmission, or (b) require Buyer to purchase non-firm transmission, and schedule and deliver the affected portion of the Product on the basis of Buyer's purchase of non-firm transmission from the Designated Interface or an ADI designated by Seller, or (c) to the extent firm transmission is available on an hourly basis, require Buyer to purchase firm transmission, and schedule and deliver the affected portion of the Product on the basis

of Buyer's purchase of such hourly firm transmission from the Designated Interface or an ADI designated by Seller.

ii. If the Available Transmission utilized by Buyer as required by Seller pursuant to Section 3A(i) ceases to be available to Buyer for any reason, then Seller shall again have those alternatives stated in Section 3A(i) in order to satisfy its obligations.

iii. Seller's obligation to schedule and deliver the Product at an ADI is subject to Buyer's obligation referenced in Section 4B to cooperate reasonably therewith. If Buyer and Seller cannot complete the scheduling and/or delivery at an ADI, then Buyer shall be deemed to have satisfied its receipt obligations to Seller and Seller shall be deemed to have failed its delivery obligations to Buyer, and Seller shall be liable to Buyer for amounts determined pursuant to Article Four.

iv. In each instance in which Buyer and Seller must make alternative scheduling arrangements for delivery at the Designated Interface or an ADI pursuant to Sections 3A(i) or (ii), and Firm Transmission had been purchased by both Seller and Buyer into and within the Receiving Transmission Provider's transmission system as to the scheduled delivery which could not be completed as a result of the interruption or curtailment of such Firm Transmission, Buyer and Seller shall bear their respective transmission expenses and/or associated congestion charges incurred in connection with efforts to complete delivery by such alternative scheduling and delivery arrangements. In any instance except as set forth in the immediately preceding sentence, Buyer and Seller must make alternative scheduling arrangements for delivery at the Designated Interface or an ADI under Sections 3A(i) or (ii), Seller shall be responsible for any additional transmission purchases and/or associated congestion charges incurred by Buyer in connection with such alternative scheduling arrangements.

**B. Timely Request for Firm Transmission Made by Buyer but Rejected by the Receiving Transmission Provider.** If Buyer's Timely Request for Firm Transmission is rejected by the Receiving Transmission Provider because of unavailability of Firm Transmission from the Designated Interface, then Buyer shall notify Seller

within 15 minutes after receipt of the Receiving Transmission Provider's notice of rejection ("Buyer's Rejection Notice"). If Buyer timely notifies Seller of such unavailability of Firm Transmission from the Designated Interface, then Seller shall be obligated either (1) to the extent Firm Transmission is available to Buyer from an ADI on a day-ahead basis, to require Buyer to purchase (at Buyer's own expense) such Firm Transmission from such ADI and schedule and deliver the Product to such ADI on the basis of Buyer's purchase of Firm Transmission, and thereafter the provisions in Section 3A shall apply, or (2) to require Buyer to purchase (at Buyer's own expense) non-firm transmission, and schedule and deliver the Product on the basis of Buyer's purchase of non-firm transmission from the Designated Interface or an ADI designated by the Seller, in which case Seller shall bear the risk of interruption or curtailment of the non-firm transmission; provided, however, that if the non-firm transmission is interrupted or curtailed or if Seller is unable to deliver the Product for any reason, Seller shall have the right to schedule and deliver the Product to another ADI in order to satisfy its delivery obligations, in which case Seller shall be responsible for any additional transmission purchases and/or associated congestion charges incurred by Buyer in connection with Seller's inability to deliver the Product as originally prescheduled. If Buyer fails to timely notify Seller of the unavailability of Firm Transmission, then Buyer shall bear the risk of interruption or curtailment of transmission from the Designated Interface, and the provisions of Section 3D shall apply.

C. Timely Request for Firm Transmission Made by Buyer, Accepted by the Receiving Transmission Provider and not Purchased by Buyer. If Buyer's Timely Request for Firm Transmission is accepted by the Receiving Transmission Provider but Buyer elects to purchase non-firm transmission rather than Firm Transmission to take delivery of the Product, then Buyer shall bear the risk of interruption or curtailment of transmission from the Designated Interface. In such circumstances, if Seller's delivery is interrupted as a result of transmission relied upon by Buyer from the Designated Interface, then Seller shall be deemed to have satisfied its delivery obligations to Buyer, Buyer shall be deemed to have failed to receive the Product and Buyer shall be liable to Seller for amounts determined pursuant to Article Four.

