ISDA and its Commodity Annexes: The New EEI or NAESB?

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In the energy commodity industry, the NAESB Base Contract for Sale and Purchase of Natural Gas (“NAESB”)\(^1\) is commonly used to document natural gas (“Gas”) transactions, the EEI Master Power Purchase and Sale Agreement (the “EEI”)\(^2\) is commonly used to document power transactions, and the ISDA Master Agreement (“ISDA”) is commonly used to document derivative transactions.\(^3\)

In recent years, the ISDA also has been used to document Gas and power transactions through the use of the Gas Annex and the Power Annex. Because the ISDA Gas Annex and Power Annex contain provisions similar to the NAESB and EEI (respectively), parties using the ISDA can buy and sell Gas and power on industry-familiar terms while receiving the benefits of trading various physical and financial energy products under a single master agreement. Such benefits have caused the ISDA and its Commodity Annexes to become more widely-used in the energy industry.\(^4\)

As use of the ISDA becomes more prevalent in Gas and power markets, it is imperative that industry participants understand the differences between the ISDA, NAESB and EEI. A party may have ISDA, NAESB and EEI agreements, and multiple versions of each, outstanding with the same counterparty at the same time. Minor differences between such trading agreements could create risk for a party transacting under different agreements. Parties can

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\(^1\) For purposes herein, (i) all citations and references to the “2002 NAESB” shall be to the version published by the North American Energy Standards Board, Inc. on April 19, 2002; (ii) all citations and references to the “2006 NAESB” shall be to the version published by the North American Energy Standards Board, Inc. on September 5, 2006; and (iii) all citations and references to “NAESB” shall be to (a) both the 2002 NAESB and 2006 NAESB, collectively, and/or (b) the North American Energy Standards Board, in each case as appropriate herein.

\(^2\) For purposes herein, all citations and references to “EEI” shall be to (a) the Master Power Purchase and Sale Agreement published by the Edison Electric Institute and National Energy Marketers Association, version 2.1 (modified March 3, 2000); and/or (b) the Edison Electric Institute, in each case as appropriate herein.

\(^3\) For purposes herein, (i) all citations and references to the “ISDA Master Agreement” or the “1992 ISDA” shall be to 1992 Master Agreement (Multicurrency-Cross Border) published by the International Swaps and Derivatives Association, Inc. (“ISDA”); (ii) all citations and references to the “2002 ISDA” shall be to the 2002 Master Agreement (Multicurrency-Cross Border) published by ISDA; (iii) all citations and references to the “ISDA Schedule” shall be to the ISDA Schedule to the Master Agreement, which forms part of the ISDA Master Agreement; (iv) all citations and references to the “ISDA CSA” shall be to the 1994 Credit Support Annex published by ISDA; (v) all citations and references to the “Gas Annex” shall be to the ISDA North American Gas Annex published by ISDA in 2004; (vi) all citations and references to the “Power Annex” shall be to the North American Power Annex published by ISDA in 2003; and (vii) all citations and references to “ISDA” shall be to (a) the collective ISDA Agreement, including the ISDA Master Agreement (whether the 1992 or 2002 form), the ISDA Schedule, the ISDA CSA, and any other Annexes or documents the parties may elect to incorporate thereunder; and/or (b) the International Swaps and Derivatives Association, in each case as appropriate herein.

\(^4\) This paper focuses on the use of the ISDA to trade Gas under the Gas Annex and power under the Power Annex. Accordingly, for purposes of this paper, the term “Commodity Annexes” refers to the ISDA Gas Annex and Power Annex. Please note, however, that ISDA also has published other annexes to facilitate the purchase and sale of various commodities. For example, ISDA has published a U.S. Crude Oil and Refined Petroleum Products Annex (the “Crude Oil Annex”), a U.S. Emissions Allowance Transaction Annex (the “Emissions Annex”), and a Global Physical Coal Annex (the “Coal Annex”). For a complete list of ISDA publications, please visit the ISDA website at http://www.isda.org/publications/pubguide.aspx.
mitigate such risks by modifying the concepts contained in trading contracts to promote consistency across agreements. However, parties first must be aware of the numerous trading risks created by such differences.5

The purpose of this paper is to (i) discuss the use of the ISDA Gas Annex and Power Annex in relation to the NAESB and EEI, respectively; and (ii) analyze differences among the ISDA and its Commodity Annexes, the NAESB and the EEI that could create trading risk due to inconsistent terms among such agreements.6

I. Use of the ISDA Commodity Annexes: A Growing Trend

A. Drafting the ISDA Commodity Annexes with EEI and NAESB

In 2003, ISDA and EEI announced the publication of the ISDA Power Annex “to enable market participants to enter into physical power purchases and sales as well as financial derivative transactions under one agreement.”7 Drafted through a combined effort of the EEI and ISDA, the Power Annex is intentionally structured to incorporate EEI provisions applicable to physical power transactions that are not otherwise covered in the ISDA.8 Such consistency across the EEI and Power Annex promotes market efficiency in documenting transactions and reduces risk across agreements, allowing parties to execute physical power transactions under the structure of the ISDA while adhering to prevailing market standards otherwise set forth in the EEI.9

Shortly after the release of the Power Annex, ISDA announced the publication of the ISDA Gas Annex in 2004.10 The Gas Annex was drafted with the assistance of NAESB and incorporates most of the NAESB terms relating to Gas deliveries that are not otherwise covered in the ISDA, thereby permitting market participants to document ISDA Gas trades in a manner

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5 E.g., to avoid gaps between various energy contracts, parties may wish to amend the terms of form trading agreements by incorporating special provisions or additional elections that are consistent throughout such party’s energy transactions.

6 Though differences exist between the various credit documents associated with the NAESB, EEI and ISDA (such as the NAESB’s Credit Support Addendum (the “NAESB CSA”), the EEI’s Collateral Annex, and the ISDA CSA), an analysis of the distinctions between such credit documents is beyond the scope of this paper. Similarly, a detailed analysis comparing the differences between the 2002 and 2006 NAESB and the 1992 and 2002 ISDA is beyond the scope of this paper.


8 E.g., clauses (b)-(c), (d)-(e), (f) and (g) of the Power Annex are similar to Articles 3-4, 6-7, 9 and Sections 10.3-10.4 of the EEI Master Agreement, respectively.

9 See supra note 7 (“The Power Annex will promote efficiencies in the execution of power transactions and reduce documentation basis risk for participants in the North American power market.”) (quoting Steven Bunkin, then Vice President and Associate General Counsel, Goldman, Sachs & Co and Chair of ISDA’s North American Energy and Developing Products Committee); (“Standardization of key contract terms and products promotes greater liquidity in the power market and less risk to market participants….Integrating the energy industry’s standard agreement into the ISDA Master Agreement will help promote market stability and reduce party, systemic, legal and credit risk.”) (quoting Edward Comer, then Vice President and General Counsel of EEI).

consistent with the NAESB.\textsuperscript{11} The similarities between the ISDA Gas Annex and the NAESB advance greater efficiency in the Gas marketplace. Parties can streamline the documentation of Gas transactions by simply incorporating a Gas Annex into an existing ISDA framework, while ensuring that the terms governing such Gas transactions align with industry-standard NAESB provisions.

B. Benefits of the ISDA

Unlike the NAESB and EEI, the ISDA allows parties to trade numerous physical and financial energy products under a single master agreement.\textsuperscript{12} The benefits inherent to the ISDA’s single-agreement structure often prompt market participants to use a Gas Annex and/or a Power Annex instead of, or in addition to, the NAESB and/or the EEI.

1. Collateral and Payment Obligations

One of the most important benefits of using the ISDA is the impact on a party’s collateral and payment obligations. Parties engaging in physical and derivative Gas and power transactions under the ISDA are able to net payment and collateral obligations under all transactions.\textsuperscript{13} This can lead to greater efficiencies in managing accounts payable and receivable, as well as preserving capital and improving cash flow because parties do not have to manage separate collateral streams under various NAESB, EEI and ISDA agreements. Other mechanisms exist to allow cross-commodity netting and collateralization,\textsuperscript{14} but the ISDA with its Gas and Power Annexes are gaining popularity as the most common means of achieving these goals.\textsuperscript{15}

2. Cross-Product Setoff Under Single Agreement

Another benefit of trading multiple products under the ISDA relates to the exercise of setoff rights. Setoff provisions generally allow a non-defaulting party to offset amounts owed to it against amounts owed by it to the defaulting party. If a party has multiple energy trading agreements with a counterparty, it may include a setoff provision in one, several, or all such agreements in order to setoff amounts owed under contracts for different energy products\textsuperscript{16} or to setoff physical transactions against financial transactions.\textsuperscript{17} If setoff rights vary across a party’s

\textsuperscript{11} Id.

\textsuperscript{12} E.g., parties using an ISDA to document interest rate swaps also may use the same ISDA to enter into physical Gas and/or power transactions through the Gas Annex and Power Annex, respectively.

