SHIPPING COAL THROUGH SAFE HARBORS: APPLICATION OF THE BANKRUPTCY CODE SAFE HARBORS TO COAL SUPPLY AGREEMENTS

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I. INTRODUCTION

The Bankruptcy Code includes certain "safe harbors"[1] designed to protect the commodities and financial markets from the destabilizing effects of bankruptcy proceedings.[2] Specifically, the Bankruptcy Code limits the application of the automatic stay, its prohibition of ipso facto clauses, and the trustee's avoidance powers under certain enumerated circumstances.[3] Two of these circumstances should be of particular interest to entities that routinely enter into coal supply agreements: "forward contracts" entered into by "forward contract merchants,"[4] and "swap agreements" (specifically "commodity forward agreements") entered into by "swap participants."[5] If a given coal supply agreement is deemed to fit within either of these two classifications, the non-debtor counterparty to the agreement can terminate the agreement, setoff any obligations due under the agreement, and will have an absolute defense to any related preference or constructive fraud claims that may be asserted by the debtor or trustee.[6] Determining whether a particular contract fits within one of these classifications, however, is often difficult, given the paucity of applicable case law (particularly in the coal supply agreement context) and the conflicting statutory text and

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[1] Stephen J. Lubben, *Repeal the Safe Harbor*, 18 AM. BANKR. INST. L. REV. 319, 322 (2010) ("The term 'safe harbors' is a kind of shorthand for a variety of provisions in the Bankruptcy Code that reflect the 'well-established Congressional intent to protect the derivatives markets from the disruptive effects of bankruptcy proceedings.'").

[2] *See id.* at 326–27.

[3] *See* 11 U.S.C. §§ 362(b)(6), (b)(17), 546, 556, 560 (2012); *see also* Eleanore Heard Gilbane, *Testing the Bankruptcy Code Safe Harbors in the Current Financial Crisis*, 18 AM. BANKR. INST. L. REV. 241, 241–43 (2010).

[4] *See* 11 U.S.C. § 101(25)–(26) (defining the terms "forward contract" and "forward contract merchant").

[5] *See id.* § 101(53B)–(53C) (defining the terms "swap agreement" and "swap participant").

[6] *See id.* §§ 362(b)(6), (b)(17), 546, 556, 560.

legislative history surrounding the safe harbors themselves.[7] Notwithstanding any such difficulties, the ability to perform this analysis has taken on additional significance given the expansion of the Bankruptcy Code safe harbors in 2005; the Fourth Circuit Court of Appeals' controversial decision in *In re National Gas Distributors* in 2009; and the recent levels of dislocation in the coal, steel, and power-generation industries.

The discussion below is divided into six parts. Parts II–IV outline the protections offered by the forward contract and swap agreement safe harbors and analyze, based upon the available case law, the common characteristics of those contracts and contract counterparties that courts have ruled are within the scope of these safe harbors. Part V summarizes the standard terms of coal supply agreements, addresses the current state of the coal trading markets, and examines whether standard coal supply agreements between producers and end-users are subject to protection as either forward contracts or swap agreements. This Article is not intended to definitively ascertain the Bankruptcy Code classification of all coal supply agreements, but rather is intended to identify the unique characteristics of such agreements and to examine the implications of those characteristics in light of the existing case law regarding forward contracts and swap agreements. Part VI argues, in exceedingly general terms, that most long-term coal supply agreements constitute protected contracts (assuming the ontinuing viability of *In re National Gas Distributors*), but that certain coal supply contracts, particularly those that require shipment of coal from a specific mining operation, may fall outside of the Code's existing safe harbor protections. Part VII provides the author's concluding thoughts.

II. SAFE HARBOR PROTECTIONS

The safe harbors set forth in sections 362(b)(6) and (17), 546(e) and (g), 556, and 560 of the Bankruptcy Code exempt certain protected contracts

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[7] *See, e.g.*, Hutson v. M.J. Soffe Co. (*In re* Nat'l Gas Distribs., LLC), 412 B.R. 758, 762 (Bankr. E.D.N.C. 2009).

> The analysis of what constitutes a commodity forward agreement and a swap agreement involves a difficult journey through what the court of appeals described as an "imperfect statute" that includes "counterintuitive definitions, as well as inconsistencies." Furthermore, the analysis must be undertaken without "the benefit of developed case law," and without "the benefit of clear market-place definitions."

Id. (citation omitted) (quoting Hutson v. E.I du Pont de Nemours & Co. (*In re* Nat'l Gas Distribs., LLC), 556 F.3d 247, 259 (4th Cir. 2009)).

entered into by certain protected counterparties from three of the most critical protections typically granted to bankrupt debtors: the nullification of ipso facto clauses,[8] the automatic stay,[9] and the ability to assert preference and constructive fraudulent transfer claims.[10] The various protections offered by each of the relevant safe harbors are described in detail below. Although granted pursuant to different statutory sections, counterparties to both forward contracts and swap agreements receive the same protections from their respective safe harbors.[11]

A. Ipso Facto Provisions

Many contracts, including most coal supply agreements, include provisions that allow a party to terminate or modify the contract if the contract counterparty files a bankruptcy petition or otherwise encounters significant financial distress (i.e., an ipso facto clause). As a general matter, the Bankruptcy Code invalidates contractual provisions, such as those referenced above, that alter a party's rights based on its filing of a bankruptcy case.[12] If the subject contract is a forward contract or swap agreement, however, and one of the parties to the contract is a forward contract merchant or swap participant, the non-debtor party to the contract can enforce any applicable ipso facto clause and can, depending upon the terms of the relevant provision, terminate the contract without obtaining court approval.[13] This is a particularly powerful tool where a non-debtor party is contractually obligated to deliver a commodity to the debtor at a below-market price or to accept delivery of a commodity from the debtor at an above-market price.[14]

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[8] *See* 11 U.S.C. § 365(e).

[9] *See id.* § 362(a).

[10] *See id.* §§ 544, 547, 548, 550.

[11] *See infra* Parts III–IV.

