Client Alert

August 2012

Fifth Circuit Applies Safe Harbor Protection To Power Supply Contract in Real Estate Manager's Bankruptcy

On August 2, 2012, the United States Court of Appeals for the Fifth Circuit issued its decision in *Lightfoot v. MXEnergy Elec., Inc. (In re MBS Mgmt. Servs., Inc.*), Case No. 11-30553 (5th Cir. 2012), holding that a real estate management company's electricity supply contract qualified as a "forward contract", payments on account of which are protected from avoidance as preferential transfers under the Bankruptcy Code's "safe harbor" provisions.

Since the enactment of the Bankruptcy Code in 1978, Congress has provided protections, or "safe harbors," for parties to specified commodities and financial contracts, in order to protect the financial markets from certain destabilizing effects of the Bankruptcy Code. Among these specified contracts is a "forward contract" which section 101(25) of Bankruptcy Code defines as a "contract (other than a commodity contract[]) for the purchase, sale or transfer of a commodity...with a maturity date more than two days after the date the contract is entered into…."

Case Background

MBS Management Services, Inc. ("MBS") is a management company for dozens of apartment complexes. MBS contracted with MX Energy Electric, Inc. ("MX"), a power supplier/broker, to supply electricity to the complexes. MBS agreed to purchase the "full electric requirements" for certain of its properties for twenty-four months at $0.119 per kilowatt-hour, based on actual metered usage. In late August 2007, MBS paid approximately $156,000 to MX for electricity previously provided under the contract. MBS filed a chapter 11 petition with the United States Bankruptcy Court for the Eastern District of Louisiana on November 5, 2007.

After the bankruptcy was filed, the trustee for MBS sought to recover the August payment to MX as an avoidable preferential transfer under section 547(b) of Bankruptcy Code. The parties agreed that whether the payment could be recovered as a preference turned solely on whether the contract was a "forward contract" and thus protected from avoidance as a preference pursuant to one of the Bankruptcy Code's safe harbor protections. Specifically, section 546(e) of the Bankruptcy Code protects payments "made by or to (or for the benefit of) a …forward contract merchant…in connection with a …forward contract."

The contract contemplated the delivery of electricity more than two days after the contract's execution, and thus seemingly fit the section 101(25) definition of a "forward contract", payments on account of which would be protected from avoidance as a preference or fraudulent transfer under the section 546(e) safe harbor. Nevertheless, the trustee argued that the contract should not be protected under the Bankruptcy Code's safe harbor provisions, which were designed to protect financial markets and not "ordinary supply contracts" such as the contract at issue. The trustee cited the absence of exact quantities and delivery dates as evidence that the power supply contract was not the type of contract Congress intended to "safe harbor." The Fifth Circuit disagreed, affirming rulings by the bankruptcy court and district court that the power supply contract constitutes a "forward contract" within the meaning of the Bankruptcy Code, and is therefore protected from avoidance under section 546(e). The Court relied on the plain language of sections 101(25) and 546(e), which do not distinguish forward contracts from

ordinary supply contracts, or impose the requirements of exact quantities and delivery dates as suggested by the trustee.

Conclusion

The upshot of the Fifth Circuit's decision is that payments on ordinary commodity supply contracts may be insulated from exposure as preferential or fraudulent transfers. This potentially includes payments on natural gas, fuel, and electricity contracts which, like the power supply contract at issue in *Lightfoot v. MXEnergy Elec., Inc.*, are typically structured as requirements contracts, as well as contracts for the supply of other commodities. Commodity suppliers might want to consider this decision in formulating supply contracts to their customer base.

Contacts

Benjamin C. Ackerly
backerly@hunton.com

Tyler P. Brown
tpbrown@hunton.com

Jarrett L. Hale
jhale@hunton.com

Jason W. Harbour
jharbour@hunton.com

Michael S. Held
mheld@hunton.com

Gregory G. Hesse
ghesse@hunton.com

Andrew E. Jillson
ajillson@hunton.com

Andrew Kamensky
akamensky@hunton.com

Justin F. Paget
jpaget@hunton.com

Peter S. Partee, Sr.
ppartee@hunton.com

Robert A. Rich
rrich2@hunton.com

Michael P. Richman
mrichman@hunton.com

Lynnette R. Warman
lwarman@hunton.com

Michael G. Wilson
mwilson@hunton.com