\textsuperscript{13} See ISDA § 2(c) and ISDA CSA, Paragraph 12, definition of “Exposure” (defining Exposure with respect to all Transactions under the ISDA); see also discussion infra at Section II(A)(2).

\textsuperscript{14} See, e.g., the EEI Master Netting, Setoff, Security, and Collateral Agreement, version 1.2 (published by EEI in January 2003).

\textsuperscript{15} Reasons for this popularity include the complexity of master netting agreements, the desire to include the sophisticated credit terms of the ISDA CSA in physical transactions and the relative ease of entering into the Gas and/or Power Annex if an ISDA agreement has already been executed.

\textsuperscript{16} E.g., parties may wish to setoff amounts owed under a NAESB contract for Gas transactions against amounts owed under an EEI agreement for power transactions.

\textsuperscript{17} E.g., parties may wish to setoff amounts owed under a NAESB contract for Gas transactions against amounts owed under an ISDA agreement for derivative transactions.
trading agreements, however, such party may not be able to realize the full benefit of setoff across all outstanding transactions and products. Instead, setoff rights may be limited to a particular agreement, potentially creating separate payment obligations across a party’s trading positions. This is particularly important if the defaulting party is bankrupt, as independent payment obligations across agreements increase the likelihood that the non-defaulting party must pay amounts to the insolvent counterparty.

Because the ISDA’s framework anticipates both physical and financial transactions under a single integrated agreement, a non-defaulting party is able to setoff obligations across all ISDA transactions and products to arrive at a single net sum payable thereunder. Such cross-product setoff directly minimizes a party’s payment obligations on a portfolio-wide, rather than an agreement-by-agreement, basis. Moreover, in the context of bankruptcy, it allows the non-defaulting party to reduce its entanglement in bankruptcy proceedings and minimizes any payment the non-defaulting party may be required to make to the debtor.

3. Streamlined Negotiation Process

To the extent parties are trading under an existing ISDA, the incorporation of a Gas Annex and/or Power Annex may be particularly attractive because the Annexes are fairly easy to incorporate into the Agreement. By avoiding any lengthy negotiation of separate NAESB and/or EEI agreements, parties are able to more quickly enter into Gas and power transactions. Even if a party has NAESB and/or EEI agreements in place with various counterparties, it still may consider entering into an ISDA with a Gas Annex and/or Power Annex to govern existing and/or future transactions because of the benefits inherent to the ISDA’s structure.

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18 E.g., if parties have entered into a NAESB for Gas transactions, an EEI for power transactions and an ISDA for derivative transactions, each with varying setoff provisions, the non-defaulting party may be limited to setting off obligations with respect to each contract, thus creating three separate payment obligations with the same counterparty.

19 E.g., Party A and Party B enter into a NAESB, EEI and ISDA with inconsistent setoff provisions. Party B files for bankruptcy, and Party A declares an early termination date under each of the agreements. In calculating the termination payments under each agreement, Party A owes Party B $4,000,000 under the NAESB, Party B owes Party A $6,000,000 under the EEI, and Party A owes Party B $1,000,000 under the ISDA. Because of the inconsistent setoff provisions in each trading agreement, Party A may not be able to setoff amounts across all of its trading agreements with Party B. Instead, Party A would be required to pay $5,000,000 to an insolvent Party B in bankruptcy, and Party B would be required to pay Party A $6,000,000 (which would likely be reduced by the bankruptcy court). If the Parties instead had used an ISDA to document their Gas, power and derivative transactions, then Party A would be able to setoff the above-stated Gas, power and derivative payment obligations in order to reach a single amount of $1,000,000 payable by Party B to Party A under the ISDA.

20 Id; see also discussion infra at Section II(A)(8).

21 E.g., to the extent that the parties have already negotiated and executed an ISDA Master Agreement and Schedule, such negotiated terms generally are not modified unless expressly stated in the Gas Annex or Power Annex. Thus, the parties make necessary elections and modifications to the Gas Annex and Power Annex (if any), and incorporate such Annexes as part of the previously-negotiated ISDA Schedule.
II. Gap Risks Across the ISDA, NAESB and EEI

A. 2002 NAESB Compared to ISDA Gas Annex

1. Confirmation Procedures

The 2002 NAESB allows the parties to elect on the Cover Sheet whether a Gas transaction shall be formed through an “Oral Transaction Procedure” or a “Written Transaction Procedure.” The Oral Transaction Procedure provides that a transaction is formed and the parties are legally bound when the parties agree to a transaction’s commercial terms by telephone or electronic data interchange transmission. Such oral agreement is considered a “writing” and deemed to be “signed” by the parties. Though the NAESB requires that the Confirming Party (as designated in the Cover Sheet) send a Transaction Confirmation to the other party reflecting such commercial terms, the failure to send a Transaction Confirmation does not affect the parties’ obligations to perform under the Contract.

Alternatively, the Written Transaction Procedure requires that the parties exchange non-conflicting written Transaction Confirmations before a transaction is formed and the parties are legally obligated to perform under the NAESB.

If a Transaction Confirmation sent by the Confirming Party is materially different from the receiving party’s understanding of any transaction terms, the receiving party must notify the Confirming Party by the Confirm Deadline (as designated by the parties on the Cover Sheet) or the Transaction Confirmation will be deemed to reflect the binding agreement of the parties.

To facilitate the formation of a transaction by either the Oral or Written Transaction Procedure, Section 1.4 of the 2002 NAESB includes a stipulation that either party may electronically record all telephone conversations between the parties with respect to any NAESB transaction without further notice to the other party.

Similar to the NAESB, the ISDA contemplates that the parties shall be legally bound by the terms of each Transaction from the moment they agree to commercial terms (whether orally or otherwise), and shall confirm Transactions in writing as soon as reasonably practicable.
through the use of Confirmations. However, the specific details concerning the formation of Transactions and the exchange of Confirmations clearly articulated under the NAESB are not similarly incorporated into the ISDA Master Agreement or Gas Annex. Accordingly, many parties often negotiate and incorporate Confirmation terms and procedures into the ISDA Schedule similar to Confirmation terms and procedures found under the NAESB.

In determining whether to incorporate an oral or written transaction procedure in its energy trading agreements, a party may wish to consider whether the applicable transaction (or the relationship with the counterparty) is short-term or long-term. Oral transaction procedures under the NAESB may be more desirable to a party in the context of a short-term transaction where speed in forming a deal is paramount. This may be particularly useful to parties when confronted with the risk that a transaction’s commercial terms are volatile. On the other hand, a written transaction procedure requires the parties to clearly articulate and agree on the commercial terms of a transaction before becoming legally bound to perform, thus minimizing the risk that parties disagree on future performance obligations under a transaction.

2. **Netting**

Section 7.7 of the 2002 NAESB provides that all payments due and owing (and/or past due) between the parties under the Contract shall be netted into a single amount, such that the party owing the greater amount shall make a single payment of the net amount owed to the other party as and when required under the NAESB. Notably, the NAESB does not limit netting to amounts owed under a single transaction between the parties.

In contrast, Section 2(c) of the ISDA Master Agreement expressly limits netting to amounts (i) due on the same date; (ii) due in the same currency; and (iii) due in respect of the same Transaction. However, the ISDA clearly anticipates that the parties may wish to modify such default netting provision through the ISDA Schedule or a Confirmation, stating that the parties can elect to net amounts owed with respect to all amounts payable on the same date in the same currency with respect to two or more Transactions. If trading under multiple agreements, a party may wish to ensure that all of its trading contracts contain consistent netting provisions, thus minimizing the operational risk that payments under any agreement are incorrectly calculated or delivered to the counterparty.

3. **Notices**

Section 9 of the 2002 NAESB concerns the manner of providing Notices and the dates on which such Notices are deemed delivered by a party. Section 9.2 states that Notices may be sent by “facsimile or mutually acceptable electronic means, a nationally recognized overnight courier service, first class mail or hand delivered.” Section 9.3 generally provides that Notices are

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31 ISDA Master Agreement § 9.2(e)(ii); see recitals to ISDA Master Agreement, defining “Confirmation” as “documents and other confirming evidence exchanged between the parties confirming [ISDA] Transactions.”

32 ISDA Master Agreement § 2(c).

33 E.g., if a party is consistently netting across transactions with a counterparty under a NAESB, it may create operational risk if such party is not permitted to net across all transactions with the same counterparty under an ISDA.
deemed delivered when received on a Business Day by the addressee. However, if proof of actual receipt is not available, Notices are expressly subject to the following presumptions:

(i) Notice by facsimile shall be deemed to have been received upon the sending party’s receipt of its facsimile machine’s confirmation of successful transmission. If a facsimile is received after 5:00 p.m. on a Business Day or is not otherwise received on a Business Day, the date of receipt shall be the next following Business Day;

(ii) Notice by overnight mail or courier shall be deemed to have been received on the next following Business Day after such Notice was sent, or earlier as confirmed by the receiving party; and

(iii) Notice by first class mail shall be deemed to have been delivered five (5) Business Days after mailing.\(^{34}\)

The dates that Notices are deemed to be delivered and received becomes important under the operation of the NAESB, as the sending of Notices may directly impact the timing of Events of Default and designation of an Early Termination Date under the Contract. Timing requirements or other administrative procedures regarding Notices increase the risk that a Non-Defaulting Party may not be able to exercise its early termination rights as quickly as desired, thus potentially increasing the Non-Defaulting Party’s market and credit risk to the Defaulting Party.