[12] *See* 11 U.S.C. § 365(e)(1)(A)–(B); *see also* Lehman Bros. Special Fin., Inc. v. Ballyrock ABS CDO 2007–1 Ltd. (*In re* Lehman Bros. Holdings Inc.), 452 B.R. 31, 39 (Bankr. S.D.N.Y. 2011) ("It is now axiomatic that *ipso facto* clauses are unenforceable in bankruptcy."); *In re* Enron Corp., 306 B.R. 465, 472–73 (Bankr. S.D.N.Y. 2004) ("Ipso facto clauses are generally unenforceable pursuant to section 365(e) of the Bankruptcy Code because the automatic termination of a debtor's contractual rights deters rehabilitation and causes a forfeiture of assets." (citing Summit Inv. & Dev. Corp. v. Leroux, 69 F.3d 608, 610 (1st Cir. 1995); *In re* C.A.F. Bindery, Inc., 199 B.R. 828, 832 (Bankr. S.D.N.Y. 1996))).

[13] *See* 11 U.S.C. §§ 556, 560. Sections 556 and 560 do not automatically grant a non-debtor counterparty the right to terminate a contract based upon a debtor's bankruptcy filing; such a provision must already be included in the underlying contract. *See, e.g.*, *In re* Clearwater Natural Res., LP, No. 09-70011, 2009 WL 2208463, at *3 (Bankr. E.D. Ky. July 23, 2009); *see also In re Enron Corp.*, 306 B.R. at 473 (noting that the basis for termination must be one of those proscribed in section 365(e)).

[14] Whether a forward contract is beneficial or detrimental to a counterparty over the full term of the contract may not be immediately apparent upon a debtor's bankruptcy filing. Although a counterparty

B. Automatic Stay and Setoff

Perhaps the most fundamental protection offered to debtors by the Bankruptcy Code is the "automatic stay" of all actions seeking to obtain property of the debtor's bankruptcy estate.[15] Absent relief from the automatic stay, a counterparty to a contract with the debtor cannot exercise its contractual rights to setoff or net-out mutual debts between the parties, or call upon any collateral pledged to secure such debts.[16] If the contract granting such rights, however, is a forward contract or swap agreement and one of the parties is a forward contract merchant or swap participant, then the non-debtor counterparty can terminate the agreement and exercise any rights of setoff permitted by the contract or applicable law.[17] The non-debtor counterparty can also enforce any security interests, apply any collateral pledged to secure that contract, or both.[18] Such protections may have particular relevance where a party serves as both a purchaser and seller of a commodity under a single master sales agreement.

C. Avoidance Actions

The Bankruptcy Code grants debtors the right to assert preference and fraudulent transfer claims (under both state and federal law) against parties that received transfers from the debtor in the period preceding the debtor's bankruptcy filing.[19] Payments made to suppliers in the ninety days prior to a bankruptcy filing, for instance, are frequently subject to avoidance as preferential payments, regardless of the debtor's intent in making such

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may be entitled to some short period of time to exercise its termination rights, any meaningful delay could be deemed a waiver of that right. *Compare In re* Enron Corp., No. 01 B 16034(AJG), 2005 WL 3874285, at *4 (Bankr. S.D.N.Y. Oct. 5, 2005) ("[I]f based upon the bankruptcy filing, the election to terminate must be made fairly contemporaneously with the bankruptcy filing."), *with In re* Mirant Corp., 314 B.R. 347, 351–53 (Bankr. N.D. Tex. 2004) (rejecting argument that counterparty, "through the passage of time," lost its rights under section 560 to terminate).

[15] *See* 11 U.S.C. § 362(a); Bank of Am., N.A. v. Lehman Bros. Holdings Inc. (*In re* Lehman Bros. Holdings Inc.), 439 B.R. 811, 833 (Bankr. S.D.N.Y 2010) ("The automatic stay provision of the Bankruptcy Code, 11 U.S.C. § 362, is 'one of the fundamental debtor protections provided by the bankruptcy laws.'" (quoting Midlantic Nat'l Bank v. N.J. Dep't of Envt'l Prot., 474 U.S. 494, 503 (1986))); *see also* Mirant Ams. Energy Mktg., L.P. v. Kern Oil & Ref. Co. (*In re* Mirant Corp.), 310 B.R. 548, 562–63 (Bankr. N.D. Tex. 2004).

[16] *See, e.g.*, *In re Lehman Bros. Holdings*, 439 B.R. at 833–34; *In re Mirant Corp.*, 310 B.R. at 562–63.

[17] *See* 11 U.S.C. § 362(b)(6), (17); *see also In re Lehman Bros. Holdings*, 439 B.R. at 833–36 (holding that safe harbor does not create setoff rights that do not otherwise exist under applicable law); *In re Mirant Corp.*, 310 B.R. at 562–63.

[18] *See, e.g.*, Clear Peak Energy, Inc. v. S. Cal. Edison Co. (*In re* Clear Peak Energy, Inc.), 488 B.R. 647, 662–63 (Bankr. D. Ariz. 2013); *In re Lehman Bros. Holdings*, 439 B.R. at 834–35.

[19] *See, e.g.*, 11 U.S.C. §§ 544, 547, 548, 550.

payments.[20] If, however, the payment is a "settlement payment" to or from a forward contract merchant pursuant to a forward contract, or is made by or to a swap participant in connection with a swap agreement, that payment cannot be avoided by the debtor (unless it is the result of "actual fraud").[21] The vast majority of litigation regarding the scope of the Bankruptcy Code safe harbors has arisen in the context of avoidance actions.[22]

As the discussion above indicates, the Bankruptcy Code's safe harbors provide significant protections to forward contract merchants and swap participants who are parties to forward contracts and swap agreements. The critical remaining inquiry is whether a particular contract constitutes a forward contract or swap agreement and whether either party to the contract is a forward contract merchant or swap participant. Given the tension between the relevant statutory provisions, financial market definitions, and legislative history, numerous courts have reached conflicting answers to these questions from remarkably similar facts. A majority position has begun to develop, however, and the following summary is focused, in primary part, on that majority position. To the extent that an alternative interpretation may be particularly relevant in the coal supply agreement context, that interpretation is also discussed.

III. SCOPE OF THE FORWARD CONTRACT SAFE HARBOR

A. What is a Forward Contract?

1. Bankruptcy Code Definition (Section 101(25))

The term forward contract means:

> a contract (other than a commodity contract as defined in section 761) for the purchase, sale, or transfer of a commodity, as defined in section 761(8) of this title, or any similar good, article, service, right, or interest

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[20] *See id.* § 547(b).

