COMMENTARY ON THE
2002 ISDA® ENERGY AGREEMENT BRIDGE

This note will explain the provisions set forth in the 2002 ISDA Energy Agreement Bridge (the "Energy Bridge") and highlight some of the benefits of the approach taken by the Energy Bridge.

THIS NOTE DOES NOT PURPORT TO BE (AND SHOULD NOT BE CONSIDERED TO BE) A GUIDE TO, OR EXPLANATION OF, ALL ISSUES OR CONSIDERATIONS RELEVANT IN DOCUMENTING A PARTICULAR CONTRACTUAL RELATIONSHIP. PARTIES SHOULD, THEREFORE, CONSULT THEIR LEGAL ADVISORS AND ANY OTHER ADVISORS THEY DEEM APPROPRIATE PRIOR TO USING THE ENERGY BRIDGE. ISDA ASSUMES NO RESPONSIBILITY FOR ANY USE TO WHICH THE ENERGY BRIDGE OR ANY OTHER ISDA DOCUMENTATION MAY BE PUT.

1. General Considerations. The Energy Bridge, which is based on the 2001 ISDA Cross-Agreement Bridge (the "2001 Bridge"), was developed by a working group of ISDA member institutions. It is intended to provide parties to an agreement in the form of either the 1992 ISDA Master Agreement (Multicurrency - Cross Border) or the 1992 ISDA Master Agreement (Local Currency - Single Jurisdiction) (each an "ISDA Master Agreement") with a means of using that agreement to achieve a form of cross-product netting. It does so by enabling them, upon the occurrence of certain events under any one of a variety of industry-standard agreements (including the ISDA Master Agreement), to terminate transactions documented under each of those agreements and to incorporate the net close-out amounts calculated in respect of transactions documented under industry-standard agreements other than the ISDA Master Agreement within the close-out provisions of their ISDA Master Agreement.

   It is intended that parties will be able to use the Energy Bridge with a broad range of industry-standard master agreements, whether or not those agreements are designed exclusively for use in the energy markets. Parties should note that, towards the end of 2000, ISDA received preliminary advice from its counsel on the question of whether the use of the 2001 Bridge with various master agreements (including those that provide for the physical delivery of commodities, such as coal, electricity or gas) would affect the conclusions expressed in each netting opinion. The advice received from the majority of ISDA's counsel was that the conclusions would not be affected. However, in a few jurisdictions, counsel expressed the preliminary view that using the 2001 Bridge with agreements that provide for the physical delivery of commodities would affect the conclusions expressed in their netting opinions. This advice, which is contained in the "SDR Opinions", is available to members of ISDA on the ISDA website, www.isda.org, under "What's New". The advice contained in the SDR Opinions refers only to the 2001 Bridge, but, for purposes of the netting opinion updates requested by ISDA in October 2002, counsel have now been asked to consider both the Energy Bridge and the published form of the 2001 Bridge.

2. Operation of Energy Bridge. Parties who wish to use the Energy Bridge would include it in Part 5 of the Schedule to a 1992 ISDA Master Agreement (Multicurrency - Cross Border), or Part 4 of the Schedule to a 1992 ISDA Master Agreement (Local Currency - Single Jurisdiction) (or amend an existing ISDA Master Agreement to include the provision). If parties do include the Energy Bridge in an ISDA Master Agreement, precisely how the Energy Bridge will operate is a matter to be agreed between the parties.

For example, the parties must specify, in paragraph 1(b)(i) of the Energy Bridge, the agreements other than the ISDA Master Agreement ("Bridged Agreements") they wish to be covered by the terms of the Energy Bridge.[1] Also, the parties must agree the circumstances in which the provisions of the Energy Bridge are to be triggered. To do this, they must agree the terms of the "Bridging Events".

3. <u>Occurrence of Bridging Event</u>. The Energy Bridge only operates if a Bridging Event is triggered. A Bridging Event will be triggered:

   (a) assuming Automatic Early Termination does not apply, immediately upon the designation of an Early Termination Date under the ISDA Master Agreement as a result of the occurrence of an Event of Default (as specified by the parties in paragraph 1(c)(i) of the Energy Bridge); or

   (b) assuming the relevant Bridged Agreement does not provide for the automatic termination of transactions, immediately upon the designation, pursuant to the terms of a Bridged Agreement and as a result of the occurrence of an event of default (however such concept is described, but unless the event of default is specified as an Excluded Event in paragraph 1(d) of the Energy Bridge), of a day on which all transactions outstanding under the Bridged Agreement will be terminated.