Though the Gas Annex does not contain express provisions concerning the manner, method and delivery of notice with respect to Gas Transactions as in the NAESB, the ISDA Master Agreement contains notice provisions affecting all ISDA Transactions—including those for the purchase and sale of Gas. Section 12(a) of the ISDA Master Agreement provides that any notice under the ISDA may be provided by the following relevant methods and shall be deemed delivered as follows:

(i) Notices in writing and delivered by person or courier shall be effective on the date it is delivered;

(ii) Notices sent by facsimile transmission shall be effective on the date such transmission is received by a responsible employee of the recipient in legible form. The burden of proving receipt shall be on the sender, and receipt cannot be conclusively shown through a transmission report generated by the sender’s facsimile machine;

(iii) Notices sent by certified or registered mail or the equivalent (return receipt requested) shall be deemed delivered on the date such mail is delivered or its delivery is attempted; and

\(^{34}\) 2002 NAESB § 9.3.
(iv) Notices sent by electronic messaging system shall be deemed delivered on the date such electronic message is received.\textsuperscript{35}

In addition to the above, the 2002 ISDA also contemplates that notices sent by e-mail shall be deemed effective on the date delivered.\textsuperscript{36}

The above-stated notice provisions differ from the NAESB’s requirements, particularly with respect to the dates in which notices by facsimile are deemed delivered and received.\textsuperscript{37} Moreover, unlike the NAESB, the ISDA clarifies that any notices or other communications sent with respect to Events of Default (under Section 5 of the ISDA Master Agreement) or termination of the Agreement (under Section 6 of the ISDA Master Agreement) may not be provided by facsimile, electronic messaging system or e-mail.\textsuperscript{38} As a result, parties should be cognizant of the need to potentially deliver different types of notices under various trading agreements, even if such notices relate to the same counterparty and the same Event of Default. To avoid the operational risk that the timing, manner or method of a party’s notice is ineffective or insufficient under a relevant agreement, parties may wish to ensure that its trading contracts contain consistent notice provisions.

4. \textit{Credit Obligations}

The 2002 NAESB allows either party to demand Adequate Assurance of Performance if at any time such party has reasonable grounds for insecurity regarding the performance of the other party’s obligations under the contract, whether or not such obligations are then due.\textsuperscript{39} Importantly, the NAESB does not define what constitutes “reasonable grounds for insecurity” other than stating that such phrase includes “a material change in the creditworthiness” of the other party.\textsuperscript{40} The Adequate Assurance of Performance concept in Section 10.1 of the 2002 NAESB is the only provision expressly providing credit security to the parties, apart from any NAESB CSA the parties may elect to incorporate into the Contract.

The ISDA Gas Annex has no provision allowing for Adequate Assurance of Performance or other form of credit protection, thus creating potential credit and settlement risk under a Transaction. To avoid such risks, parties to the ISDA often enter into a Gas Annex in conjunction with an ISDA CSA. Although the ISDA CSA does not contain an Adequate Assurance of Performance provision similar to the 2002 NAESB, it does contain other forms of credit protection such as threshold margining.\textsuperscript{41}

\textsuperscript{35} ISDA Master Agreement § 12(a).
\textsuperscript{36} 2002 ISDA § 12(a)(vi).
\textsuperscript{37} E.g., the ISDA squarely places the burden of proving receipt of a facsimile upon the sending party, but expressly provides that a facsimile confirmation does not meet such burden. ISDA Master Agreement § 12(a)(iii). The NAESB directly contradicts such ISDA provision, stating that notice by facsimile shall be deemed to be received when the sending party receives a facsimile confirmation from its machine. 2002 NAESB § 9.3.
\textsuperscript{38} 1992 ISDA § 12(a) (preventing such notices by “facsimile or electronic messaging system”); 2002 ISDA § 12(a) (preventing such notices by “electronic messaging system or e-mail”).
\textsuperscript{39} 2002 NAESB § 10.1.
\textsuperscript{40} Id.
\textsuperscript{41} See, e.g., ISDA CSA, Paragraph 3.
5. *Events of Default and Termination Events*

Both the 2002 NAESB and the Gas Annex (in conjunction with the ISDA Master Agreement) generally provide that a party may terminate and liquidate outstanding Gas transactions upon the occurrence and continuation of an Event of Default.\(^{42}\) However, because the structure of the Gas Annex differs from the structure of the NAESB, the specific acts constituting Events of Default under each agreement differ as well. For example, the Gas Annex does not contain any Events of Default, but instead generally relies on the Events of Default specified in the ISDA Master Agreement. Because the ISDA Master Agreement is intended to provide a framework facilitating various types of transactions (e.g., both physical and financial deals with respect to any number of commodities), the Events of Default and Termination Events set forth under the ISDA Master Agreement (which apply to Transactions under the Gas Annex) are much broader in scope than the Events of Default provided in the 2002 NAESB.\(^{43}\)

The 2002 NAESB contains Events of Default relating to bankruptcy and insolvency, as well as a party’s failure to make payments under the Contract or any Credit Support Obligation.\(^{44}\) Similarly, Section 5(a) of the ISDA Master Agreement contains Events of Default relating to a party’s failure to pay, the breach of obligations under Credit Support Documents, and bankruptcy-related events indicating a party’s insolvency.\(^{45}\) However, unlike the 2002 NAESB, the ISDA contains other Events of Default which may be implicated in Transactions entered into under the Gas Annex, such as (i) breaches of the Agreement (other than a failure to pay) (“Breach of Agreement”);\(^{46}\) (ii) misrepresentations concerning the Agreement or any Credit Support Document (“Misrepresentation”);\(^{47}\) (iii) defaults by a party, its Credit Support Provider or any Specified Entity of the party with respect to any Specified Transaction (such as rates, swaps, options, or other Transactions designated by the parties) (“Default Under Specified Transaction”);\(^{48}\) (iv) defaults by a party or its Credit Support Provider with respect to agreements

\(^{42}\) 2002 NAESB § 10.3; ISDA Master Agreement § 6(a).

\(^{43}\) Compare ISDA Master Agreement §§ 5(a) and (b) to 2002 NAESB § 10.2.

\(^{44}\) 2002 NAESB §§ 10.2(i) – (vi) and (viii).

\(^{45}\) ISDA Master Agreement §§ 5(a)(i), (iii) and (vii). Notably, with respect to a party’s filing of bankruptcy, the ISDA incorporates a 30-day waiting period not otherwise found in the NAESB, such that an ISDA Event of Default will not occur after a bankruptcy petition is filed by or against a party if the petition is dismissed within thirty (30) days after instituted.

\(^{46}\) ISDA Master Agreement § 5(a)(ii) (“Failure by the party to comply with or perform any agreement or obligation (other than an obligation to make any payment under this Agreement or delivery under Section 2(a)(i) or 2(e) or to give notice of a Termination Event or any agreement or obligation under Section 4(a)(i), 4(a)(iii) or 4(d)) to be complied with or performed by the party in accordance with this Agreement if such failure is not remedied on or before the thirtieth day after notice of such failure is given to the party”). Notably, clause (j)(ii) of the Gas Annex amends the Event of Default under § 5(a)(ii) to exclude any failure to deliver or receive Gas as a party’s exclusive remedy for failure to deliver or receive Gas is liquidated damages pursuant to clause (b)(ii) of the Gas Annex.

\(^{47}\) ISDA Master Agreement § 5(a)(iv) (“A representation (other than a representation under Section 3(e) or (f)) made or repeated or deemed to have been made or repeated by the party or any Credit Support Provider of such party in this Agreement or any Credit Support Document proves to have been incorrect or misleading in any material respect when made or repeated or deemed to have been made or repeated”).