[21] *See id.* § 546(e), (g); *see also* Buchwald v. Williams Energy Mktg. & Trading Co. (*In re* Magnesium Corp. of Am.), 460 B.R. 360, 366 (Bankr. S.D.N.Y 2011). The question of whether subsections 546(e) or (g) can serve as a defense to state court fraudulent transfer claims initiated by creditors (or assigned to a trustee by creditors) based on principles of implied preemption is currently the subject of conflicting decisions in the Second Circuit. *Compare In re* Tribune Co. Fraudulent Conveyance Litig., 499 B.R. 310 (S.D.N.Y. 2013), *and* Weisfelner v. Fund 1 (*In re* Lyondell Chem. Co.), 503 B.R. 348 (Bankr. S.D.N.Y. 2014), *with* Whyte v. Barclays Bank PLC, 494 B.R. 196 (S.D.N.Y. 2013).

[22] *See generally* Daniel J. Merrett & John H. Case, *Safe Harbor Supernova: Is Section 546(e)'s Stellar Protection of Private LBO Transactions About to Burn Out?*, 21 NORTON J. BANKR. L. & PRAC. 3 (2012).

which is presently or in the future becomes the subject of dealing in the forward contract trade . . . with a maturity date more than two days after the date the contract is entered into . . . .[23]

2. Definition in Financial Industry (Non-Bankruptcy Judicial Definition)

The Sixth Circuit Court of Appeals has defined a forward contract, for purposes of the Commodity Exchange Act, as "an individual agreement to buy or sell . . . some agreed-upon quantity of . . . some commodity . . . at some agreed-upon price . . . at some agreed upon time in the future."[24] Forward contracts typically contain individualized terms and, as such, the contracts themselves are not subject to trading on a market exchange.[25] Futures contracts, by contrast, involve the sale of a standardized contract, rather than the underlying commodity, with each party's obligations due to an intermediary.[26] Although most forward contracts anticipate physical delivery and most futures contracts anticipate financial settlement, such generalizations are not always accurate and do not provide an adequate legal basis to distinguish between the two categories of contracts.[27] The "primary purpose of a forward contract is to hedge against possible fluctuations in the price of a commodity . . . as opposed to the primary

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[23] 11 U.S.C. § 101(25)(A).

[24] Commodity Futures Trading Comm'n v. Erskine, 512 F.3d 309, 324 (6th Cir. 2008). The Commodity Futures Trading Commission has described forward contracts "as transactions entered into for commercial purposes related to the business of a producer, processor, fabricator, refiner or merchandiser who may wish to purchase or sell a commodity for deferred shipment or delivery in connection with the conduct of its business." Statutory Interpretation Concerning Forward Transactions, 55 Fed. Reg. 39,188, 39,191 (Sept. 25, 1990).

[25] *Erskine*, 512 F.3d at 325.

[26] Commodity Futures Trading Comm'n v. Zelener, 373 F.3d 861, 865 (7th Cir. 2004) (Easterbrook, J.); *see also Erskine*, 512 F.3d at 323–24. Another critical difference between future and forward contracts is the relative risk of non-performance under the contract. With a forward contract, the risk of default lies with the contract counterparty and is, therefore, wholly dependent on the creditworthiness of the particular counterparty. With a futures contract, there is no direct contractual relationship between the buyer and seller and, as such, any risk of default is based on the solvency of the intermediary or broker. *See* Rhett G. Campbell, *Energy Future and Forward Contracts, Safe Harbors and the Bankruptcy Code*, 78 AM. BANKR. L.J. 1, 3–4 (2004).

[27] *See, e.g.*, Hutson v. E.I du Pont de Nemours & Co. (*In re* Nat'l Gas Distribs., LLC), 556 F.3d 247, 258 (4th Cir. 2009); *Erskine*, 512 F.3d at 325; *Zelener*, 373 F.3d at 866. *But see* Commodity Futures Trading Comm'n v. Co Petro Mktg. Grp., 680 F.2d 573, 576 (9th Cir. 1982). Notwithstanding continued judicial pronouncements that "intent to deliver" is not a determining factor in deciding whether a contract is a forward or future contract for purposes of the Commodity Exchange Act, the CFTC continues to adopt this approach. *See, e.g.*, Wright, [2011-2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 32,008 (Oct. 25, 2010), *available at* 2010 WL 9486847 ("[I]t is well-established that the intent to make or take delivery is the critical factor in determining whether a contract qualifies as a forward." (citing Stovall, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941 (Dec. 6, 1979); Statutory Interpretation Concerning Forward Transactions, 55 Fed. Reg. 39,188).

purpose of an ordinary commodity contract, which is to arrange for the purchase and sale of a commodity."[28] The financial industry's characterization of forward contracts has been utilized by bankruptcy courts as part of their safe harbor analyses,[29] but absent some perceived ambiguity in section 101(25), it is the Bankruptcy Code definition that is controlling in the safe harbor context.[30]

3. Strict Statutory Elements

The elements of a forward contract, based solely upon the definition provided in section 101(25) of the Bankruptcy Code, are as follows: (1) a contract for the sale of a *commodity* (or any similar good which is or becomes the subject of dealing in the *forward contract trade*); (2) that is not a *commodity contract* (as defined in section 761); and (3) that has a *maturity date* more than *two days* after entry into the contract.[31] Each of these elements is discussed in more detail below.

a. Commodity

In relevant part, a "commodity," for purposes of the Commodity Exchange Act (and, therefore, the safe harbor provisions of the Bankruptcy Code), is defined as all "goods and articles . . . in which contracts for future delivery are presently or in the future dealt in."[32] As such, any product can be a commodity so long as future contracts for that commodity (as described in Part III.A.2) are currently, or in the future, traded on some exchange or cleared "over-the-counter" by a registered clearinghouse.[33] The breadth of this definition is intentional. The legislative history to the 1974 amendments to the Commodity Exchange Act indicates that the definition was made intentionally open-ended to capture all products that might eventually become subject to trading in the futures markets.[34]

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[28] BCP Liquidating LLC v. Bridgeline Gas Mktg., LLC (*In re* Borden Chems. & Plastics Operating L.P.), 336 B.R. 214, 220 (Bankr. D. Del. 2006) (quoting H.R. REP. NO. 101-484, at 4 (1990)) (internal quotation mark omitted).

