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Bankruptcy Court Limits the Scope of "Forward Contracts"

By [Craig Enochs](#), [Kevin Page](#) and [Samir Najam](#)

The United States Bankruptcy Court for the Western District of Wisconsin (the "Court") recently issued an opinion analyzing the definition of "forward contract" in the context of the safe harbor provisions of the U.S. Bankruptcy Code (the "Code").¹

In the case of *In re Renew Energy*, Plains Marketing Canada ("Plains") entered into three contracts to sell natural gasoline to Renew Energy LLC ("Debtor"). The parties entered into two contracts in February 2008 with terms that expired in December 2008 (the "February Contracts"), and a third contract on October 28, 2008 that expired on October 31, 2008 (the "October Contract").² After Debtor filed for bankruptcy on January 20, 2009, the trustee brought a preference action against Plains to recover approximately \$808,000 in payments that Debtor made to Plains under the February Contracts and October Contract (the "Contracts") within the 90 days immediately prior to the bankruptcy filing (the "Preference Period"). Plains moved for summary judgment, claiming that Debtor's payments made during the Preference Period were "settlement payments" under "forward contracts" and therefore were protected by the Code's safe harbor rights.³ The key issue analyzed by the Court was whether the Contracts constituted "forward contracts" under the Code.

While other bankruptcy courts have undertaken an analysis of the term "forward contract" by scrutinizing a contract's language, its purpose and the parties' motives under the relevant agreement, this Court focused its attention on the statutory definition of "forward contract."⁴ Under the Code, a "forward contract" must have a maturity date more than two days after the date the contract is entered into.⁵ Noting that the term "maturity date" had never been expressly defined under the Code or by a court, the Court adopted a definition based on "common sense" and "common usage."⁶ According to the Court, "maturity date" means the date on which a delivery obligation under a forward contract has been fully performed and the only remaining obligation is the tender of payment for such delivery.⁷ Under this definition, the Court reasoned that a forward contract involving multiple deliveries (e.g., a delivery obligation each month during a stated term) will have multiple maturity dates as a result.

Based on this analysis, the Court held that the February Contracts were "forward contracts" because payments made to Plains in November 2008 related to deliveries with a maturity date arising in September 2008—seven months after the Contracts were originally entered into by the parties—and therefore fell within the Code's safe harbor rights and could not be avoided by the trustee as preferential transfers.⁸ As to the October Contract, however, the Court held that it was not a "forward contract" because the delivery of natural gasoline was fully performed within two days of the date the

Contract was entered into by the parties. Therefore, the trustee was not precluded from pursuing a preference action against Plains as to payments made during the Preference Period under the October Contract.

The Court's definition of "maturity date" may raise some practical issues to consider if a party desires its commodity contracts to fall within the safe harbor protections. If a party determines that only certain of its trading agreements constitute "forward contracts" under the Court's analysis while other agreements (e.g., spot-price or day-ahead transactions) do not meet the definition, this may directly impact the management of credit risk associated with a counterparty's potential bankruptcy and the calculation of collateral requirements.⁹ With respect to physical power and natural gas transactions, the definition of "maturity date" also raises the question of whether short-term transactions for next-day volumes or daily balancing volumes are considered "forward contracts." If such short-term transactions are not "forward contracts" but are entered into under a master agreement along with other transactions that do constitute "forward contracts," it remains unclear how such mixed transactions would impact a bankruptcy court's analysis of whether the master agreement qualifies as a "forward contract" subject to safe harbor protections and how a party should treat its credit exposure under the master agreement.

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¹See *In re Renew Energy LLC*, 2011 WL 3793157 (Bankr.W.D.Wis. Aug. 24, 2011) (the "Opinion").

²Opinion at 2-4.

³See Opinion at 4-5; see also 11 U.S.C. § 546(e) (Settlement payments made pursuant to forward contracts cannot be avoided by the debtor as preferential transfers).

⁴Opinion at 5-6 (citing *In re MBS Management*, 432 B.R. 570, 575 (Bankr. E.D. La. 2010); *In re National Gas Distributors*, 369 B.R. 884, 894-95 (Bankr. E.D.N.C. 2007)). For additional information about the *In re MBS Management* case, please see our previous e-Alert published online at <http://www.jw.com/publications/article/1451>.

⁵See 11 U.S.C. § 101(25)(A).

⁶Opinion at 7-8.

⁷*Id.*

⁸Note that the Court also briefly analyzed whether Plains was a "forward contract merchant" in order to determine whether the safe harbor provisions applied to the February Contracts. Because the Code defines a "forward contract merchant" as "an entity the business of which consists in whole or in part of entering into forward contracts," the Court summarily held that Plains was a "forward contract merchant" simply by demonstrating that the February contracts constituted "forward contracts" under the Code. Opinion at 10; see also 11 U.S.C. § 101(26).

⁹For example, a party entering into a contract that is not a "forward contract" (and therefore not subject to the Code's safe harbor rights) may be more aggressive in managing its exposure and demanding collateral to mitigate any potential entanglement in bankruptcy proceedings if a counterparty defaults.

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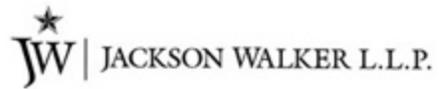
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