\(^{48}\) ISDA Master Agreement § 5(a)(v) (“The party, any Credit Support Provider of such party or any applicable Specified Entity of such party (1) defaults under a Specified Transaction and, after giving effect to any applicable notice requirement or grace period, there occurs a liquidation of, an acceleration of obligations under, or an early
or instruments relating to Specified Indebtedness (such as bank debt or other forms of debt specified by the parties) ("Cross Default");\textsuperscript{49} and (v) situations where a party or its Credit Support Provider merges with or transfers substantially all of its assets to another entity, and such transferee entity does not assume the transferor’s obligations under the ISDA Agreement ("Merger Without Assumption").\textsuperscript{50}

In addition to Events of Default, the ISDA Master Agreement also contains Termination Events, the occurrence of which may give rise to the termination and liquidation of Transactions entered into under the Gas Annex that are affected by the Termination Event. Examples of Termination Events under the ISDA include (i) when the passage of laws or other regulations prevent the parties’ performance under the Agreement ("Illegality");\textsuperscript{51} (ii) when a change in tax laws or actions by taxing authorities would require a party to either pay more (or deduct from

\textsuperscript{49} ISDA Master Agreement § 5(a)(vi) ("If “Cross Default” is specified in the Schedule as applying to the party, the occurrence or existence of (1) a default, event of default or other similar condition or event (however described) in respect of such party, any Credit Support Provider of such party or any applicable Specified Entity of such party under one or more agreements or instruments relating to Specified Indebtedness of any of them (individually or collectively) in an aggregate amount of not less than the applicable Threshold Amount (as specified in the Schedule) which has resulted in such Specified Indebtedness becoming, or becoming capable at such time of being declared, due and payable under such agreements or instruments, before it would otherwise have been due and payable or (2) a default by such party, such Credit Support Provider or such Specified Entity (individually or collectively) in making one or more payments on the due date thereof in an aggregate amount of not less than the applicable Threshold Amount under such agreements or instruments (after giving effect to any applicable notice requirement or grace period).”). It should be noted that although the 2002 NAESB does not incorporate an Event of Default similar to Default Under Specified Transaction under the ISDA, the 2006 NAESB does include such Event of Default if elected by the parties (termed a "Transactionable Cross Default") as a NAESB “Additional Event of Default”. See discussion \textit{infra} at Section II(B).

\textsuperscript{50} ISDA Master Agreement § 5(a)(viii) ("The party or any Credit Support Provider of such party consolidates or amalgamates with, or merges with or into, or transfers all or substantially all its assets to, another entity and, at the time of such consolidation, amalgamation, merger or transfer: — (1) the resulting, surviving or transferee entity fails to assume all the obligations of such party or such Credit Support Provider under this Agreement or any Credit Support Document to which it or its predecessor was a party by operation of law or pursuant to an agreement reasonably satisfactory to the other party to this Agreement; or (2) the benefits of any Credit Support Document fail to extend (without the consent of the other party) to the performance by such resulting, surviving or transferee entity of its obligations under this Agreement.”).

\textsuperscript{51} ISDA Master Agreement § 5(b)(i) ("Due to the adoption of, or any change in, any applicable law after the date on which a Transaction is entered into, or due to the promulgation of, or any change in, the interpretation by any court, tribunal or regulatory authority with competent jurisdiction of any applicable law after such date, it becomes unlawful (other than as a result of a breach by the party of Section 4(b)) for such party (which will be the Affected Party): (1) to perform any absolute or contingent obligation to make a payment or delivery or to receive a payment or delivery in respect of such Transaction or to comply with any other material provision of this Agreement relating to such Transaction; or (2) to perform, or for any Credit Support Provider of such party to perform, any contingent or other obligation which the party (or such Credit Support Provider) has under any Credit Support Document relating to such Transaction.”).
amounts received more) than originally anticipated under the Agreement as a result of such tax law or action (“Tax Event”);\(^\text{52}\) (iii) when a party, its Credit Support Provider or another Specified Entity merges with or transfers substantially all of its assets to another entity, and the resulting entity or transferee is “materially weaker” than immediately prior to such merger or transfer (“Credit Event Upon Merger”);\(^\text{53}\) and (iv) when any other event occurs designated by the parties as an “Additional Termination Event” under the ISDA Schedule (“Additional Termination Event”).\(^\text{54}\)

When compared to the 2002 NAESB, the Gas Annex, through the ISDA Master Agreement, contains more events which may trigger the termination of the Agreement and liquidation of transactions. However, industry participants should weigh whether the additional Events of Default and Termination Events in the ISDA provide substantive benefit to the Gas transaction at issue. For parties entering into a fairly short-term Gas transaction, the NAESB Events of Default may provide adequate protection from the primary risk involved in short-term deals: whether a counterparty pays amounts owed when due. For long-term Gas transactions, however, parties may desire to either supplement the NAESB’s Events of Default to provide protection against risks associated with long-term trading relationships, or use an ISDA Agreement with Gas Annex.\(^\text{55}\)

\(^{52}\) ISDA Master Agreement § 5(b)(ii) (“Due to (x) any action taken by a taxing authority, or brought in a court of competent jurisdiction, on or after the date on which a Transaction is entered into (regardless of whether such action is taken or brought with respect to a party to this Agreement) or (y) a Change in Tax Law, the party (which will be the Affected Party) will, or there is a substantial likelihood that it will, on the next succeeding Scheduled Payment Date (1) be required to pay to the other party an additional amount in respect of an Indemnifiable Tax under Section 2(d)(i)(4) (except in respect of interest under Section 2(e), 6(d)(ii) or 6(e)) or (2) receive a payment from which an amount is required to be deducted or withheld for or on account of a Tax (except in respect of interest under Section 2(e), 6(d)(ii) or 6(e)) and no additional amount is required to be paid in respect of such Tax under Section 2(d)(i)(4) (other than by reason of Section 2(d)(i)(4)(A) or (B)).”.

\(^{53}\) ISDA Master Agreement § 5(b)(iv) (“If “Credit Event Upon Merger” is specified in the Schedule as applying to the party, such party (“X”), any Credit Support Provider of X or any applicable Specified Entity of X consolidates or amalgamates with, or merges with or into, or transfers all or substantially all its assets to, another entity and such action does not constitute an event described in Section 5(a)(viii) but the creditworthiness of the resulting, surviving or transferee entity is materially weaker than that of X, such Credit Support Provider or such Specified Entity, as the case may be, immediately prior to such action (and, in such event, X or its successor or transferee, as appropriate, will be the Affected Party).”.

\(^{54}\) ISDA Master Agreement § 5(b)(v) (“If any “Additional Termination Event” is specified in the Schedule or any Confirmation as applying, the occurrence of such event (and, in such event, the Affected Party or Affected Parties shall be as specified for such Additional Termination Event in the Schedule or such Confirmation).”.

\(^{55}\) One commentator states the following on this issue: “[In the context of a short-term trading contract, [the NAESB’s] approach- limited to payment failures and other credit difficulties- [is] sufficient to protect the interests of the short-term trader whose primary concern is either being paid for the natural gas that was supposed to be purchased or sold or being reimbursed under Section 3.2…pursuant to the Cover Standard or the Spot Price Standard, as appropriate…However, once parties have entered into a Confirmation for a long-term transaction under a NAESB Contract, that solution is no longer adequate…Both parties are bound to perform for the required duration of such Confirmation, unless there is an actual payment default or bankruptcy.” Karen Goepfert, “For the Long Haul: The Suitability of the Base Contract for the Sale and Purchase of Natural Gas for Long-Term Transactions,” 27 Energy Law Journal 583, 593-94 (2006).
6. Automatic Early Termination

Automatic Early Termination is an option under the ISDA not found in the NAESB.\(^56\) The Automatic Early Termination election allows parties to disregard the procedures otherwise required to designate an Early Termination Date, and instead provides that an Early Termination Date shall immediately occur upon the occurrence of certain bankruptcy events.\(^57\)

Automatic Early Termination is extremely valuable in jurisdictions without “safe harbor” protections otherwise provided to parties under the United States Bankruptcy Code (the “Bankruptcy Code”).\(^58\) However, in Transactions where both parties are located in the United States, many parties do not elect Automatic Early Termination in recognition that Automatic Early Termination may not be necessary to protect the Non-Defaulting Party, and (i) to control the timing of when Transactions terminate under the ISDA; (ii) to continue the contractual relationship and provide the Defaulting Party with time to cure; (iii) to negotiate better terms and conditions with the counterparty in exchange for not terminating the Agreement immediately; (iv) to avoid the risk that Transactions will terminate without the Non-Defaulting Party’s knowledge, potentially exposing such party to un-hedged positions with other entities and disrupting portfolio risk assumptions; and (v) in situations where the Non-Defaulting Party is “out of the money,” to avoid immediately owing the Defaulting Party a Settlement Amount upon such termination.\(^59\)

Whether Automatic Early Termination creates or reduces risk by its absence or inclusion in trading agreements depends on the jurisdiction in which the relevant parties are located and the types of Transactions at issue in the contract. However, inclusion of Automatic Early Termination in less than all of a party’s trading contracts with counterparties could leave the Non-Defaulting Party exposed if such counterparties become insolvent or declare bankruptcy, resulting in the immediate termination of only some—but not all—of the Transactions between the parties.

7. Termination and Liquidation of Gas Transactions

The methods of valuating terminated transactions in order to calculate an early termination payment vary between the NAESB and the ISDA.

Under the NAESB, the Non-Defaulting Party determines, in good faith and in a commercially reasonable manner, (i) the amount owed (whether or not then due) by each party with respect to all Gas delivered and received between the parties under Terminated Transactions on and before the Early Termination date, and (ii) all other applicable charges related to such

\(^{56}\) See ISDA Master Agreement §6.

\(^{57}\) ISDA Master Agreement § 6(a).

