"DEALING WITH THE BANKRUPTCY OF OTHERS"

by Chuck Willing

Partner, Rath, Young & Pignatelli

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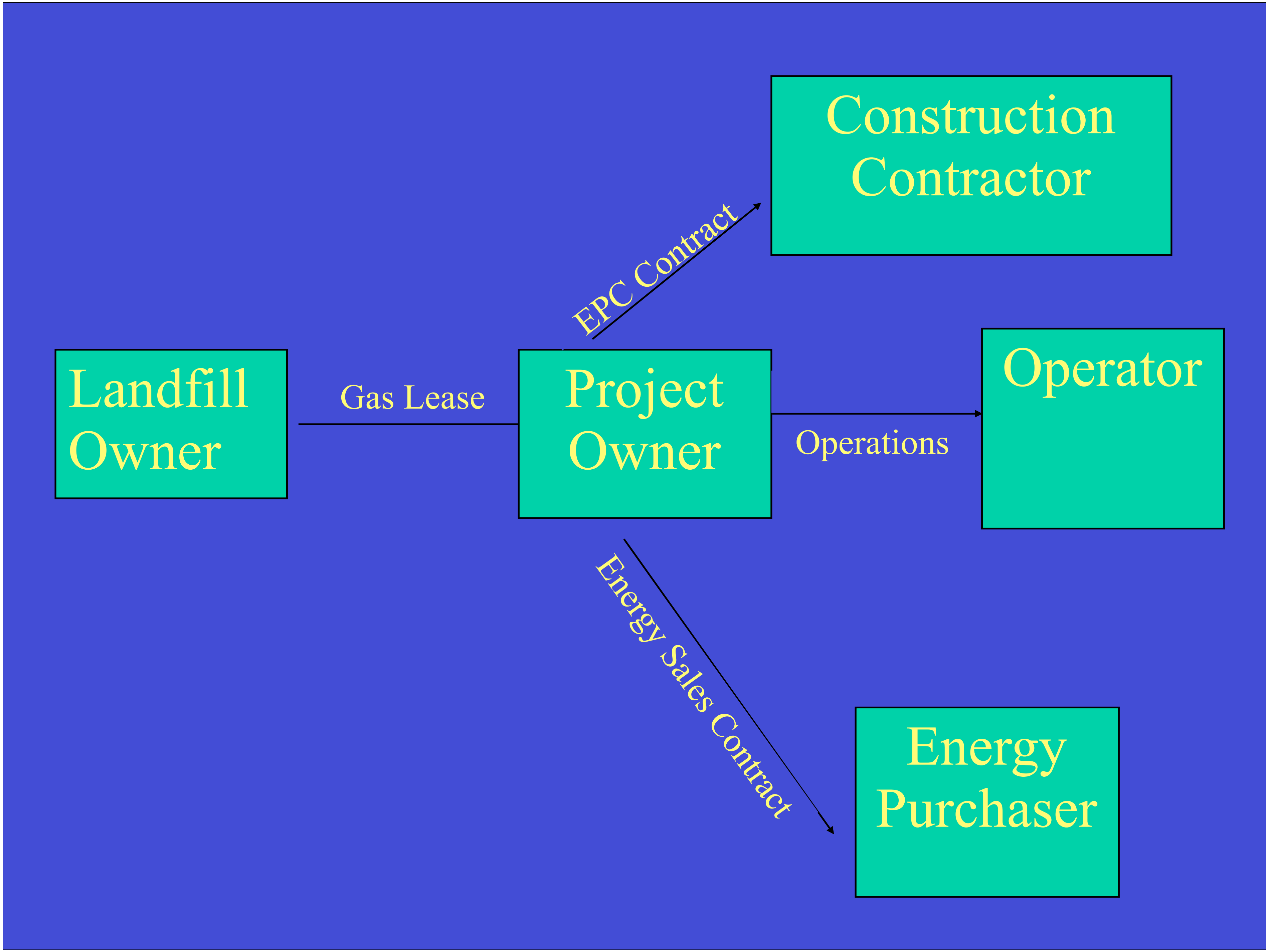
Major Energy Companies Declaring Bankruptcy Since 2001:

- Pacific Gas & Electric (PG&E)
- Enron
- NRG Energy
- Mirant
- PG&E National Energy Group/ USGen New England



Construction Contractor
EPC Contract
Landfill Owner
Gas Lease
Project Owner
Operator
Operations
Energy Sales Contract
Energy Purchaser

Outline of Presentation:

- What is Bankruptcy and how does it work?
- What happens to the contract when a counterparty goes bankrupt?
- How can you protect your company against the risk of a counterparty bankruptcy?