   In providing for a Bridging Event to occur not only upon the designation of an Early Termination Date under the ISDA Master Agreement, but also upon the designation of a termination date under a Bridged Agreement, the Energy Bridge reflects a different approach from that taken in the 2001 Bridge. Under the 2001 Bridge, only the designation (or deemed occurrence) of an Early Termination Date following the occurrence of a relevant Event of Default under the ISDA Master Agreement constitutes a Bridging Event.

   The Energy Bridge presumes that parties will specify, in paragraph 1(c)(i), either all Events of Default under the ISDA Master Agreement or only the Bankruptcy Event of Default, although parties may specify other particular Events of Default if they wish.

   In paragraph 1(d) of the Energy Bridge, by specifying "Excluded Events", parties are able to prevent the provisions of the Energy Bridge being triggered by the occurrence of a particular event under a Bridged Agreement and the subsequent designation of a day on which all transactions under that agreement will be terminated. This may be useful, for example, if parties wish to ensure that there is no possibility of a particular event (such as an illegality or a force majeure event) being construed as an "event of default (however described)", and therefore potentially triggering the provisions of the Energy Bridge.

   The Energy Bridge also provides parties with a framework for addressing the possibility that Automatic Early Termination might apply under the ISDA Master Agreement between them, or similar automatic termination provisions might apply under one or more Bridged Agreements. In each instance, parties have the choice (in paragraphs 1(c)(i) and 1(c)(ii), respectively) between specifying that the automatic termination of transactions following the occurrence of a relevant event will trigger a Bridging Event, or specifying that such automatic termination will *not* trigger a

[1] The definition of "Bridged Agreements" also includes any agreement that the parties agree will be subject to the provisions of the Energy Bridge. Note that if the parties include the Energy Bridge in the Schedule to a 1992 ISDA Master Agreement (Local Currency - Single Jurisdiction), they should be aware that this form of agreement does not contain any Termination Currency conversion provisions. Accordingly, they should ensure that they specify as Bridged Agreements only agreements that generate close-out amounts in the same currency as that involved in transactions entered into under the 1992 ISDA Master Agreement (Local Currency - Single Jurisdiction).

Bridging Event. In the latter case, where an event occurs which triggers the automatic termination of transactions under the relevant agreement, the non-defaulting party will not be able to rely on the provisions of the Energy Bridge.

Parties should note that a Bridging Event described in paragraph 1(c)(i) cannot be triggered following the occurrence of a specified Event of Default under the ISDA Master Agreement unless there are transactions outstanding under that agreement. In the absence of outstanding transactions, there is no possibility of an Early Termination Date either being designated or arising automatically. Neither can a Bridging Event described in paragraph 1(c)(ii) be triggered following the occurrence of a relevant event of default under a Bridged Agreement unless there are transactions outstanding under that agreement. Paragraph 1(c)(ii) of the Energy Bridge requires the "designation…of a day on which all transactions outstanding under the Bridged Agreement will be accelerated, terminated or cancelled, as the case may be".

In this respect, the Energy Bridge takes a different approach from the 2001 Bridge. The 2001 Bridge, the operation of which, as discussed above, can only be triggered by the occurrence of an Event of Default under the ISDA Master Agreement, includes provisions that address the possibility that there might not be any transactions outstanding under the ISDA Master Agreement. Members of the working group involved in the development of the Energy Bridge felt that, especially considering the use of expanded Bridging Events in the Energy Bridge, including equivalent provisions in the Energy Bridge would add unnecessary complication.

4. Effect of Bridging Event. The effect of the occurrence of a Bridging Event depends on whether a Bridging Event described in paragraph 1(c)(i) or a Bridging Event described in paragraph 1(c)(ii) occurs.

(a) If a Bridging Event described in paragraph 1(c)(i) occurs, an event of default (however such concept is described) under each Bridged Agreement will be deemed to have occurred with respect to the party that is the Defaulting Party under the ISDA Master Agreement and in respect of all transactions outstanding under each Bridged Agreement.

Notwithstanding the provisions of each relevant Bridged Agreement, transactions under the Bridged Agreements will then be closed out and valued in accordance with the provisions of each relevant Bridged Agreement,[2] but so that the transactions will be closed out on the Early Termination Date (or, if applicable, the deemed Early Termination Date).