\(^{58}\) See Craig R. Enochs & Merida de la Pena, “Netting and Offset Principles in Energy Transactions”, State Bar of Texas 24th Annual Advanced Oil Gas & Energy Resources Law Course, October 5-6, Houston, Texas, Chapter 9, at 6-9.

deliveries and receipts for which payment has not yet been made by the party that owes such payment under the Contract. If the parties also elect on the NAESB Cover Sheet that “Early Termination Damages Apply,” then the Non-Defaulting Party additionally liquidates and accelerates each Terminated Transaction at its Market Value by pricing similar Gas transactions at the same Delivery Point as the Terminated Transaction, and considering sources including, but not limited to, NYMEX quotations, quotes from industry dealers, or similar Gas sales or purchases from bona fide third-party offers. The Non-Defaulting Party then compares the Market Value of each Terminated Transaction to the Contract Value for such transaction. If the Market Value exceeds the Contract Value, then the difference in such values is due to Buyer; if the Contract Value exceeds the Market Value, then the difference in such values is due to Seller.

In contrast, payments on early termination under the ISDA Master Agreement are determined pursuant to either “Market Quotation” or “Loss” calculations, as well as the “First Method” or “Second Method” of payment—each as may be elected by the parties in the ISDA Schedule. Market Quotation calculates the amount due upon early termination by determining the difference between (i) the value of Terminated Transactions based on quotations from four (4) leading dealers in the relevant market selected in good faith (“Reference Market-makers”) and any other Unpaid Amounts owed to the Non-Defauling Party; and (ii) the value of any Unpaid Amounts owed to the Defaulting Party. Loss calculates the value of the Non-

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60 NAESB § 10.3.1.
61 NAESB § 10.3.1 (Early Termination Damages Apply).
62 Id.
63 ISDA Master Agreement § 6(e).
64 ISDA Master Agreement § 14 (“ “Market Quotation” means, with respect to one or more Terminated Transactions and a party making the determination, an amount determined on the basis of quotations from Reference Market-makers. Each quotation will be for an amount, if any, that would be paid to such party (expressed as a negative number) or by such party (expressed as a positive number) in consideration of an agreement between such party (taking into account any existing Credit Support Document with respect to the obligations of such party) and the quoting Reference Market-maker to enter into a transaction (the “Replacement Transaction”) that would have the effect of preserving for such party the economic equivalent of any payment or delivery (whether the underlying obligation was absolute or contingent and assuming the satisfaction of each applicable condition precedent) by the parties under Section 2(a)(i) in respect of such Terminated Transaction or group of Terminated Transactions that would, but for the occurrence of the relevant Early Termination Date, have been required after that date. For this purpose, Unpaid Amounts in respect of the Terminated Transaction or group of Terminated Transactions are to be excluded but, without limitation, any payment or delivery that would, but for the relevant Early Termination Date, have been required (assuming satisfaction of each applicable condition precedent) after that Early Termination Date is to be included. The Replacement Transaction would be subject to such documentation as such party and the Reference Market-maker may, in good faith, agree. The party making the determination (or its agent) will request each Reference Market-maker to provide its quotation to the extent reasonably practicable as of the same day and time (without regard to different time zones) on or as soon as reasonably practicable after the relevant Early Termination Date. The day and time as of which those quotations are to be obtained will be selected in good faith by the party obliged to make a determination under Section 6(e), and, if each party is so obliged, after consultation with the other. If more than three quotations are provided, the Market Quotation will be the arithmetic mean of the quotations, without regard to the quotations having the highest and lowest values. If exactly three such quotations are provided, the Market Quotation will be the quotation remaining after disregarding the highest and lowest quotations. For this purpose, if more than one quotation has the same highest value or lowest value, then one of such quotations shall be disregarded. If fewer than three quotations are provided, it will be deemed that the Market Quotation in respect of such Terminated Transaction or group of Terminated Transactions cannot be determined.”); (“ “Reference Market-makers” means four leading dealers in the relevant market selected by the party determining a
Defaulting Party’s total losses and costs (or gains, expressed as a negative number) resulting from the early termination and liquidation of Terminated Transactions, including any loss of bargain, costs of funding, and costs of terminating, liquidating or reestablishing any hedge.  

Once the amount owed upon early termination is calculated pursuant to Market Quotation or Loss, a designation of either First or Second Method determines to whom such amount is paid. Under the First Method, only the Non-Defaulting Party may be paid any amounts owed to it upon an Early Termination Date. Thus, if amounts would otherwise be owed to the Defaulting Party from the Non-Defaulting Party upon an Early Termination Date, the Defaulting Party receives nothing—a clear risk that parties should consider in determining whether to elect payment under the First Method. By contrast, the Second Method allows either the Non-Defaulting Party or the Defaulting Party to receive amounts owed to it from the other party upon an Early Termination Date. Where the parties fail to designate a payment measure or method under the ISDA Master Agreement, Market Quotation and Second Method apply by default.

The various methods of liquidating transactions each contain inherent risks that a party should consider in determining how to calculate termination amounts under trading agreements. If parties rely on market quotations or other external sources in liquidating transactions to calculate a termination amount (whether under the NAESB or the Market Quotation election under the ISDA Master Agreement), it is possible that the market quotations or sources incorporated into such calculation may not accurately reflect the value of such transactions—potentially resulting in a loss or windfall to a party. Similarly, because the Loss method under the ISDA Master Agreement allows the Non-Defaulting Party to determine its total losses and costs with respect to Terminated Transactions without referencing any external market quotations or sources, it is possible that such Loss calculation may include additional amounts not otherwise contemplated under the NAESB or the Market Quotation calculation.

Market Quotation in good faith (a) from among dealers of the highest credit standing which satisfy all the criteria that such party applies generally at the time in deciding whether to offer or to make an extension of credit and (b) to the extent practicable, from among such dealers having an office in the same city.”).

65 ISDA Master Agreement § 14 (““Loss” means, with respect to this Agreement or one or more Terminated Transactions, as the case may be, and a party, the Termination Currency Equivalent of an amount that party reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number) in connection with this Agreement or that Terminated Transaction or group of Terminated Transactions, as the case may be, including any loss of bargain, costs of funding or, at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or reestablishing any hedge or related trading position (or any gain resulting from any of them). Loss includes losses and costs (or gains) in respect of any payment or delivery required to have been made (assuming satisfaction of each applicable condition precedent) on or before the relevant Early Termination Date and not made, except, so as to avoid duplication, if Section 6(e)(i)(1) or (3) or 6(e)(ii)(2)(A) applies. Loss does not include a party’s legal fees and out-of-pocket expenses referred to under Section 11. A party will determine its Loss as of the relevant Early Termination Date, or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets.”).

66 ISDA Master Agreement § 6(e).

67 Id.

68 Id.
8. **Setoff Rights**

Parties to the NAESB or Gas Annex may elect for setoff rights to arise upon liquidation and termination of Gas transactions. Setoff provisions generally allow a party to offset amounts owed to it against amounts owed by it to the other party. With respect to obligations that are setoff, (i) it immediately extinguishes such obligations between the parties; (ii) it eliminates the non-defaulting Party’s credit risk for amounts owed by the defaulting party to the extent such obligations are setoff; (iii) it eliminates the non-defaulting party’s cash flow risk that would otherwise be present while waiting for payments; and (iv) if the defaulting party is bankrupt, it allows the non-defaulting party to reduce its involvement in bankruptcy proceedings and minimizes any payments the non-defaulting party must make to the bankrupt counterparty.  

The 2002 NAESB allows the parties to elect on the Cover Sheet whether a Non-Defaulting Party may setoff a Net Settlement Amount (i) against collateral held by the Non-Defaulting Party, or (ii) other amounts owed to the Non-Defaulting Party by the Defaulting Party under any other agreements or arrangements. Regardless of the election made by the parties, the Non-Defaulting Party will, at a minimum, be permitted to setoff any Net Settlement Amount against amounts owed under the NAESB.

The 1992 ISDA does not contain any setoff provisions. However, the 2002 ISDA incorporates a setoff provision similar to the 2002 NAESB. Section 6(f) of the 2002 ISDA provides that any Early Termination Amount payable to one party (the “Payee”) by the other party (the “Payer”) will, at the option of the Non-Defaulting Party (with respect to an Event of Default) or the Non-affected Party (with respect to a Termination Event), be setoff against any other amounts owed by the Payee to the Payer, whether or not such payments arise under the Agreement. While the 2002 ISDA contains equivalent rights of setoff as the 2002 NAESB, parties trading under the 1992 ISDA may wish to avoid inconsistencies between the 1992 ISDA and 2002 NAESB by incorporating a setoff provision into the ISDA Schedule which would apply to Transactions under the Gas Annex. Setoff provisions are particularly important to parties trading under multiple agreements or through affiliates, as such provisions protect against credit and payment risks involved with the termination and liquidation of transactions on a portfolio-wide basis.

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70 2002 NAESB § 10.3.2.
71 *Id.*
72 See 2002 ISDA § 6(f).
B.  2006 NAESB Compared to ISDA Gas Annex

1.  Events of Default

Unlike the 2002 NAESB, the 2006 NAESB incorporates “Additional Events of Default” which expressly include “Transactional Cross Default” and “Indebtedness Cross Default,” each of which may be elected by the parties on the NAESB Cover Sheet.

