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End User of Electricity Forward Contract Found Not To Be Forward Contract Merchant Under Bankruptcy Code Safe Harbor Provisions

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On January 15th, 2019, the U.S. Bankruptcy Court for the Northern District of Ohio held that the end user of an electricity forward contract was not entitled to the benefits of the safe harbor provisions under Section 556 of the Bankruptcy Code. Section 556 allows a “forward contract merchant” to terminate a forward contract post-petition based on an *ipso facto* clause in the contract and exempts such actions from the automatic stay. The term “forward contract merchant” is defined by Section 101(26) as a person whose business consists in whole or in part of entering into forward contracts as or with merchants in a commodity.

Prior to the petition date, an auto parts manufacturer, Meadville Forging Company, L.P. (“Meadville”), entered into a customer supply agreement (“CSA”) with FirstEnergy Solutions Corporation (“FirstEnergy”). The CSA was a forward contract by which FirstEnergy supplied electricity to Meadville based on its needs, and Meadville did not trade or re-sale the electricity. The CSA also contained an *ipso facto* clause which allowed Meadville to terminate the CSA upon FirstEnergy’s bankruptcy. Soon thereafter, FirstEnergy filed for Chapter 11 bankruptcy and sought to enforce the automatic stay seeking to stop Meadville from unilaterally terminating the CSA. Meadville argued that it was free to terminate the CSA under Section 556 because it was a forward contract merchant under Section 101(26), and that the prohibition against enforcing the *ipso facto* clause under Section 365(e) did not apply. The Court disagreed.

In holding that Meadville was not entitled to the benefits of Section 556, the Court found that the parties cannot contractually agree to confer legal status as forward contract merchant on Meadville, and bind the Court to that conclusion, “any more than they could have backed into that status by mutually signing an agreement stipulating that Meadville is a Federal Reserve Bank.”

The Court also rejected Meadville’s argument that the Court should follow the line of cases adopting a broader interpretation of Section 101(26) which only requires that one party to the contract to be a forward contract merchant. However, the Court stopped short of finding that the definition of forward contract merchant excludes all producers and end users. Instead, the Court found that to be a forward contract merchant that party’s business must involve, at least in part, “enter[ing] into forward contracts for the purchase and sale of electricity to generate a profit [and not] [m]erely entering into supply contracts as an end user of electricity.”

By adopting the more limited definition of forward contract merchant but yet refusing to exclude all producers and end users from the definition, this decision highlights the need to analyze the entirety of the non-debtor counter-party's business in determining whether such party will be able to avail itself to the safe harbor provisions of the Bankruptcy Code, even if the contract specifically designates a party as one.