[29] *See, e.g.*, *Erskine*, 512 F.3d at 324.

[30] *See, e.g.*, Clear Peak Energy, Inc. v. S. Cal. Edison Co. (*In re* Clear Peak Energy, Inc.), 488 B.R. 647, 665–66 (Bankr. D. Ariz. 2013).

[31] *See* 11 U.S.C. § 101(25)(A) (2012).

[32] 7 U.S.C. § 1a(9) (2012). The term "future delivery," for purposes of the Commodity Exchange Act, excludes "any sale of any cash commodity for deferred shipment or delivery." *Id*. § 1a(27).

[33] *See* Commodity Futures Trading Comm'n v. Am. Bd. of Trade, Inc., 473 F. Supp. 1177, 1181–82 (S.D.N.Y. 1979); Bd. of Trade v. SEC, 677 F.2d 1137, 1142–43 (7th Cir.), *vacated as moot*, 459 U.S. 1026 (1982).

[34] *See, e.g.*, Conroy v. Andeck Res. '81 Year-End Ltd., 484 N.E.2d 525, 530–31 (Ill. App. Ct.

Even if a product is not a commodity (i.e., its futures are not traded on an exchange or through a clearinghouse), it can still be the subject of a forward contract for purposes of the Bankruptcy Code if it is or "becomes the subject of dealing in the forward contract trade."[35] The term "forward contract trade" is not defined in the Bankruptcy Code.[36] According to one bankruptcy court, the forward contract trade is the "customary course of action for forward contracts."[37] This definition is not particularly helpful, however, as it does not specify the number of forward contracts that must be entered into (or the number of individual parties that must enter into such contracts) prior to a contract of that type being considered a part of the forward contract trade.[38]

There are few reported bankruptcy decisions in which a party has challenged the commodity element of the forward contract definition, and thus, there is exceedingly limited case law exploring the scope of that defined term. The majority of safe harbor cases involve goods like natural gas or electricity where neither party disputes their classification as a commodity.[39] The case law is even more limited (and is, in fact, non-existent) with regard to whether a particular good, which is not a commodity, can still be the subject of a forward contract because it is "similar" to a commodity and is "the subject of dealing in the forward contract trade."[40]

1985); *see also* William L. Stein, *The Exchange-Trading Requirements of the Commodity Exchange Act*, 41 VAND. L. REV. 473, 485–86 (1988). The use of the Commodity Exchange Act's definition of "commodity" for purposes of identifying the proper subject of a forward contract is somewhat counterintuitive, given that forward contracts are excluded from the scope of the Commodity Exchange Act and the jurisdiction of the CFTC. *See, e.g.*, Salomon Forex, Inc. v. Tauber, 8 F.3d 966, 970–72 (4th Cir. 1993).

[35] 11 U.S.C. § 101(25)(A).

[36] *See* Buchwald v. Williams Energy Mktg. & Trading Co. (*In re* Magnesium Corp. of Am.), 460 B.R. 360, 368 (Bankr. S.D.N.Y. 2011).

[37] Clear Peak Energy, Inc. v. S. Cal. Edison Co. (*In re* Clear Peak Energy, Inc.), 488 B.R. 647, 661 (Bankr. D. Ariz. 2013).

[38] *See* Peter Ruggero & Richard J. Corbi, *Contracts for Commodities: Forward Contract or Commodity Contract*, 18 NORTON J. BANKR. L. & PRAC. 439, 447–48 (2009); Shmuel Vasser, *Derivatives in Bankruptcy*, 60 BUS. LAW. 1507, 1515–16 (2005).

[39] *See, e.g.*, Lightfoot v. MXEnergy Elec., Inc. (*In re* MBS Mgmt. Servs., Inc.), 432 B.R. 570, 573 (Bankr. E.D. La. 2010) (holding that electricity is a commodity without discussion), *aff'd sub nom.* Lightfoot v. MXEnergy, Inc., No. 10-2794, 2011 WL 1899764 (E.D. La. May 19, 2011), *aff'd sub nom.* Lightfoot v. MXEnergy Elec., Inc. (*In re* MBS Mgmt. Servs., Inc.), 690 F.3d 352 (5th Cir. 2012); BCP Liquidating LLC v. Bridgeline Gas Mktg., LLC (*In re* Borden Chems. & Plastics Operating L.P.), 336 B.R. 214, 218–19 (Bankr. D. Del. 2006) ("[A]t this point in time, it can hardly be questioned that natural gas is a commodity."). *But see* Superior Livestock Auction, Inc. v. E. Livestock Co. (*In re* E. Livestock Co.), Bankruptcy No. 10-93904-BHL-11, Adversary No. 11-59088, 2012 WL 4210347, at *4 (Bankr. S.D. Ind. Apr. 5, 2012) (dismissing trustee's contention that specific livestock were not commodities because they were not fungible).

[40] 11 U.S.C. § 101(25)(A).

b. Commodity Contract

A "commodity contract," as that term is defined in section 761 of the Bankruptcy Code, is expressly excluded from the definition of a forward contract.[41] Section 761 includes a number of individual definitions for a commodity contract, but the unifying feature of these definitions, according to the majority of courts, is that all commodity contracts are "subject to the rules of[] a contract market or board of trade."[42] As such, in order for a contract to be a forward contract it cannot be subject to the rules of a contract market or board of trade (i.e., it must be traded over-the-counter, if it is traded at all).[43]

c. Maturity Date

The term "maturity date" is utilized but not defined in the Bankruptcy Code. The critical focus, according to most courts, in defining a contract's maturity date is the time at which the underlying commodity is to be delivered and payment is due.[44] Most forward contracts contemplate multiple deliveries, and therefore, a single contract may contain multiple maturity dates for Bankruptcy Code purposes.[45] Courts have ruled that so long as a contract clearly calls for either delivery or performance more than two days after execution of the contract, the contract need not include an express maturity date.[46]

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[41] *See id.*

[42] *Id.* § 761(4)(A), (D); *see also* Williams v. Morgan Stanley Capital Grp., Inc. (*In re* Olympic Natural Gas Co.), 294 F.3d 737, 741 (5th Cir. 2002); Buchwald v. Williams Energy Mktg. & Trading Co. (*In re* Magnesium Corp. of Am.), 460 B.R. 360, 371 (Bankr. S.D.N.Y. 2011); *In re Borden Chemicals & Plastics*, 336 B.R. at 218.

