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Retail Electricity Agreement Found Protected Under the Bankruptcy Code's Safe Harbor Provisions

On August 2, 2012, in the case of *In re MBS Management Services, Inc.,*[1] the Court of Appeals for the Fifth Circuit ruled that a retail electricity agreement with a real estate management company constituted a forward contract protected by the "safe harbor" provisions of the U.S. Bankruptcy Code ("Bankruptcy Code").

Background. MBS Management Services Inc. ("MBS"), a property manager for dozens of apartment complexes, agreed to purchase the "full electric requirements" for certain of its affiliates' properties from Vantage Power Services, LP, which later sold the agreement to MXEnergy Electric, Inc. ("MX"). In late August 2007, MBS paid MX for various past due electric bills. MBS filed for Chapter 11 protection on November 5, 2007, and the MBS Trustee sought to avoid the August payment as preferential. MX argued that the payment was shielded from avoidance under 546(e), which protects payments made pursuant to forward contracts. The MBS Trustee argued that the agreement did not specify a quantity or delivery date(s), and that mere evidence of recurring payments for a commodity is insufficient to include it within the definition of a protected "forward contract" under the Bankruptcy Code. The MBS Trustee also argued that the agreement did not contain a maturity date and thus did not satisfy Bankruptcy Code section 101(25)(A)'s requirement that a forward contract contain a "maturity date more than two days after the date the contract is entered into." The bankruptcy and district courts rejected the MBS Trustee's claim that payments made by the debtor to MX to reimburse MX for supplying electricity were avoidable preferences, holding that the agreement qualified as a forward contract.

The Fifth Circuit Decision. The Fifth Circuit agreed with the bankruptcy and district courts that the payments were made under a "forward contract" and, as a consequence, were expressly exempt from the Bankruptcy Code's preference provision by Bankruptcy Code section 546(e). The Fifth Circuit rejected the MBS Trustee's argument that a forward contract must specify quantity and delivery dates. The Fifth Circuit noted that neither the definition of "forward contract" in Bankruptcy Code section 101(25) nor the exemption from preference liability for forward contracts in Bankruptcy Code section 546(e) contain such requirements.

The Fifth Circuit similarly rejected the MBS Trustee's argument that the contract could not be deemed a forward contract because it did not specify a maturity date. The Fifth Circuit noted that although courts may have been uncertain about the meaning of "maturity date" as used in

[1] *Lightfoot* v. *MXEnergy Electric, Inc.* (*In re MBS Management Servs., Inc.*), No. 11-30553 (5th Cir. Aug. 2, 2012).

Bankruptcy Code section 101(25), none suggest that contracts that do not *specify* a maturity date do not *have* one.[2]

Conclusion. While each case must be analyzed independently, the Fifth Circuit's ruling in *In re MBS Management Servs., Inc.* reflects a continued clear trend among courts to plainly interpret the safe harbor provisions of the Bankruptcy Code and protect covered transactions.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Douglas R. Davis
212-373-3130
ddavis@paulweiss.com

Brian S. Hermann
212-373-3545
bhermann@paulweiss.com

Associate Arina Popova contributed to this client alert.

[2] In a footnote, the Fifth Circuit noted but declined to resolve whether any fixed-price agreement between a residential consumer and his local utility would necessarily be safe-harbored, but noted that utilities already have special protections in section 366 of the Bankruptcy Code that might produce a similar result in any event.

NEW YORK
1285 Avenue of the Americas
New York, NY 10019-6064
+1-212-373-3000

BEIJING
Unit 3601, Fortune Plaza Office
Tower A
No. 7 Dong Sanhuan Zhonglu
Chao Yang District, Beijing 100020
People's Republic of China
+86-10-5828-6300

HONG KONG
12th Fl., Hong Kong Club Building
3A Chater Road, Central
Hong Kong
+852-2846-0300

LONDON
Alder Castle, 10 Noble Street
London EC2V 7JU
United Kingdom
+44-20-7367-1600

TOKYO
Fukoku Seimei Building, 2nd Floor
2-2, Uchisaiwaicho 2-chome
Chiyoda-ku, Tokyo 100-0011
Japan
+81-3-3597-8101

TORONTO
Toronto-Dominion Centre
77 King Street West, Suite 3100
P.O. Box 226
Toronto, ON M5K 1J3
Canada
+1-416-504-0520

WASHINGTON, D.C.
2001 K Street NW
Washington, DC 20006-1047
+1-202-223-7300

WILMINGTON
500 Delaware Avenue, Suite 200
Post Office Box 32
Wilmington, DE 19899-0032
+1-302-655-4410