If Transactional Cross Default applies to a party, then it will constitute an Event of Default under the NAESB if such party defaults under any Specified Transaction. The term “Specified Transaction” means any other transaction or agreement between the parties for the purchase, sale or exchange of Gas, and any other transaction or agreement specified by the parties on the NAESB Cover Sheet. By electing Transactional Cross Default, a party can ensure that if the other party defaults on Gas transactions or agreements (or any other agreement(s) specified by the parties on the Cover Sheet), it shall constitute an Event of Default under the NAESB. This protects a party from performance risk while still allowing it to document transactions in separate NAESB agreements.

If Indebtedness Cross Default applies to a party, then it shall be an Event of Default under the NAESB if (i) such party or its Guarantor experiences a default under one or more agreements or instruments relating to indebtedness for the payment or repayment of borrowed money, and the default results in such indebtedness becoming immediately due and payable; and (ii) the amount of such default, in the aggregate, is greater than such party’s (or its Guarantor’s) threshold specified in the NAESB Cover Sheet.

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73 Many of the differences between the NAESB and the Gas Annex have been addressed in Section II(A) herein. To the extent the 2002 NAESB differs from the 2006 NAESB but does not substantively impact the analysis herein in Section II(A), such provisions are not discussed in Section II(B). However, to the extent the analysis comparing the 2006 NAESB to the Gas Annex substantively differs from the analysis in Section II(A) herein, Section II(B) addresses such differences.

74 2006 NAESB § 10.2, subsection (ix).

75 2006 NAESB § 2.1 (“Additional Event of Default” shall mean Transactional Cross Default or Indebtedness Cross Default, each as and if selected by the parties pursuant to the Base Contract.”).

76 2006 NAESB § 2.33 (“Transactional Cross Default” shall mean if selected on the Base Contract by the parties with respect to a party, that it shall be in default, however therein defined, under an Specified Transaction.”).

77 2006 NAESB § 2.30 (“Specified Transaction(s)” shall mean any other transaction or agreement between the parties for the purchase, sale or exchange of physical Gas, and any other transaction or agreement identified as a Specified Transaction under the Base Contract.”).

78 E.g., a party may wish to document a structured transaction using a NAESB separate from that used to document routine trading transactions with a counterparty, but still terminate each NAESB if such counterparty defaults under the relevant NAESB.

79 2006 NAESB § 2.23 (“Indebtedness Cross Default” shall mean if selected on the Base Contract by the parties with respect to a party, that it or its Guarantor, if any, experiences a default, or similar condition or event however therein defined, under one or more agreements or instruments, individually or collectively, relating to indebtedness (such indebtedness to include any obligation whether present or future, contingent or otherwise, as principal or surety or otherwise) for the payment or repayment of borrowed money in an aggregate amount greater than the threshold specified in the Base Contract with respect to such party or its Guarantor, if any, which results in such indebtedness becoming immediately due and payable.”).
Both Transactional Cross Default and Indebtedness Cross Default may be useful to parties in evaluating a counterparty’s commercial and credit risk, as both events look to a counterparty’s performance outside the NAESB (whether in Gas agreements or agreements relating to indebtedness) as indicators in determining an Event of Default under the NAESB.

The Additional Events of Default under the 2006 NAESB are substantively identical to the Default Under Specified Transaction and Cross Default Events of Default under the ISDA Master Agreement. If a party prefers to use the NAESB instead of the Gas Annex but wants to incorporate additional Events of Default found in the ISDA Master Agreement, it may be beneficial for the party to use the 2006 NAESB instead of the 2002 NAESB.

C. EEI Compared to ISDA Power Annex

1. Confirmation Procedures

The EEI sets forth detailed confirmation procedures that the Parties must follow when entering into a power Transaction. Seller may confirm a Transaction by providing a Confirmation to Buyer within three (3) Business Days after a Transaction is negotiated by the Parties. If Buyer objects to any of the terms in the Confirmation, then Buyer notifies Seller of such objection within two (2) Business Days of Buyer’s receipt of the Confirmation. Importantly, if Buyer fails to object within two (2) Business Days, then the Confirmation is deemed accepted by Buyer and binding on the Parties.

Similarly, if Seller fails to provide a Confirmation within three (3) Business Days after a Transaction is entered into, then Buyer may send a Confirmation to Seller and Seller has a right to object to such Confirmation within two (2) Business Days after receipt. If Seller fails to object to Buyer’s Confirmation, then Buyer’s Confirmation is deemed accepted by Seller and binding on the Parties.

Notably, the failure by either Seller or Buyer to send or return an executed Confirmation or provide any objections shall not invalidate the Transaction agreed to by the Parties. Thus, while the EEI anticipates a written confirmation procedure, the Parties’ oral agreement relating to a Transaction may sufficiently bind the Parties if a Confirmation is not otherwise executed.


81 Capitalized terms used in this Section II(C) but not otherwise defined herein shall have the meanings set forth in the EEI or the ISDA, as applicable.

82 EEI § 2.3.

83 Id.

84 Id.

85 Id.

86 EEI § 2.3.

87 Id.
Similar to the EEI, the ISDA contemplates that the parties shall be legally bound by the terms of each Transaction from the moment they agree to commercial terms (whether orally or otherwise), and shall confirm Transactions in writing as soon as reasonably practicable through the use of Confirmations.\(^{88}\) Because the ISDA Master Agreement and Power Annex do not clearly articulate any other specific details concerning the formation of Transactions and exchange of Confirmations, however, most parties negotiate and incorporate Confirmation terms and procedures into the ISDA Schedule.\(^{89}\)

2. **Netting**

Section 6.4 of the EEI provides that the Parties shall discharge mutual debts and payment obligations due and owing to each other on the same date pursuant to all Transactions through netting. All amounts owed by each Party to the other Party during a monthly billing period under the EEI are netted together so that only the excess amount remaining due is payable by the Party who owes it.\(^{90}\) Notably, the EEI does not limit netting to amounts owed under a single Transaction between the Parties.\(^{91}\)

As discussed herein, Section 2(c) of the ISDA Master Agreement expressly limits netting to amounts (i) due on the same date; (ii) due in the same currency; and (iii) due in respect of the same Transaction.\(^{92}\) However, parties often elect to net amounts owed with respect to all amounts payable on the same date in the same currency with respect to all ISDA Transactions.\(^{93}\) If a party trades power under both a Power Annex and an EEI, consistent netting provisions across such agreements minimizes the operational risk that payments under either agreement will be incorrectly calculated or delivered to a counterparty.\(^{94}\)

3. **Notices**

Section 10.7 of the EEI provides that all notices, requests, statements or payments shall be made by hand delivery, United States mail, overnight courier or facsimile, unless otherwise specified by the Parties on the Cover Sheet. Generally, notices under the EEI are subject to the following conditions:

(i) If notice sent by facsimile or hand delivery is received during business hours on a Business Day, such notice shall be deemed effective at the close of business on the day actually received. If notice is received after business hours,

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\(^{88}\) ISDA Master Agreement § 9.2(e)(ii); see recitals to ISDA Master Agreement, defining “Confirmation” as “documents and other confirming evidence exchanged between the parties confirming [ISDA] Transactions.”

\(^{89}\) See discussion supra at Section II(A)(1).

\(^{90}\) EEI § 6.4.

\(^{91}\) See id.

\(^{92}\) See discussion supra at Section II(A)(2).

\(^{93}\) See ISDA Master Agreement § 2(c). To elect netting across transactions, parties generally state in the ISDA Schedule that “Section 2(c)(ii) shall not apply.”

\(^{94}\) E.g., if a party is consistently netting across transactions with a counterparty under an EEI, it may create operational risk if such party is not permitted to net across all transactions with the same counterparty under an ISDA.
then such notice shall be effective at the close of business on the following Business Day; and

(ii) If notice is sent by overnight United States mail or courier, notice shall be effective on the next Business Day after it was sent.95

The effective date for the receipt of notices under the EEI is important because it directly impacts the timing of Events of Default and the designation of an Early Termination Date. Any modifications to timing requirements or other administrative procedures regarding notices may increase the risk that a party will not be able to exercise early termination rights as quickly as desired.96

Although the Power Annex does not contain provisions concerning the manner and timing of notices, the ISDA Master Agreement contains notice provisions affecting all ISDA Transactions—including Power Transactions.97 Importantly, the ISDA specifically excludes facsimile, electronic messaging system and e-mail as a means of providing notices with respect to the occurrence of Events of Default or the designation of an Early Termination Date.98

To avoid the risk that the manner, method or timing of a party’s notice may be ineffective, such party may wish to incorporate similar notice provisions throughout its various trading contracts.99

4. Credit Obligations

The EEI allows Parties to elect on the Cover Sheet whether the following forms of credit protection shall apply with respect to each Party: (i) Credit Assurances; (ii) Collateral Threshold; and/or (iii) Downgrade Event.100