D. No Timely Request for Firm Transmission Made by Buyer, or Buyer Fails to Timely Send Buyer's Rejection Notice. If Buyer fails to make a Timely Request for Firm Transmission or

Buyer fails to timely deliver Buyer's Rejection Notice, then Buyer shall bear the risk of interruption or curtailment of transmission from the Designated Interface. In such circumstances, if Seller's delivery is interrupted as a result of transmission relied upon by Buyer from the Designated Interface, then Seller shall be deemed to have satisfied its delivery obligations to Buyer, Buyer shall be deemed to have failed to receive the Product and Buyer shall be liable to Seller for amounts determined pursuant to Article Four.

4. Transmission.

A. Seller's Responsibilities. Seller shall be responsible for transmission required to deliver the Product to the Designated Interface or ADI, as the case may be. It is expressly agreed that Seller is not required to utilize Firm Transmission for its delivery obligations hereunder, and Seller shall bear the risk of utilizing non-firm transmission. If Seller's scheduled delivery to Buyer is interrupted as a result of Buyer's attempted transmission of the Product beyond the Receiving Transmission Provider's system border, then Seller will be deemed to have satisfied its delivery obligations to Buyer, Buyer shall be deemed to have failed to receive the Product and Buyer shall be liable to Seller for damages pursuant to Article Four.

B. Buyer's Responsibilities. Buyer shall be responsible for transmission required to receive and transmit the Product at and from the Designated Interface or ADI, as the case may be, and except as specifically provided in Section 3A and 3B, shall be responsible for any costs associated with transmission therefrom. If Seller is attempting to complete the designation of an ADI as a result of Seller's rights and obligations hereunder, Buyer shall co-operate reasonably with Seller in order to effect such alternate designation.

5. Force Majeure. An "Into" Product shall be subject to the "Force Majeure" provisions in Section 1.23.

6. Multiple Parties in Delivery Chain Involving a Designated Interface. Seller and Buyer recognize that there may be multiple parties involved in the delivery and receipt of the Product at the Designated Interface or ADI to the extent that (1) Seller may be purchasing the Product from a succession of other sellers ("Other Sellers"), the first of which Other Sellers shall be causing the Product to be generated from a source ("Source Seller") and/or (2) Buyer may be selling the Product to a succession of other buyers ("Other Buyers"), the last of which Other Buyers

shall be using the Product to serve its energy needs ("Sink Buyer"). Seller and Buyer further recognize that in certain Transactions neither Seller nor Buyer may originate the decision as to either (a) the original identification of the Designated Interface or ADI (which designation may be made by the Source Seller) or (b) the Timely Request for Firm Transmission or the purchase of other Available Transmission (which request may be made by the Sink Buyer). Accordingly, Seller and Buyer agree as follows:

A. If Seller is not the Source Seller, then Seller shall notify Buyer of the Designated Interface promptly after Seller is notified thereof by the Other Seller with whom Seller has a contractual relationship, but in no event may such designation of the Designated Interface be later than the prescheduling deadline pertaining to the Transaction between Buyer and Seller pursuant to Section 1.

B. If Buyer is not the Sink Buyer, then Buyer shall notify the Other Buyer with whom Buyer has a contractual relationship of the Designated Interface promptly after Seller notifies Buyer thereof, with the intent being that the party bearing actual responsibility to secure transmission shall have up to 30 minutes after receipt of the Designated Interface to submit its Timely Request for Firm Transmission.

C. Seller and Buyer each agree that any other communications or actions required to be given or made in connection with this "Into Product" (including without limitation, information relating to an ADI) shall be made or taken promptly after receipt of the relevant information from the Other Sellers and Other Buyers, as the case may be.

D. Seller and Buyer each agree that in certain Transactions time is of the essence and it may be desirable to provide necessary information to Other Sellers and Other Buyers in order to complete the scheduling and delivery of the Product. Accordingly, Seller and Buyer agree that each has the right, but not the obligation, to provide information at its own risk to Other Sellers and Other Buyers, as the case may be, in order to effect the prescheduling, scheduling and delivery of the Product

"Native Load" means the demand imposed on an electric utility or an entity by the requirements of retail customers located within a franchised service territory that the electric utility or entity has statutory obligation to serve.

“Non-Firm” means, with respect to a Transaction, that delivery or receipt of the Product may be interrupted for any reason or for no reason, without liability on the part of either Party.