[43] *See, e.g.*, *In re Olympic Natural Gas*, 294 F.3d at 741 ("'[F]orward contracts' are 'contracts for the future purchase and sale of commodities that are not subject to the rules of a contract market or board of trade.'" (quoting 5 COLLIER ON BANKRUPTCY ¶ 556.02[2], at 556-5 (Lawrence P. King ed., 15th ed. rev. 2002))).

[44] *See, e.g.*, DeGirolamo v. McIntosh Oil Co. (*In re* Laurel Valley Oil Co.), Bankruptcy No. 05-64330, Adversary No. 12-6014, 2013 WL 832407, at *3 (Bankr. N.D. Ohio Mar. 5, 2013); McKittrick v. Gavilon, LLC (*In re* Cascade Grain Prods., LLC), 465 B.R. 570, 573–76 (Bankr. D. Or. 2011) (holding, based on legislative history, that "maturity date" means the future date at which the commodity must be bought and sold because that is "the date on which the benefit or detriment will be realized, depending on the market price"); *In re Magnesium Corp.*, 460 B.R. at 373; *In re Eastern Livestock Co.*, 2012 WL 4210347, at *4; U.S. Bank Nat'l Ass'n v. Plains Mktg. Can. LP (*In re* Renew Energy, LLC), 463 B.R. 475, 480–81 (Bankr. W.D. Wis. 2011).

[45] *See, e.g.*, *In re Magnesium Corp*., 460 B.R. at 374; *In re Renew Energy*, 463 B.R. at 481; Mirant Ams. Energy Mktg., L.P. v. Kern Oil & Ref. Co. (*In re* Mirant Corp.), 310 B.R. 548, 565 n.26 (Bankr. N.D. Tex. 2004).

[46] *See, e.g.*, Lightfoot v. MXEnergy Elec., Inc. (*In re* MBS Mgmt. Servs., Inc.), 690 F.3d 352, 356 (5th Cir. 2012) (finding no specific date necessary if contract clearly contemplates delivery more than

4. Additional Elements Implied Based on Industry Usage

As noted in Part III.A.2, the standard industry definition of a forward contract includes fixed terms for both the price and quantity of the underlying commodity. The Bankruptcy Code definition of a forward contract, by contrast, does not expressly include such requirements.[47] Nevertheless, a number of courts have ruled that in order for a contract to constitute a forward contract, the contract must include fixed quantity and price terms.[48] Even if one assumes that such requirements exist, courts have ruled that a requirements contract satisfies the fixed quantity standard and that a contract with a formula for calculating future prices, based on the then-existing market price, satisfies the fixed price standard.[49]

5. Legislative History Relevant to Definition (Market Effect)

As has been noted by numerous commentators, the Bankruptcy Code definition of a forward contract ostensibly includes standard commercial contracts, such as long-term supply contracts between producers and end-users of a commodity.[50] Whether this is the result that was intended by Congress is a matter of some dispute. The legislative history surrounding the various amendments to the Bankruptcy Code's safe harbors indicates that the purpose of these provisions was to protect the financial markets from the destabilizing effects of bankruptcy proceedings for parties to specified commodities and financial contracts.[51] Absent such protections, it

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two days after execution); Clear Peak Energy, Inc. v. S. Cal. Edison Co. (*In re* Clear Peak Energy, Inc.), 488 B.R. 647, 658 (Bankr. D. Ariz. 2013) (same); *In re Cascade Grain Products*, 465 B.R. at 575 (finding maturity date where contract "called for shipments within particular windows of time").

[47] *See* 11 U.S.C. § 101(25) (2012).

[48] *See, e.g.*, Hutson v. E.I du Pont de Nemours & Co. (*In re* Nat'l Gas Distribs., LLC), 556 F.3d 247, 260 (4th Cir. 2009) (including fixed quantity, price, and time requirements based on case law and industry usage); *In re Clear Peak Energy*, 488 B.R. at 658–59; Hutson v. M.J. Soffe Co. (*In re* Nat'l Gas Distribs., LLC), 412 B.R. 758, 764–66 (Bankr. E.D.N.C. 2009). *But see In re MBS Management Services*, 690 F.3d at 356 ("As in *Olympic*, we rely on the statutory language alone, and the Trustee's proffered requirements of specific quantity and delivery date must fail.").

[49] *See In re MBS Management Services*, 690 F.3d at 356 n.3, 357 (stating, in dicta, that most forward contracts for electricity are "generally for the entire needs or demands of the purchaser" and that requirements contracts are sufficiently definite to be enforceable under the Uniform Commercial Code); *In re Clear Peak Energy,* 488 B.R. at 658–59 (finding a contract with price and "escalator clause" was a forward contract); *In re Renew Energy*, 463 B.R. at 481–82 (finding a contract that called for index price plus "adder" was a forward contract). *But see In re National Gas Distributors*, 412 B.R. at 765–66 (finding that a requirements contract was not a forward contract).

[50] *See generally* Jay Jaffe, *How Big is the § 546(E) Forward Contract Safe Harbor?*, AM. BANKR. INST. J., Feb. 2013, at 28; Peter Marchetti, *Is the Agreement a Simple Supply or Swap? A Post-BAPCPA Case of First Impression in the Fourth Circuit*, AM. BANKR. INST. J., Apr. 2009, at 30.

[51] *See, e.g.*, Edward R. Morrison & Joerg Riegel, *Financial Contracts and the New Bankruptcy Code: Insulating Markets from Bankruptcy Debtors and Bankruptcy Judges*, 13 AM. BANKR. INST. L.

was feared that the bankruptcy of a single commodity firm could create a ripple or domino effect that would result in the failure of multiple firms within that same market.[52] The applicable legislative history also states, however, that the safe harbors generally, and the forward contact definition more specifically, are not intended to apply to standard commercial agreements, such as supply contracts between producers and end-users.[53] Courts have addressed this seemingly conflicting legislative history in two different ways.[54]

First, a majority of courts have determined that the applicable sections of the Bankruptcy Code are unambiguous and that, therefore, no examination of the legislative history is warranted or permitted.[55] The Fifth Circuit Court of Appeals, for example, explained that there was "no reason to . . . distinguish between 'financial' forward contracts, and 'ordinary purchase and sale' forward contracts, when the statutory language makes no such distinction."[56] As such, these courts have refused to read a supply contract exemption or any market relevance test into the definition of a forward contract.[57]

Second, other courts have utilized the legislative history to adopt a requirement that a contract must have "financial characteristics," or some

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REV. 641, 642 (2005).