Bankruptcy Overview:

- Bankruptcy is intended to ensure:
  - Equitable treatment of Creditors.
  - Orderly distribution of assets.
  - Breathing spell, fresh start for Debtor.
- Chapter 7 (Liquidation) or Chapter 11 (Reorganization).

A Bankruptcy Filing. . .

- Creates new legal entity - Bankruptcy Estate.
- Triggers Automatic Stay.
- Requires Trustee or Debtor-in-Possession (DIP) to assume or reject contracts.
- If successful, discharges debts and pays claims at a discount.

Chapter 11 Reorganization:

- Premise – A business is worth more alive than dead. Creditors paid out of future earnings.
- Plan of Reorganization.
- DIP usually proposes Plan and manages estate.
- Creditors - committees and classes.

Creditor Claims:

- Filing, Allowance, Payment/Discharge.
- Priority:
  - Secured Claims - Paid in full up to value of Collateral before Unsecured Claims are Paid.
  - Priority Unsecured Claims.
  - General Unsecured Claims.

Automatic Stay on Creditor Collection Claims:

- Creditor Cannot:
  - Sue Debtor or Continue Suit.
  - Create, Perfect, Enforce Liens Against Debtor Property.
  - Terminate a Contract.
- Stay does not apply to government police power actions.
- Relief from Stay.

Assumption or Rejection of Contracts:

- Assumption - Estate becomes party.
- Rejection - DIP not liable.
- Court approval required. Court defers to DIP – "business judgment rule".
- "Limbo Period".
- Motion to Compel Assumption/Rejection.
- Unexpired Leases.

Wholesale Power Contracts:

- Tug-of-war between Bankruptcy Courts and FERC in NRG Energy, Mirant bankruptcies:
  - Courts assert exclusive jurisdiction over motions to reject Debtor contracts.
  - FERC asserts exclusive jurisdiction over wholesale electric contracts, cites police power exception to automatic stay.

Treatment of Non-Debtor Counterparties:

- The contract might be rejected.
- Until rejection, you have to perform, Debtor does not.
- You cannot terminate the contract.
- Your property rights (leasehold, security interests) are respected.
- You have a claim for damages.

Bankruptcy of Landfill Owner or Property Owner:

- DIP Owner cannot terminate the lease.
- DIP Owner may not fulfill other obligations.
- Recommendations:
  - Obtain all real property rights (e.g., lease, access easements) you need.
  - Record property rights.

Bankruptcy of Power Purchaser or LFG Purchaser:

- During "limbo period":
  - You have to keep delivering. Debtor might not pay under terms of contract.
  - Purchaser might reject but you cannot terminate.
- Motion to compel early assumption/rejection decision.
- Special protection for FERC-regulated contracts?

Bankruptcy of Power Purchaser or LFG Purchaser (cont'd):

- Analyze at the outset: What is your backup plan? What are your other sales options? What is your capital investment?
- If you install dedicated lines to Debtor, seek security interest or other form of protection from buyer. Always perfect security interest.
- Contract price vs. market price.
- Renegotiation of price.

Bankruptcy of Construction Contractor:

- Project owner is vulnerable to risk of a general contractor bankruptcy: substantial prepayments.
- Risks:
  - Bankrupt general contractor abandons project or otherwise fails to fully perform.
  - Subcontractors abandon or fail to fully perform.
  - Subcontractors file mechanics liens. You have to pay subs to release liens, then chase bankrupt general.

Bankruptcy of Construction Contractor (cont'd):

- Recommendations:
  - Examine financial condition of contractor ahead of time.
  - Hold contractor payments until deliveries are made.
  - Ask for payment bond.
  - Pay subcontractors directly.
  - Ask for parent company guaranty.

Bankruptcy of a Project Operator:

- Harm caused by Operator bankruptcy is less.
- Operator may continue to perform under the contract if it makes money.
- Quality of performance may be a risk. Bankrupt Operator may lose or lay off key employees.
- Recommendation: Enter a short-term (1-year) operations contract that does not automatically renew.

Conclusion:

- Assess Bankruptcy risk before signing contract.
- Know your counterparty.
- Property interests are your best protection.
- Record/perfect your property interests.
- No contract is completely bankruptcy-proof. Minimize the harm.
- You do not need maximum bankruptcy protection in every contract. Do what makes sense.