“System Firm” means that the Product will be supplied from the owned or controlled generation or pre-existing purchased power assets of the system specified in the Transaction (the “System”) with non-firm transmission to and from the Delivery Point, unless a different Transmission Contingency is specified in a Transaction. Seller’s failure to deliver shall be excused: (i) by an event or circumstance which prevents Seller from performing its obligations, which event or circumstance was not anticipated as of the date the Transaction was agreed to, which is not within the reasonable control of, or the result of the negligence of, the Seller; (ii) by Buyer’s failure to perform; (iii) to the extent necessary to preserve the integrity of, or prevent or limit any instability on, the System; (iv) to the extent the System or the control area or reliability council within which the System operates declares an emergency condition, as determined in the system’s, or the control area’s, or reliability council’s reasonable judgment; or (v) by the interruption or curtailment of transmission to the Delivery Point or by the occurrence of any Transmission Contingency specified in a Transaction as excusing Seller’s performance. Buyer’s failure to receive shall be excused (i) by Force Majeure; (ii) by Seller’s failure to perform, or (iii) by the interruption or curtailment of transmission from the Delivery Point or by the occurrence of any Transmission Contingency specified in a Transaction as excusing Buyer’s performance. In any of such events, neither party shall be liable to the other for any damages, including any amounts determined pursuant to Article Four.

“Transmission Contingent” means, with respect to a Transaction, that the performance of either Seller or Buyer (as specified in the Transaction) shall be excused, and no damages shall be payable including any amounts determined pursuant to Article Four, if the transmission for such Transaction is unavailable or interrupted or curtailed for any reason, at any time, anywhere from the Seller’s proposed generating source to the Buyer’s proposed ultimate sink, regardless of whether transmission, if any, that such Party is attempting to secure and/or has purchased for the Product is firm or non-firm. If the transmission (whether firm or non-firm) that Seller or Buyer is attempting to secure is from source to sink is unavailable, this contingency excuses performance for the entire Transaction. If the transmission (whether firm or non-firm) that Seller or Buyer has secured from source to sink is interrupted or curtailed for any reason, this contingency excuses performance for the duration of the interruption or curtailment notwithstanding the provisions of the definition of “Force Majeure” in Article 1.23 to the contrary.

“Unit Firm” means, with respect to a Transaction, that the Product subject to the Transaction is intended to be supplied from a generation asset or assets specified in the Transaction. Seller’s failure to deliver under a “Unit Firm” Transaction shall be excused: (i) if the specified generation asset(s) are unavailable as a result of a Forced Outage (as defined in the NERC Generating Unit Availability Data System (GADS) Forced Outage reporting guidelines) or (ii) by an event or circumstance that affects the specified generation asset(s) so as to prevent Seller from performing its obligations, which event or circumstance was not anticipated as of the date the Transaction was agreed to, and which is not within the reasonable control of, or the result of the negligence of, the Seller or (iii) by Buyer’s failure to perform. In any of such events, Seller shall not be liable to Buyer for any damages, including any amounts determined pursuant to Article Four.

**EXHIBIT A**

**MASTER POWER PURCHASE AND SALE AGREEMENT  
CONFIRMATION LETTER**

This confirmation letter shall confirm the Transaction agreed to on \_\_\_\_\_, \_\_\_ between \_\_\_\_\_ (“Party A”) and \_\_\_\_\_ (“Party B”) regarding the sale/purchase of the Product under the terms and conditions as follows:

Seller: \_\_\_\_\_

Buyer: \_\_\_\_\_

Product:

**Into \_\_\_\_\_, Seller’s Daily Choice**

**Firm (LD)**

**Firm (No Force Majeure)**

**System Firm**

(Specify System: \_\_\_\_\_)

**Unit Firm**

(Specify Unit(s): \_\_\_\_\_)

**Other \_\_\_\_\_**

**Transmission Contingency (If not marked, no transmission contingency)**

**FT-Contract Path Contingency**       **Seller**       **Buyer**

**FT-Delivery Point Contingency**       **Seller**       **Buyer**

**Transmission Contingent**       **Seller**       **Buyer**

**Other transmission contingency**

(Specify: \_\_\_\_\_)

Contract Quantity: \_\_\_\_\_

Delivery Point: \_\_\_\_\_

Contract Price:

Energy Price: \_\_\_\_\_

Other Charges: \_\_\_\_\_



Confirmation Letter

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Delivery Period: \_\_\_\_\_

Special Conditions: \_\_\_\_\_

Scheduling: \_\_\_\_\_

Option Buyer: \_\_\_\_\_

Option Seller: \_\_\_\_\_

Type of Option: \_\_\_\_\_

Strike Price: \_\_\_\_\_

Premium: \_\_\_\_\_

Exercise Period: \_\_\_\_\_

This confirmation letter is being provided pursuant to and in accordance with the Master Power Purchase and Sale Agreement dated \_\_\_\_\_ (the "Master Agreement") between Party A and Party B, and constitutes part of and is subject to the terms and provisions of such Master Agreement. Terms used but not defined herein shall have the meanings ascribed to them in the Master Agreement.

[Party A]

[Party B]

Name: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Title: \_\_\_\_\_

Phone No: \_\_\_\_\_

Phone No: \_\_\_\_\_

Fax: \_\_\_\_\_

Fax: \_\_\_\_\_