[52] *See id.* (explaining the risk of "indefinite exposure to market movements" and of "cherrypicking" multiple contracts between the same parties); *see also* Weisfelner v. Fund 1 (*In re* Lyondell Chem. Co.), 503 B.R. 348, 370–72 (Bankr. S.D.N.Y. 2014) (analyzing legislative intent behind section 546(e)). Forward contracts (as that term is used in the financial markets) arguably fit within this ambit because their primary function is financial and risk-shifting in nature. BCP Liquidating LLC v. Bridgeline Gas Mktg., LLC (*In re* Borden Chems. & Plastics Operating L.P.), 336 B.R. 214, 221 (Bankr. D. Del. 2006) ("If the price of a commodity—such as crude oil or soybeans—rises or falls on some future date, the buyer or seller can minimize the risk involved through the use of forward contracts to offset the fluctuation in price from the date of the agreement to the actual date of transfer or delivery." (quoting H.R. REP. NO. 101-484, at 4 (1990))).

[53] *See* H.R. REP. NO. 101-484, at 6 ("[T]he exemptions do not apply to ordinary supply-of-goods contracts, which are not essentially financial in character."); *see also In re Clear Peak Energy*, 488 B.R. at 659 ("The courts have concluded that 'ordinary supply contracts' should not receive the special protections given to forward contracts."). The legislative history to the 2005 swap agreement amendments (discussed *infra* Part IV) evidences a similar intent to exclude standard supply agreements. *See* H.R. REP. NO. 109-31, pt. 1, at 122 (2005) ("The definition of 'swap agreement,' however, should not be interpreted to permit parties to document non-swaps as swap transactions. Traditional commercial arrangements, such as supply agreements . . . cannot be treated as 'swaps' under . . . the Bankruptcy Code simply because the parties purport to document or label the transactions as 'swap agreements.'").

[54] *See* Buchwald v. Williams Energy Mktg. & Trading Co. (*In re* Magnesium Corp. of Am.), 460 B.R. 360, 378 (Bankr. S.D.N.Y. 2011) (recognizing tension between statute and legislative history).

[55] *See, e.g.*, Lightfoot v. MXEnergy Elec., Inc. (*In re* MBS Mgmt. Servs., Inc.), 690 F.3d 352, 356 (5th Cir. 2012); Williams v. Morgan Stanley Capital Grp., Inc. (*In re* Olympic Natural Gas Co.), 294 F.3d 737, 742 (5th Cir. 2002); *In re Borden Chemicals & Plastics*, 336 B.R. at 219–20.

[56] *In re Olympic Natural Gas*, 294 F.3d at 742.

[57] *See id.*

effect on the financial markets (i.e., a risk-shifting or hedging function) in order to constitute a forward contract.[58] The majority of these courts, however, have only required that a contract protect against fluctuations in price (or be a part of a larger group of contracts designed for that purpose) in order to satisfy this test.[59] These courts have not required that these functions be the primary purpose of the contract, only that the contract serve some financial purpose in addition to its routine supply function.[60] Almost any supply contract in a volatile market will satisfy this test; therefore, for practical purposes, it adds very little to the strict statutory approach noted above.

Notwithstanding these judicial pronouncements, a number of parties have argued (and continue to argue) that, based on the legislative history's purported exclusion of standard supply contracts, any contract between a producer and end-user of a product cannot be a forward contract regardless of any perceived financial effect generated by that contract.[61] This argument has not gained any traction, however, and has been expressly repudiated by all courts that have ruled on the forward contract issue.[62]

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[58] *See In re Magnesium Corp.*, 460 B.R. at 378 n.72 (collecting cases); *see also* Hutson v. E.I du Pont de Nemours & Co. (*In re* Nat'l Gas Distribs., LLC), 556 F.3d 247, 260 (4th Cir. 2009); *In re Clear Peak Energy*, 488 B.R. at 659–60.

[59] *See In re National Gas Distributors*, 556 F.3d at 257–58 (finding even indirect effect based upon subsequent hedging is sufficient); *In re Magnesium Corp.*, 460 B.R. at 378–79 (setting fixed price for thirty days in volatile market is sufficient to establish financial characteristics and economic substance); *In re Borden Chemicals & Plastics*, 336 B.R. at 220–21 (finding protection against price fluctuation is sufficient). The following excerpt from *In re National Gas Distributors* evidences the minimal showing required to prove a market effect:

> A business can enter into a forward agreement with a party who then, in reliance on that forward agreement, enters into another contract with yet another market participant, who in turn may enter into even other contracts. And so a simple forward agreement may readily become tied into the broader markets that Congress aimed to protect in BAPCPA.

In re National Gas Distributors, 556 F.3d at 257.

[60] *See In re National Gas Distributers*, 556 F.3d at 258; *In re Magnesium Corp.*, 460 B.R. at 378–79; *In re Borden Chemicals & Plastics*, 336 B.R. at 220–21. *But see In re Clear Peak Energy*, 488 B.R. at 659–60 (analyzing primary purpose of contract).

[61] *See* Lightfoot v. MXEnergy Elec., Inc. (*In re* MBS Mgmt. Servs., Inc.), 690 F.3d 352, 356 (5th Cir. 2012) ("The Trustee's arguments reflect concerns expressed in various cases that payments debtors make on 'ordinary supply contracts' should not be protected [by the safe harbors]. . . . [T]hese concerns are immaterial when laid against the statutory text . . . ."); *In re Borden Chemicals & Plastics*, 336 B.R. at 219 ("BCP argues the legislative history supports its position that Congress intended to exclude 'normal purchase and sale agreements . . . .'").