The Energy Bridge deems all amounts due or which otherwise would become due under Bridged Agreements (or transactions under Bridged Agreements) to be amounts which were due under Section 2(a)(i) of the ISDA Master Agreement on the Early Termination Date (rather than under the relevant Bridged Agreements or transactions themselves). As with all other payments under Section 2(a)(i), upon the occurrence or effective designation of an Early Termination Date, no further such payments are required to be made (by virtue of Section 6(c)(ii) of the ISDA Master Agreement). Section 6(c)(ii) further provides that the amount, if any, payable in respect of an Early Termination Date shall be determined pursuant to Section 6(e). By amending the definition of "Unpaid Amounts", the Energy Bridge provides the mechanism for including in the close-out calculations under Section 6(e) of the ISDA Master Agreement any

[2] It is expected that amounts provided or due as margin in respect of transactions under a Bridged Agreement will be included in the calculation of the net close-out amount due in respect of those transactions. Whether this is correct will depend on the precise nature of the margin arrangements.

amounts due (or which would have become due but for Section 6(c)(ii)) as a result of any acceleration, termination or cancellation of the parties' obligations under a Bridged Agreement. Just like any other Unpaid Amounts, those amounts will be included in the calculations under Section 6(e).

(b) If a Bridging Event described in paragraph 1(c)(ii) occurs, an event of default (however such concept is described) under each Bridged Agreement other than the Bridged Agreement in respect of which the Bridging Event has occurred and an Event of Default under the ISDA Master Agreement will be deemed to have occurred with respect to the party that is the party in default under the relevant Bridged Agreement.

The Energy Bridge includes provisions to ensure that all transactions, whether documented under the ISDA Master Agreement or under Bridged Agreements, will be closed out on the day designated (or, if applicable, deemed to occur) on which transactions under the particular Bridged Agreement in respect of which a Bridging Event occurred will be closed out. The rationale for focusing on this date is that it was the designation or deemed occurrence of this date that constituted the Bridging Event.

Accordingly, the Energy Bridge provides that notice designating an Early Termination Date under the ISDA Master Agreement will be deemed to have been given with effect from a date such that an Early Termination Date will occur on the above day. The Energy Bridge also provides that, notwithstanding the provisions of each relevant Bridged Agreement, transactions under the Bridged Agreements will be closed out and valued in accordance with the provisions of each relevant Bridged Agreement,[3] but so that the transactions will be closed out on the deemed occurrence of the Early Termination Date as described above.

In the same way as if a Bridging Event described in paragraph 1(c)(i) occurs, the Energy Bridge deems all amounts due or which otherwise would become due under Bridged Agreements (or transactions under Bridged Agreements) to be amounts which were due under Section 2(a)(i) of the ISDA Master Agreement on the Early Termination Date (rather than under the relevant Bridged Agreements or transactions themselves). As explained above, these amounts are ultimately included only in the calculation of an amount pursuant to Section 6(e) of the ISDA Master Agreement as Unpaid Amounts.

5. Inconsistency. The Energy Bridge provides that where the provisions of the Energy Bridge are inconsistent with the terms of any Bridged Agreement, the provisions of the Energy Bridge will prevail. In a change from the 2001 Bridge, the Energy Bridge also provides that, to the extent that the terms of a Bridged Agreement are inconsistent with the provisions of the Energy Bridge, the Bridged Agreement is amended accordingly. This is intended to address concerns expressed by some market participants that the terms of existing letters of credit or similar instruments that are triggered by the occurrence of an event of default under an agreement specified as a Bridged Agreement may not be triggered in certain circumstances where the operation of the Energy Bridge is triggered (where a Bridging Event is triggered pursuant to the occurrence of an event that does not constitute an event of default under the Bridged Agreement).

6. Benefits of Approach. The approach taken by the Energy Bridge keeps the agreements between the parties essentially separate from each other, and simply places the close-out mechanics of the ISDA Master Agreement between the parties "on top" of the specified Bridged Agreements if a Bridging

[3] See footnote 2.

Event is triggered.

This approach has the advantage of not significantly interfering with the operational procedures or the close-out and valuation provisions of a Bridged Agreement, which are widely known and accepted in the relevant market.

It is also expected that, in most jurisdictions, this approach will minimize the insolvency, regulatory and tax implications of using the Energy Bridge. Nevertheless, parties should consider the implications of using the Energy Bridge in consultation with their advisors.

Including the Energy Bridge in an ISDA Master Agreement effectively turns the ISDA Master Agreement into a "master master" agreement. However, using the Energy Bridge in an existing ISDA Master Agreement may offer parties significant advantages:

(a) it makes use of the ISDA Master Agreement's close-out netting provisions, which are supported by an extensive and well respected library of netting opinions;

(b) it may offer, in many jurisdictions, a more robust way of achieving a form of cross-product netting; and

(c) the Energy Bridge can be easily incorporated into a new ISDA Master Agreement or by way of a single amendment without the need to negotiate a separate agreement.