

# **Directed Contracts**

## **Market Power Group Meeting**

**20 November 2006**



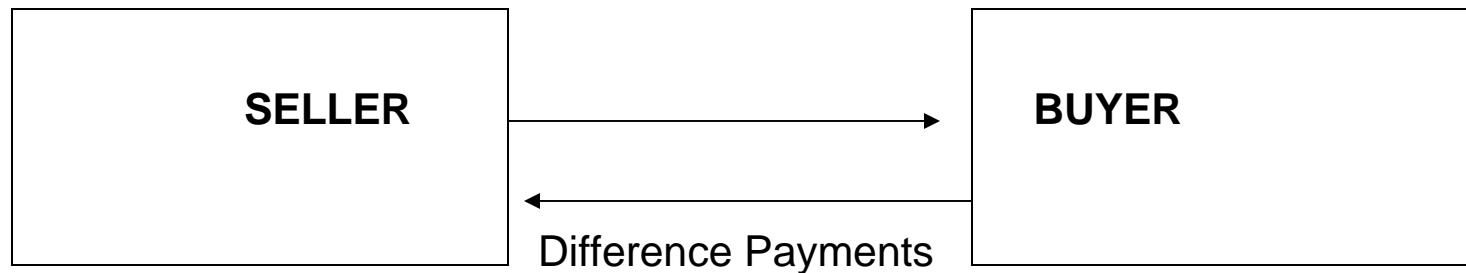
## Meeting Aims

- to facilitate collaborative industry efforts to develop a standard form CFD for Directed Contract (this may help to create a standard CFD for the SEM).
- no intention to impose a contract on the industry, consensus between Seller and Buyer preferred.
- content to take on board comments on the draft CFD issued on 13 November but these must be followed up in writing with appropriate drafting.



## CFD Basics

- it is a financial instrument and industry participants will need to check their financial authorisation status.
- there is no physical delivery of electricity or any right given to power stations or plant.
- it is a two way CFD:



- strike price
- contract volumes
- SMP



## Start and Duration (Clause 2)

- contract enters into force on date of signing to allow trading to begin on 1 November 2007.
- cash flows in terms of transaction monies begin on first publication of SMP on 1 November 2007.
- contract duration depends on decisions to be taken regarding the possible future harmonisation of PES tariff years in the North and South.



## Trading Procedure (Clause 3)

- facility for verbal trades backed up evidentially by phone call recording.
- written confirmation letter details strike price and type of product e.g. Baseload.
- transactions binding when they are agreed – could mean transaction binding when agreed verbally.
- Buyer and Seller to agree content of mutual representations and warranties (Clause 4).



## Quantity Reduction (Clause 5.3)

- the Regulatory Authorities will re-examine eligibility using MIC's and will have the authority to adjust the directed contract level downward if the Buyer's aggregate MIC has reduced. Any such reductions will be prospective only.
- directed contracts will not be assignable as they are subject to reduction in the event of material loss of load served.



## Index / SMP (Clause 6)

- if an index is no longer published then the parties can agree to substitute a suitable replacement, for example, another Argus Index.
- if SMP is not published then this is a force majeure event and is the only force majeure event under the contract. Reflects the position that this CFD is not a contract for physical delivery.
- question whether force majeure event should permit the contract to be terminated after a certain duration – industry to consider.
- may be further work required to agree more detailed references to indices in order to have more precision as to the specific index being used.



## Billing / Netting (Clause 7)

- billing cycle requires the issuance of a monthly statement within business day 5 of the preceding month and payment of any undisputed amount normally within business day 10 of the preceding month.
- may be weekly billing cycle is more appropriate.
- contract currently on a monthly basis but may be quarterly depending on DC quantification decision paper
- disputes – no reference to expert / arbitration as parties to consider whether going straight to court is more appropriate in that its orders can be enforced.
- consider cure periods regarding non-payment.
- Netting provided – currency / Transaction.



## **Credit Cover (Clause 10.2)**

- Buyer is required to provide margin through either letter of credit or an escrow account.
- margin follows the suggested forms from the Trading and Settlement Code.
- non-provision of margin by the Buyer is a default as is non-return of surplus margin by the Seller.
- credit cover provisions will operate prior to 1 November 2007.

### **Termination (Clause 11)**

- “standard” events e.g. insolvency – consider/adequacy of cure periods.
- Loss Payment calculation – “seal off” parties financial exposure.



## Disputes (Clause 12)

- CFD uses only expert (for example regarding replacement index – consider widening reference scope) or the courts.
- no MAC (Material Adverse Change) clause, change of law/taxes “re-openers” – reflects relatively short duration of CFD.
- jurisdictional questions will be based on the Seller’s jurisdiction.

### **Alignment Issues:**

- standard definition of peak load period between the North and the South.
- public holidays are not coincident in the North and the South.