[62] *See In re MBS Management Services*, 690 F.3d at 356; *In re Borden Chemicals & Plastics*, 336 B.R. at 219. A similar argument regarding legislative history has been made and largely (although not entirely) rejected in cases involving the application of section 546(e) to private, as opposed to market-based, sales of securities. *See, e.g.*, Geltzer v. Mooney (*In re* MacMenamin's Grill Ltd.), 450 B.R. 414,

B. Who is a Forward Contract Merchant?

1. Bankruptcy Code Definition (Section 101(26))

The term forward contract merchant means "an entity the *business* of which consists *in whole or in part* of entering into forward contracts as or with *merchants*."[63]

2. Broad Interpretation

A single bankruptcy court and one noted treatise have interpreted the term forward contract merchant broadly to include any person or entity that is a party to a forward contract in a commercial setting.[64] According to Judge Walsh, the breadth of this interpretation is warranted by the modifying phrase "in whole or in part," which could technically include any entity that is a party to at least one forward contract.[65] Although this interpretation has not been widely accepted, its use in the United States Bankruptcy Court for the District of Delaware, arguably the nation's most significant commercial bankruptcy court, lends it an air of credibility that a minority position might not otherwise possess.

3. Narrow Interpretation

The interpretation of forward contract merchant utilized by most courts is that espoused by Judge Lynn in *In re Mirant Corp*.[66] According to Judge Lynn, the key undefined portions of the definition of forward contract merchant are the terms "business" and "merchant."[67] Utilizing the common

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419–20 (Bankr. S.D.N.Y. 2011) (collecting cases).

[63] 11 U.S.C. § 101(26) (2012) (emphasis added).

[64] *See* sources cited *infra* note 65. Arguably, the bankruptcy court in *In re Renew Energy* utilized this same broad approach, but did so without any meaningful discussion of the basis for its decision. *See* U.S. Bank Nat'l Ass'n v. Plains Mktg. Can. LP (*In re* Renew Energy, LLC), 463 B.R. 475, 482 (Bankr. W.D. Wis. 2011) ("Plains has demonstrated that it is a forward contract merchant by showing that Contracts 954 and 955 qualify as forward contracts.").

[65] *In re Borden Chemicals & Plastics*, 336 B.R. at 225 ("Congress's addition of the phrase 'in whole or in part' had the effect that 'essentially any person that is in need of protection with respect to a forward contract in a business setting should be covered, except in the unusual instance of a forward contract between two nonmerchants who do not enter into forward contracts with merchants.'" (quoting 5 COLLIER ON BANKRUPTCY ¶ 556.03[2], at 556-6 (Lawrence P. King et al. eds., 15th ed. rev. 2001))).

[66] *See* Mirant Ams. Energy Mktg., L.P. v. Kern Oil & Ref. Co. (*In re* Mirant Corp.), 310 B.R. 548 (Bankr. N.D. Tex. 2004); *accord* Superior Livestock Auction, Inc. v. E. Livestock Co. (*In re* E. Livestock Co.), Bankruptcy No. 10-93904-BHL-11, Adversary No. 11-59088, 2012 WL 4210347, at *4–5 (Bankr. S.D. Ind. Apr. 5, 2012) (adopting *Mirant* test); Buchwald v. Williams Energy Mktg. & Trading Co. (*In re* Magnesium Corp. of Am.), 460 B.R. 360, 375 (Bankr. S.D.N.Y. 2011) (same).

[67] *In re Mirant Corp.*, 310 B.R. at 567.

dictionary definitions of these terms,[68] Judge Lynn concluded that a forward contract merchant is one who participates in the forward contract trade in order to make a profit, rather than as a producer or end-user of the underlying commodity itself.[69] The fact that a particular party may also be a producer or end-user of a commodity does not necessarily foreclose that party from being a forward contract merchant in relation to a particular transaction; the critical question is whether they were acting as a forward contract merchant when they entered into the subject contract.[70] Only one of the parties to a forward contract must be a forward contract merchant for the safe harbor to apply.[71] Whether a party qualifies as a forward contract merchant in a particular transaction will likely be a question of fact and may require discovery as to the purpose of the contract at issue.[72]

This narrow interpretation of the term forward contract merchant serves to balance the broad interpretation typically given to the term forward contract. According to Judge Lynn, this "is consistent with the Congressional purpose behind provisions dealing with forward contracts, which was not to affect a class of transactions (*i.e.*, forward contracts), but rather was to protect certain persons (*i.e.*, those engaged in the forward contract trade) and the market in which they were participants."[73] As such, a typical supply contract between a producer and end-user may technically constitute a forward contract (which is arguably contrary to congressional intent), but nevertheless that supply contract will not be subject to the

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[68] *See id.* at 567–68. A "merchant" is one that buys, sells, or trades in a market and is not acting as an end-user or producer. *Id.* at 567 (citing BLACK'S LAW DICTIONARY 1001 (7th ed. 1999)). A "business" is something that one engages in for profit. *Id.* at 568 (collecting sources).

[69] *Id.* at 567–70. "Forward contract merchants create or manage commodity markets by providing a place for industry participants to buy or sell a commodity in advance of its actual production." Lightfoot v. MXEnergy Elec., Inc. (*In re* MBS Mgmt. Servs., Inc.), 432 B.R. 570, 575 (Bankr. E.D. La. 2010), *aff'd sub nom.* Lightfoot v. MXEnergy, Inc., No. 10-2794, 2011 WL 1899764 (E.D. La. May 19, 2011), *aff'd sub nom.* Lightfoot v. MXEnergy Elec., Inc. (*In re* MBS Mgmt. Servs., Inc.), 690 F.3d 352 (5th Cir. 2012).

[70] *See In re Eastern Livestock Co.*, 2012 WL 4210347, at *5; *In re Magnesium Corp.*, 460 B.R. at 375–76; *In re Mirant Corp.*, 310 B.R. at 570 n.34.

[71] *See, e.g.*, DeGirolamo v. McIntosh Oil Co. (*In re* Laurel Valley Oil Co.), Bankruptcy No. 05-64330, Adversary No. 12-6014, 2013 WL 832407, at *5 (Bankr. N.D. Ohio Mar. 5, 2013); Clear Peak Energy, Inc. v. S. Cal. Edison Co. (*In re* Clear Peak Energy, Inc.), 488 B.R. 647, 658 (Bankr. D. Ariz. 2013); *In re Magnesium Corp.*, 460 B.R. at 376 n.60.

