EDISON ELECTRIC INSTITUTE

EEI's Market Disruption Provisions:

Discussion of Revised Optional Language for Transactions with Index-based Pricing

Version 2.0[1]

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[1] This version may be used as an alternative to the original market disruption provisions published by EEI.

<u>EEI's MARKET DISRUPTION PROVISIONS:</u>
DISCUSSION OF REVISED OPTIONAL LANGUAGE FOR TRANSACTIONS WITH INDEX-BASED PRICING

A. Background

The Edison Electric Institute ("EEI") first published "Optional Language for Transactions with Index-based pricing" in 2002 (the "Original Market Disruption Provisions"). This provision was published for use by parties that envision pricing certain Transactions based on an index or other third party price source and, as a result, wish to provide for an alternative basis for determining the Contract Price should the relevant index or price source be disrupted, substantially altered or no longer published.

In February 2007 the EEI Contract Drafting Committee formed a Market Disruption Subcommittee (the "Subcommittee") to consider whether the Original Market Disruption Provisions should be revised and updated to address several issues that had been raised by market participants. For example, a number of parties had found that the existing provisions did not properly address market disruption events when they actually occurred and, consequently, these terms were often disregarded in practice. In addition, some firms were concerned about the fact that other market disruption provisions commonly used in the commodity markets, such as those published by the International Swaps and Derivatives Association, Inc. (ISDA) for commodity derivative transactions, were inconsistent with EEI's optional provisions in several respects. Because of this inconsistency, these firms maintained that related transactions under separate master agreements could potentially be priced differently following the occurrence of a market disruption event, creating unintended "basis risk" for the transactions.

The Subcommittee sought to leverage the lessons learned during the last few years to create a set of provisions that would produce an outcome more closely aligned to the parties' wishes and expectations upon the occurrence of a market disruption event. As part of this effort, the Subcommittee also attempted to better harmonize these new market disruption provisions with those included in the 2005 ISDA Commodity Definitions. The result is a set of new provisions entitled "Revised Optional Language for Transactions with Index-based Pricing" (the "Revised Market Disruption Provisions"). Capitalized terms used in this discussion and not otherwise defined have the meanings given to them in the Revised Market Disruption Provisions.

B. Explanation of Changes

Expanded Definition of Market Disruption Event. As noted above, the Revised Market Disruption Provisions reflect several changes to the previously published provisions in order to achieve greater consistency with ISDA's market disruption provisions. For example, the definition of "Market Disruption Event" was expanded to include material changes to the composition of the Product. In addition language was added to address the fact that certain Transactions may reference a price that is announced or made available by a regional transmission operator (RTO) or independent system operator (ISO).

Revised Waterfall of Disruption Fallbacks. The Revised Market Disruption Provisions revise the original waterfall of fallbacks that apply following the occurrence of a Market Disruption Event in an attempt to make them not only more consistent with ISDA's waterfall but also more likely to produce a result desired by the parties. For example, upon the occurrence of a Market Disruption Event, the Revised Market Disruption Provisions first require the parties to use a fallback Floating Price to the extent such a fallback price was specified in the Confirmation, consistent with ISDA's waterfall.

If the parties have not specified a fallback Floating Price, the Revised Market Disruption Provisions require the parties to endeavor, in good faith and using commercially reasonable efforts, to agree on a substitute price taking into consideration industry initiatives (e.g., guidance, protocols, recommendations by trade organizations and industry groups) in response to such market disruption event. This fallback is similar to

ISDA's concept of "Negotiated Fallback" and one of the fallbacks included in the Original Market Disruption Provisions. However, the Revised Market Disruption Provisions specifically require the parties to look toward market conventions adopted to address the event concerned in attempting to determine a mutually agreeable substitute price. The Revised Market Disruption Provisions provide that the parties have up to 5 Business Days (rather than 12) to agree to a substitute price in an attempt to achieve greater consistency with the 2005 ISDA Commodity Definitions.

The Revised Market Disruption Provisions also provide that, to the extent the Price Source specified in the Transaction publishes the relevant Floating Price for a Disrupted Day before the parties have managed to agree to a substitute price, the parties must utilize that retrospectively published Floating Price for the relevant Disrupted Day. This fallback is similar to ISDA's "Delayed Publication or Announcement" and was not included in EEI's Original Market Disruption Provisions. In contrast, ISDA's "Postponement" fallback was not included in the waterfall for the Revised Market Disruption Provisions because the Subcommittee determined that it was not appropriate to shift the pricing date for a Transaction upon the occurrence of a Market Disruption Event.

If the parties cannot determine a Floating Price pursuant to the foregoing fallbacks within 5 Business Days of the occurrence of the Market Disruption Event, the parties must then determine the Floating Price based on a form of dealer poll. This final fallback is similar to ISDA's concept of "Fallback Reference Dealers" and the fallback included in the Original Market Disruption Provisions, with certain modifications and clarifications.

Changes to "Corrections to Published Prices". The Revised Market Disruption Provisions provide that a party may require that payments be adjusted to reflect any correction to a published price that is issued within 30 days of the original publication. This 30-day lookback period is consistent with the 2005 ISDA Commodity Definitions and represents a substantial reduction from the two-year lookback period that was included in the Original Market Disruption Provisions. However, this provision is subject to an important exception for RTO Transactions, consistent with RTO rules, as the Subcommittee recognized that a longer period may be necessary for these types of Transactions.

Rounding. On rounding the Subcommittee determined that it has become common practice to round Floating Prices to four decimal places rather than three (as the Original Market Disruption Provisions provided), so the Revised Market Disruption Provisions reflect this convention. However, the Subcommittee also observed that it is necessary for parties to consider what their systems and confirmation platforms can accommodate when agreeing to a rounding convention and therefore left the numbers in this provision in brackets.