If Credit Assurances apply, then a Party may demand Performance Assurance from the other Party if it has reasonable grounds to believe that the other Party’s creditworthiness or performance under the EEI has become unsatisfactory.101 Importantly, the EEI does not expressly define what constitutes “reasonable grounds” for believing that a Party’s creditworthiness or performance under the Agreement is unsatisfactory.102 However, the demanding Party must calculate the requested amount of Performance Assurance in a commercially reasonable manner.103

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95 EEI § 10.7.
96 See discussion supra at Section II(A)(3).
97 Id.
98 1992 ISDA § 12(a) (preventing such notices by “facsimile or electronic messaging system”); 2002 ISDA § 12(a) (preventing such notices by “electronic messaging system or e-mail”); see discussion supra at Section II(A)(3).
99 See discussion supra at Section II(A)(3).
100 See EEI Cover Sheet, Article 8, elections to §§ 8.1(b), 8.1(c), 8.1(d), 8.2(b), 8.2(c) and 8.2(d).
101 EEI §§ 8.1(b) and 8.2(b).
102 Id.
103 Id.
If the Parties elect for Collateral Threshold to apply, then the EEI sets forth a margining structure whereby a Party may demand Performance Assurance to the extent that such Party’s credit exposure exceeds the other party’s collateral Threshold.\(^{104}\) Notably, such margining protection may be elected in the EEI without the incorporation of a Collateral Annex.\(^{105}\) However, if the Parties enter into a Collateral Annex, then such Annex supersedes and replaces any Collateral Threshold provisions otherwise elected in the EEI.\(^{106}\)

If the Parties elect for Downgrade Event to apply, then the occurrence of a Downgrade Event (as defined by the Parties on the EEI Cover Sheet) with respect to a Party obligates such Party to provide Performance Assurance to the other Party. The EEI anticipates that a Downgrade Event may occur if a Party’s Credit Rating falls below a certain level, but the Parties also may specify on the Cover Sheet any particular action or event which will constitute a Downgrade Event with respect to a Party.\(^{107}\)

Importantly, the provisions relating to Credit Assurances and Downgrade Event are independent of (and in addition to) any obligations under the EEI Collateral Annex that the parties may elect to incorporate into the Agreement.\(^{108}\)

Unlike the EEI, the ISDA Power Annex does not set forth any credit protections or collateral requirements, thus creating potential credit and settlement risk with respect to a power Transaction. To avoid such risks, parties to the ISDA often enter into a Power Annex in conjunction with an ISDA CSA. Similar to the concept of Collateral Threshold in the EEI, the ISDA CSA provides the parties with credit protection through threshold margining.\(^{109}\)

5. **Events of Default and Termination Events**

The EEI contains Events of Default relating to (i) the failure by a Party or its Guarantor to make payment when due if not remedied within three (3) Business Days after written notice;\(^{110}\) (ii) false or misleading representations or warranties by a Party or its Guarantor;\(^{111}\) (iii)
the failure by a Party or its Guarantor to perform any material covenant or obligation in the Agreement (other than a failure to deliver or receive the Product) if not remedied within three (3) Business Days after written notice;\textsuperscript{112} (iv) bankruptcy of a Party or its Guarantor;\textsuperscript{113} (v) a Party’s failure to satisfy credit obligations;\textsuperscript{114} (vi) a resulting entity’s or transferee’s failure to assume a Party’s obligations under the EEI subsequent to a merger or transfer between such transferee and a Party;\textsuperscript{115} (vii) defaults by a Party or any Specified Entity on agreements relating to indebtedness for borrowed money;\textsuperscript{116} (viii) the failure of a guaranty issued by a Party’s Guarantor to be in full force and effect;\textsuperscript{117} and (ix) the repudiation of a guaranty by a Party’s Guarantor.\textsuperscript{118}

The ISDA contains Events of Default substantially similar to the above-stated EEI Events of Default.\textsuperscript{119} However, the ISDA also incorporates an Event of Default relating to defaults by a party, its Credit Support Provider or any Specified Entity of the party with respect to any Specified Transaction (such as rates, swaps, options, or other Transactions designated by the parties) (“Default Under Specified Transaction”).\textsuperscript{120} Moreover, the ISDA contains Termination

\textsuperscript{112} EEI § 5.1(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”) and (h)(ii) (the failure of a Guarantor 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”).

\textsuperscript{113} EEI § 5.1(d) (“such Party becomes bankrupt”) and (h)(iii) (“a Guarantor becomes Bankrupt”).

\textsuperscript{114} EEI § 5.1(e) (“the failure of such Party to satisfy the creditworthiness/collateral requirements agreed to pursuant to Article Eight”).

\textsuperscript{115} EEI § 5.1(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 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”).

\textsuperscript{116} EEI § 5.1(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)”).

\textsuperscript{117} EEI 5.1(h)(iv) (“the failure of a Guarantor’s guaranty to be in full force and effect for the 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”).

\textsuperscript{118} EEI 5.1(h)(v) (“a Guarantor shall repudiate, disaffirm, disclaim, or reject, in whole or in part, or challenge the validity of any guaranty”).

\textsuperscript{119} See ISDA Master Agreement § 5(a)(i) – (iv) and (vi) – (viii).

\textsuperscript{120} ISDA Master Agreement § 5(a)(v); see discussion of ISDA Events of Default and Termination Events supra at Section II(A)(5).
Events such as Illegality, Tax Event and Credit Event Upon Merger not otherwise found in the EEI, by which parties may terminate and liquidate Transactions.\textsuperscript{121}

As discussed herein, a party should analyze the various commercial and credit risks involved in each transaction to determine which Event(s) of Default may be necessary to adequately protect such party.\textsuperscript{122} To avoid inconsistencies regarding termination and liquidation of contracts, it may be beneficial for parties to incorporate similar Events of Default in each of its trading agreements.

6. \textit{Automatic Early Termination}

Automatic Early Termination is an option under the ISDA not found in the EEI.\textsuperscript{123} As discussed herein, Automatic Early Termination may be valuable in jurisdictions without “safe harbor” protections otherwise provided to parties under the Bankruptcy Code.\textsuperscript{124} However, whether Automatic Early Termination creates or reduces risk by its absence or inclusion in trading agreements depends on the jurisdiction in which the relevant parties are located and the types of Transactions at issue in the contract.\textsuperscript{125}

7. \textit{Termination and Liquidation of Power Transactions}

After an Early Termination Date has been designated under the EEI or the ISDA, all Transactions must be terminated and the value of such Transactions calculated in order to reach an amount due under the agreement.\textsuperscript{126} The EEI requires the Non-Defaulting Party to calculate a Settlement Amount for each Terminated Transaction in a “commercially reasonable manner.”\textsuperscript{127} By contrast, the ISDA requires the Non-Defaulting Party to determine amounts owed upon an Early Termination Date using either Market Quotation or Loss calculations.\textsuperscript{128} As discussed herein, inherent risks involved with various calculation methods should be analyzed by parties in determining how to liquidate transactions under trading agreements.\textsuperscript{129}

Another distinction between the EEI and ISDA relates to whether the Non-Defaulting Party is required to make a Termination Payment to the Defaulting Party. The EEI provides that after a Settlement Amount is calculated for each Terminated Transaction, the Non-Defaulting Party shall net all Settlement Amounts into a single Termination Payment that is payable either to or from the Non-Defaulting Party, as applicable.\textsuperscript{130} Thus, the EEI anticipates that the Non-

\textsuperscript{121} ISDA Master Agreement § 5(b); see discussion \textit{supra} at Section II(A)(5).
\textsuperscript{122} See discussion \textit{supra} at Section II(A)(5).
\textsuperscript{123} See ISDA Master Agreement §6.
\textsuperscript{124} See discussion \textit{supra} at Section II(A)(6).
\textsuperscript{125} Id.
\textsuperscript{126} EEI § 5.2; ISDA Master Agreement § 6(a) – (b).
\textsuperscript{127} EEI § 5.2.
\textsuperscript{128} ISDA Master Agreement § 6(e); see also discussion \textit{supra} at Section II(A)(7).
\textsuperscript{129} See discussion \textit{supra} at Section II(A)(7).
\textsuperscript{130} EEI § 5.3.
Defaulting Party may owe a Termination Payment to the Defaulting Party upon termination of all Transactions under the Agreement.

The Power Annex, through the ISDA Master Agreement, allows the parties to designate either First or Second Method to determine whether the Non-Defaulting Party may owe amounts to the Defaulting Party upon an Early Termination Date. The Second Method allows either the Non-Defaulting Party or the Defaulting Party to receive amounts owed to it from the other party upon an Early Termination Date—similar to the structure of the EEI. However, unlike the EEI, the ISDA’s First Method allows only the Non-Defaulting Party to be paid any amounts owed to it upon an Early Termination Date. In determining whether to elect the First Method under the ISDA Master Agreement, a party should consider the risk that if it defaults under the Agreement, such party will not receive any termination payment—even if an amount would otherwise be owed to it by the Non-Defaulting Party.

