



EEI Master Netting Agreement

This Important Financial Resource Can Help Companies To Mitigate Credit Exposure and Increase Liquidity in Electric Power Markets.

Shrinking liquidity and lack of access to capital markets, as a result of the current financial crisis, are threatening the ability of electric power companies to provide reliable electricity at stable prices. Credit exposure is making it increasingly difficult for electric companies to enter into transactions with end users such as trading companies and financial institutions. For the electric power industry to execute these transactions with little impact on prices, there must be liquid wholesale markets and reduced exposure.

As part of ongoing efforts to improve electric power markets and to restore investor confidence, EEI has developed a “Master Netting Agreement”. This standardized contract, released on October 22, 2002 and revised on January 10, 2003, is available for use by all companies involved in energy trading. It is an important financial resource to help companies mitigate credit risk and increase liquidity. EEI member companies, major independent energy traders, financial institutions, and law firms collaborated in a public process to produce this contract.

Following are Frequently Asked Questions about EEI’s Master Netting Agreement

What is a Master Netting Agreement?

EEI’s Master Netting Agreement is a standardized bilateral contract that enables trading counterparties to agree to net collateral requirements; and, in a closeout situation, settlement amounts related to underlying master trading contracts relating to sales and purchases of electricity, natural gas, and related financial transactions. In other words, the Master Netting Agreement offsets positive balances of one transaction with negative balances of another.

How does netting work?

Netting minimizes counterparty exposure and capital required to trade, which are essential practices for managing risk and reducing liability when energy trading. In its simplest form, netting out one’s obligations means that if someone defaults on his/her obligation to you and you have offsetting obligations to them, you are exposed only up to the net amount of mutual obligations.

Here's an example of how netting works:

Assume Energy Trader A sells Energy Trader B \$1,000 worth of energy, and Trader B sells \$1,500 of energy to Trader A. Using a netting agreement, Trader A can simply secure the difference of \$500 in the event that Trader B defaults on its obligation. As a result, Trader A can claim less money (\$500 vs. \$1,500) as a liability, thus reducing its exposure and requiring less collateral to run its business.

The Master Netting Agreement applies this concept when counterparties are trading different commodities under separate master agreements.

Why is the Master Netting Agreement important?

The Master Netting Agreement deals with the entire trading relationship of the counterparties, as opposed to focusing on each commodity traded separately. Thus, a default under one trading agreement can trigger rights to terminate other trading agreements. Second, it can reduce collateral-posting requirements by netting collateral requirements across contracts. Third, it can reduce exposure in a close-out situation by permitting the netting of settlement amounts thereunder. All of these attributes combine to facilitate greater liquidity in energy markets.

How was the Master Netting Agreement developed?

EEI member companies, major independent energy traders, financial institutions, and law firms collaborated in a public process to produce the Master Netting Agreement. A task force of lawyers representing the above-referenced groups produced several draft Master Netting Agreements that were circulated for extensive comment and suggestions from the industry. Beginning in Spring 2002, drafts were placed on public sections of the EEI Web site. Throughout the development process, meetings were held in Houston and Washington, DC, to obtain suggestions and input.

What about the legal issues involved with such an agreement?

The Master Netting Agreement is complicated and contains many optional provisions to address various likely scenarios that a trading entity will face. To make sure that potential users are fully aware of important legal issues affecting use of the Master Netting Agreement, EEI has prepared a document called a "Legal Landscape". Among other things, the Legal Landscape discusses how a netting agreement could be affected by bankruptcy and commercial laws as well as issues to consider in entering into Master Netting Agreements.

A User's Guide has also been developed to assist users of the Master Netting Agreement form in selecting options appropriate to their relationship with a particular counterparty to the Master Netting Agreement.

Why did EEI sponsor the Master Netting Agreement?

The Master Netting Agreement is needed by the electric power industry to reduce credit exposures and increase liquidity for energy traders. This is especially true now that capital is so difficult and expensive to raise.

EEI served as a neutral facilitator, bringing interested parties together to develop this agreement. And we acted quickly to develop the final product because of the importance of this type of agreement to our member companies and to our industry as a whole.

Who supports the use of the Master Netting Agreement?

The Master Netting Agreement was developed by a coalition of EEI members, independent energy traders, financial institutions, and law firms. It has been endorsed by the Committee of Chief Risk Officers, which represents many EEI members and independent energy companies.

Where can I find the Master Netting Agreement?

The Master Netting Agreement is posted on EEI's Web site, www.eei.org. It is available free of charge to interested users.

Where can I get more information?

To learn more about the Master Netting Agreement, please contact Aryeh Fishman, EEI Director of Regulatory Legal Affairs, at 202-508-5023, or via e-mail at afishman@eei.org.

How can I participate in developing important standardized contracts?

If you are interested in participating in EEI standard contract development initiatives, please contact Aryeh Fishman, EEI Director of Regulatory Legal Affairs, at 202-508-5023, or via e-mail at afishman@eei.org.

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