

Contractual Risk Management for Trading across Europe

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Why having a Standard Contract?

- Can be used in multiple markets
- Many companies familiar with contract
- Strong set of credit clauses
- EFET CPMA can deliver net amounts across several commodities
- EFET is backed by many country legal opinions including one for Poland
- EFET allows for trading via long-confirms

Practical Advantages

- Generally accepted Market Standard in Europe. Reliability has been tested.
- Easy to negotiate, negotiation of the General Agreement once and for all.
- Easy to customise through “tick-off list” in the Election Sheet
- Minimize legal basis risk by use of identical clauses with all counterparties

Why having a Polish EFET Master?

- Trading counterparties will come from European countries with EFET familiarity
- Polish market has particular circumstances
- Avoid confusion with “false” EFET’s
- Minimize risks due to approved translation
- Legal conditions require some tweaking of contractual obligations

What has been agreed (1)?

- EFET and TOE market the EFET Power Master Agreement together
- Changes to the Power Master are limited to what is required under Polish law
- Contract is in dual-language with English prevailing for all interpretation issues
- Contract allows for Polish law as option

What has been agreed (2)?

- TOE to use the EFET Logo
- No material change to the Power Master Agreement
- TOE to make non-binding recommendations to TOE members on how to customize the Master Agreement
- EFET to procure Legal Opinion on Poland
- Rafal Hadjuk appointed revising lawyer (CMS Mckenna) and advisor

EFET Power Master Agreement

- The EFET General Agreement Concerning the Delivery and Acceptance of Electricity (version 2.1) was published on 20th December 2000.
 - Developed in record time for an industry document
 - Freely available on www.efet.org.
- Has become the industry standard for continental European Power Trading.
- The “official” form agreement is in the English language.
 - “unofficial” translations into other languages.
 - EFET-approved German translation is also available.
 - EFET-approved dual-language contract for Poland.

EFET Power Master Agreement

- The EFET Power Master features a strong emphasis on Cross-Border issues unique to the European energy markets:
 - Multi-jurisdictional “Close-out Netting” - legal opinions on netting in multiple jurisdictions have been prepared by local counsel on behalf of subscribing EFET members.
 - VAT and other Tax issues - task force coordinated with various local VAT authorities to clarify VAT treatment of physical energy sales.
 - Master Netting Agreement - as amended by the EFET Commodities Schedule.

EFET Power Master Agreement

Four components make up the EFET Power Master:

- **General Agreement:**
 - Standard terms and conditions outlining the sale and purchase of power.
- **The Election Sheet**
 - Enables the parties to customise certain provisions of the General Agreement
- **Annexes**
 - Defined terms.
 - Confirmation of individual Contracts/transactions.
 - Credit Support Annex (separate EFET document).
- **Appendices**
 - Allowances Appendix (new version 2.0 of July 2005).

What is covered by the EFET?

- Standard Form Trading Contract for Power and Gas, (with Appendix for CO2 Allowances).
- Designed to support physical trading (physical delivery as intended means of settlement).
- **NOT** for Swaps, Financially Settling Options or similar financial derivatives.
- For Use in Bulk Wholesale Trading, **BUT NOT** for Retail, Highly Structured or Long Term Supply Transactions.

Scope of the Power Master

Partial review

Section 1: Subject of Agreement

- General Agreement “governs all transactions”.
 - “All” transactions, unless otherwise provided.
 - Negotiated just once.
 - Easy to document and administer transactions.
- Each transaction defined as an “individual contract”.
- Individual Contracts and the General Agreement form a “single agreement”.
- Election: whether or not to bring pre-existing contracts under the Master Agreement umbrella.

Section 3: Concluding and Confirming Individual Contracts

- Concluding (Section 3.1)
 - “May be concluded in any form of communication”.
 - “Legally binding and enforceable from the time ... concluded”.
- Confirming (Section 3.2)
 - “Both parties shall be free to confirm”
 - Written confirmation not a requirement for a legally valid Individual Contract.
 - In case of Polish law confirmation in writing may be required.
- Authorised Persons (Section 3.4)
 - Who can bind each party to Individual Contracts?

Section 4: Primary Obligation for Delivery and Acceptance of Electricity

- Definition of “Schedule” (Section 4.2)
 - “those actions necessary for a party to effect its respective delivery on acceptance obligations”.
 - The parties must do whatever it takes.

Section 7: Non-Performance due to “Force Majeure”

- “Force Majeure” (Section 7.1)
 - “occurrence beyond the reasonable control of a Party ... which it could not reasonably have avoided or overcome ... and which makes it impossible to perform”.
 - Can be partial or total (Section 7.2).
 - Performance obligations released during “Force Majeure” events (Section 7.2).
 - Claiming Party has duty to mitigate effects of “Force Majeure”.

Section 8: Remedies for Failure to Deliver and Accept

- **“Cover costs”** *plus* any “incremental transportation costs and penalties and other reasonable and verifiable costs or expenses.
- Cover costs sometimes referred to in industry as “liquidated damages”.

Section 16: Guarantees and other Initial Credit Support

- Initial Credit Support is as specified in Election Sheet:
 - parent guarantee, bank guarantee, letter of credit, credit support agreement.
- “Credit Support Provider” must be specified in Election Sheet.

Section 17: Managing Credit Risk

- Material Adverse Change (Section 17.2)
 - Numerous “triggers” to pick from.
 - Numerous “thresholds”, ratios, etc. to negotiate.
 - Heavily negotiated area; EFET offers many options.
 - Most common trigger = reduction of credit rating of Party or its Credit Support Provider below set level.
 - Problematic in Eastern Europe: Companies not rated.
 - A more subjective “trigger” is a Party’s “impaired ability to perform”.

Troubled Trading Relationships

Section 9: Suspension of Delivery

■ Triggers:

- Payment defaults.
- Failures to provide Performance Assurance or Credit Support.
- 3 days notice and right to cure.
- Permits suspension of further deliveries by Non-Defaulting Party under ALL Individual Contracts where it is the seller.

The Trading Relationship breaks down Contractual Protections 1

- Notice – Designation of Early Termination Date (Section 10.3 [b]).
- All payment and performance obligations released, replaced by new obligation of one party to pay the Termination Amount to the other party (Section 10.3 [c]).
- Automatic Early Termination – an optional clause (Section 10.4).

The Trading Relationship breaks down Contractual Protections 2

Section 11: Calculation of the Termination Amount

- Terminating Party calculates “the sum” (whether positive or negative) of all Settlement Amounts for all Individual Contracts.
- Taking into account any other amount payable between the parties in connection with the Agreement. (“Close-Out” Netting).

The Trading Relationship breaks down Contractual Protections 3

Settlement Amount

=

[(Losses + costs) – Gain]

for each individual contract

- “Losses” = present value of economic benefit loss.
- “Costs” = fees, commissions, legal costs, other third party expenses.
- “Gain” = present value of economic loss avoided.

What are the choices for jurisdiction in Poland?

- Regulated by the Polish Private International Law
- Will be replaced by the Rome Convention when it enters into force for Poland
- Polish Private International Law:
 - The parties may choose a law to govern their contract provided that there is a connection between the contract and the law chosen
 - citizenship / residence / seat of one of the parties
 - place of execution or performance of the contract

Polish Insolvency Situation

- Parties may terminate the master agreement and settle the parties' individual transactions in accordance with the settlement mechanism provided in the master
- If the master agreements stipulates that the individual transactions are terminated in case the master agreement is terminated the official receiver does not have “cherry-picking” rights.
- It is possible to set-off mutual debts resulting from the settlement.

Thank You

- For any follow-up questions please contact
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