8. Setoff Rights

A significant difference between the EEI and the Power Annex (through the ISDA Master Agreement) relates to a party’s ability to setoff obligations under other agreements. The 1992 ISDA lacks a provision relating to setoff, while the 2002 ISDA includes such right. The EEI, similar to the 2002 ISDA, allows the Non-Defaulting Party to setoff obligations under “any other agreements, instruments or undertakings between the Defaulting Party and the Non-Defaulting Party” upon the calculation of a Termination Payment. In addition, the Parties may elect for the Non-Defaulting Party to have the right to setoff obligations owed by the Defaulting Party’s Affiliate under other agreements outside of the EEI. As previously discussed herein, a party’s ability to setoff amounts across transactions and affiliates helps mitigate potential credit and payment risks involved in terminating and liquidating transactions.

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131 ISDA Master Agreement § 6(e); see discussion supra at Section II(A)(7).
132 Id.
133 See discussion supra at Section II(A)(7).
134 For a discussion of setoff rights under the 2002 ISDA, see discussion supra at Section II(A)(8).
135 EEI § 5.6, Option A; 2002 ISDA Master Agreement § 6(f).
136 EEI § 5.6, Options B and C.
137 See discussion supra at Section II(A)(8).
## APPENDIX 1

### GAP RISKS: NAESB AND ISDA GAS ANNEX

<table>
<thead>
<tr>
<th>NAESB</th>
<th>ISDA Gas Annex</th>
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| **Confirmation Procedures** | • Oral and written confirmation procedures elected by parties  
• Detailed procedures for sending/returning confirmations |  
• Gas Annex silent as to confirmation procedures; defaults to Section 9(e)(ii) of ISDA Master Agreement  
• Detailed confirmation procedures generally negotiated in the ISDA Schedule |
| **Netting** | All payments across all transactions under the Contract are netted into one amount |  
• Per Section 2(c) of Master Agreement, only amounts due (i) on the same day; (ii) in the same currency; and (iii) with respect to the same transaction may be netted  
• Parties generally elect cross-Transactional netting in the Schedule |
| **Notices** | • By fax, effective upon sender’s confirmation report, except that if not received by 5 p.m. on a Business Day, then effective the next Business Day  
• In person or by overnight mail, effective on next Business Day (earlier if confirmed by receiving party)  
• By first class mail, effective 5 Business Days after mailing |  
• By fax, effective on date received (note: sender’s confirmation report is not conclusive proof of receipt)  
• In person, effective on date delivered  
• By certified or registered mail, effective on date delivered or attempted to be delivered  
• By electronic messaging, effective on date received  
• By email, effective on date delivered (2002 ISDA only) |
| **Credit Obligations** | • Either party may demand Adequate Assurance of Performance under Section 10.1  
• NAESB Credit Support Addendum also available |  
• No credit provisions in Gas Annex  
• Generally must rely on ISDA Credit Support Annex for credit provisions |

**NOTES:** (i) All notice provisions are in Section 12 of the Master Agreement; (ii) A party may not give notice of Event of Default or Early Termination Date via fax, electronic messaging system or email.
| Events of Default and Termination Events | • Events of Default: insolvency and bankruptcy-related events, breach of credit obligations, failure to pay when due  
• No Termination Events  
• Transactional Cross Default and Indebtedness Cross Default elections (2006 NAESB only) similar to Default Under Specified Transaction and Cross Default in ISDA | • All Events of Default under the NAESB, plus (i) Breach of Agreement (other than failure to pay); (ii) Misrepresentation; (iii) Default under Specified Transaction (similar to Transactional Cross Default in 2006 NAESB); (iv) Cross Default (similar to Indebtedness Cross Default in 2006 NAESB); and (v) Merger Without Assumption  
• Termination Events: Illegality, Tax Event, Tax Event Upon Merger, and Credit Event Upon Merger  
NOTE: All Events of Default and Termination Events are in Section 5 of the Master Agreement |
| Automatic Early Termination | • Automatic early termination not available under standard NAESB | • Parties can elect for automatic early termination of ISDA to apply upon the occurrence of certain bankruptcy-related Events of Default  
NOTE: May be useful if the ISDA could be subject to a jurisdiction without the U.S. Bankruptcy Code’s “safe harbor” protections (e.g., foreign counterparty or Credit Support Provider) |
| Termination and Liquidation of Gas Transactions | • Based on Market Value calculation  
• Two-way termination payment | • 1992 ISDA: in the Schedule, the parties elect (i) Market Quotation or Loss calculations; and (ii) First Method (one-way payment) or Second Method (two-way payment)  
• 2002 ISDA: (i) Close-out Amount (hybrid of Market Quotation and Loss methods); and (ii) two-way termination payment |
| Setoff Rights | • Non-Defaulting Party can setoff amounts owed to it under the NAESB against margin or collateral held by it under the NAESB  
• Other Agreement Setoff Election: (i) 2002 NAESB: Bilateral; (ii) 2006 NAESB: Bilateral or Triangular, as elected on Cover Sheet | • 1992 ISDA: No setoff provision (though generally added in Schedule)  
• 2002 ISDA: Non-Defaulting Party may setoff amounts owed between the parties arising under the ISDA or any other agreement (similar to bilateral setoff in NAESB). No cross-affiliate (triangular) setoff unless added in Schedule |
# APPENDIX 2

## GAP RISKS: EEI AND ISDA POWER ANNEX

<table>
<thead>
<tr>
<th></th>
<th>EEI</th>
<th>ISDA Power Annex</th>
</tr>
</thead>
</table>
| **Confirmation Procedures** | • Written confirmation procedure, though failure to send/receive confirmation does not invalidate transaction  
• Detailed procedures for sending/returning confirmations | • Power Annex silent as to confirmation procedures; defaults to Section 9(e)(ii) of ISDA Master Agreement  
• Detailed confirmation procedures generally negotiated in the ISDA Schedule |
| **Netting**                 | • All payments across all transactions under the Agreement are netted into one amount | • Per Section 2(c) of Master Agreement, only amounts due (i) on the same day; (ii) in the same currency; and (iii) with respect to the same transaction may be netted  
• Parties generally elect cross-Transactional netting in the Schedule |
| **Notices**                 | • By fax or hand delivery, effective at close of business if received during business hours and at close of business of the next Business Day if received after business hours  
• By overnight mail or courier, effective on the Business Day after notice was sent | • By fax, effective on date received (note: sender’s confirmation report is not conclusive proof of receipt)  
• In person, effective on date delivered  
• By certified or registered mail, effective on date delivered or attempted to be delivered  
• By electronic messaging, effective on date received  
• By email, effective on date delivered (2002 ISDA only) |
| **Credit Obligations**      | • On EEI Cover Sheet, the Parties may elect for (i) Credit Assurances; (ii) Collateral Threshold; and/or (iii) Downgrade Event to apply  
• EEI Collateral Annex also available | • No credit provisions in Power Annex  
• Generally must rely on ISDA Credit Support Annex for credit provisions |

NOTES: (i) All notice provisions are in Section 12 of the Master Agreement; (ii) A party may not give notice of Event of Default or Early Termination Date via fax, electronic messaging system or email.
| Events of Default and Termination Events | • Events of Default: (i) failure to pay when due; (ii) false or misleading representations; (iii) breach of agreement (other than failure to pay); (iv) bankruptcy or insolvency; (v) breach of credit obligations; (vi) merger without assumption; and (vii) indebtedness cross default  
• No Termination Events | • All Events of Default under EEI, plus Default Under Specified Transaction  
• Termination Events: Illegality, Tax Event, Tax Event Upon Merger, and Credit Event Upon Merger  
NOTE: All Events of Default and Termination Events are in Section 5 of the Master Agreement |
| --- | --- | --- |
| Automatic Early Termination | • Automatic early termination not available under standard EEI | • Parties can elect for automatic early termination of ISDA to apply upon the occurrence of certain bankruptcy-related Events of Default  
NOTE: May be useful if the ISDA could be subject to a jurisdiction without the U.S. Bankruptcy Code’s “safe harbor” protections (e.g., foreign counterparty or Credit Support Provider) |
| Termination and Liquidation of Power Transactions | • Non-Defaulting Party calculates Settlement Amount for each Transaction in a “commercially reasonable manner” and nets all Settlement Amounts to reach a single Termination Payment  
• Two-way payment | • 1992 ISDA: in the Schedule, the parties elect (i) Market Quotation or Loss calculations; and (ii) First Method (one-way payment) or Second Method (two-way payment)  
• 2002 ISDA: (i) Close-out Amount (hybrid of Market Quotation and Loss methods); and (ii) two-way termination payment |
| Setoff Rights | • On the Cover Sheet, the Parties can elect (i) Bilateral setoff (Option A); (ii) Triangular setoff (Option B); or (iii) No setoff (Option C) | • 1992 ISDA: No setoff provision (though generally added in Schedule)  
• 2002 ISDA: Non-Defaulting Party may setoff amounts owed between the parties arising under the ISDA or any other agreement (similar to bilateral setoff in EEI). No cross-affiliate (triangular) setoff unless added in Schedule |