[72] *See, e.g.*, GPR Holdings, L.L.C. v. Duke Energy Trading & Mktg., L.L.C. (*In re* GPR Holdings, L.L.C.), 316 B.R. 477, 480 (Bankr. N.D. Tex. 2004) ("While Duke has presented summary judgment evidence that it was not a producer, distributor or end-user of natural gas, that does not translate into a fact that Duke was a forward contract merchant in the transaction at issue with Aurora."); *see also In re Magnesium Corp.*, 460 B.R. at 376–78; *In re Mirant Corp.*, 310 B.R. at 570.

[73] *In re Mirant Corp.*, 310 B.R. at 567; *see also In re Eastern Livestock Co.*, 2012 WL 4210347, at *4.

forward contract safe harbor because neither of the parties are acting as a forward contracts merchant in relation to that contract.[74] This common sense limitation on the scope of the forward contract safe harbor may have become moot, however, given the 2005 amendments to the definition of a swap agreement (as described in Part IV).

4. Majority Definition/Elements for Purposes of Bankruptcy Code

Utilizing the majority interpretations of the terms forward contract and forward contract merchant, to fit within the safe harbors of sections 362(b)(6), 546(e), and 556, a transaction must involve the following: (1) a contract; (2) for the sale of a commodity (or other similar good); (3) that is not traded on an exchange; (4) which contemplates delivery or performance more than two days after execution of the contract; and (5) that is entered into (by at least one of the parties to the contract) for profit and not as a producer or end-user of the underlying good.[75] Whether additional elements are also required (i.e., market effect or fixed price and quantity terms) and whether the motives of either party is a relevant factor in determining merchant status will depend upon the particular jurisdiction that is ultimately tasked with reviewing the transaction.

C. What is a Settlement Payment?

In addition to the forward contract and forward contract merchant requirements referenced above, the section 546(e) avoidance action safe harbor also requires that any transfer made pursuant to a forward contract be a settlement payment.[76] The Bankruptcy Code definition of the term "settlement payment"[77] defies "plain meaning . . . [and] is circular and cryptic."[78] Nevertheless, courts have interpreted the term broadly to mean any payment that is made when an obligation under a forward contract becomes due.[79] In a recent decision, the United States Bankruptcy Court

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[74] *See In re Mirant Corp.*, 310 B.R. at 566–69.

[75] *See* 11 U.S.C. §§ 362(b)(6), 546(e), 556 (2012).

[76] *Id.* § 546(e).

[77] *Id.* § 101(51A) ("The term 'settlement payment' means . . . a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, a net settlement payment, or any other similar payment commonly used in the forward contract trade.").

[78] Jackson v. Mishkin (*In re* Adler, Coleman Clearing Corp.), 263 B.R. 406, 475 (S.D.N.Y. 2001) (quoting Zahn v. Yucaipa Capital Fund, 218 B.R. 656, 675 (D.R.I. 1998)) (internal quotation mark omitted).

[79] *See, e.g.*, Williams v. Morgan Stanley Capital Grp., Inc. (*In re* Olympic Natural Gas Co.), 294 F.3d 737, 742 (5th Cir. 2002); Buchwald v. Williams Energy Mktg. & Trading Co. (*In re* Magnesium

for the Northern District of Ohio determined that physical delivery of a commodity under a forward contract (as opposed to the typical cash payment on account of such delivery) can also constitute a settlement payment for purposes of the Bankruptcy Code.[80] Given the breadth of this definition, most transfers made pursuant to a forward contract will constitute settlement payments, absent unique circumstances.

IV. SCOPE OF THE SWAP AGREEMENT SAFE HARBOR

A. What is a Swap Agreement?

1. Bankruptcy Code Definition (Section 101(53B))

The current Bankruptcy Code definition of the term swap agreement is "extremely broad, covering several dozen enumerated contracts and transactions, as well as combinations of them, options on them, and similar contracts or transactions."[81] The swap agreement definition was substantially expanded by the 2005 amendments to the Bankruptcy Code and now ostensibly includes "virtually *every contract traded* in derivatives markets."[82] For purposes of this Article, the most relevant portion of the definition refers to any agreement that is "a commodity index or a commodity swap, option, future or forward agreement."[83]

2. Definition in Financial Industry (Non-Bankruptcy Judicial Definition)

A swap agreement, in its most basic sense, is a "privately negotiated agreement between two parties . . . to exchange or 'swap' periodic cash flow payments which are calculated according to a prearranged formula."[84]

Corp. of Am.), 460 B.R. 360, 374–75 (Bankr. S.D.N.Y. 2011); U.S. Bank Nat'l Ass'n v. Plains Mktg. Can. LP (*In re* Renew Energy, LLC), 463 B.R. 475, 480–81 (Bankr. W.D. Wis. 2011); BCP Liquidating LLC v. Bridgeline Gas Mktg., LLC (*In re* Borden Chems. & Plastics Operating L.P.), 336 B.R. 214, 225 (Bankr. D. Del. 2006).

[80] *See* DeGirolamo v. McIntosh Oil Co. (*In re* Laurel Valley Oil Co.), Bankruptcy No. 05-64330, Adversary No. 12-6014, 2013 WL 832407, at *6 (Bankr. N.D. Ohio Mar. 5, 2013) ("Since the deliveries of the diesel fuel were Debtor's only obligations under the contracts and since the deliveries . . . determine the realization of the benefit and detriment to the parties, the deliveries must be classified as settlement payments.").

[81] Hutson v. E.I du Pont de Nemours & Co. (*In re* Nat'l Gas Distribs., LLC), 556 F.3d 247, 253 (4th Cir. 2009); *see also* 11 U.S.C. § 101(53B).

[82] Morrison & Riegel, *supra* note 51, at 651; *see also* Gilbane, *supra* note 3, at 251 ("Congress updated and broadened the definition of 'swap agreements' to include every conceivable type of swap transaction.").

[83] 11 U.S.C. § 101(53B)(A)(i)(VII).

[84] Willa E. Gibson, *Are Swap Agreements Securities or Futures?: The Inadequacies of Applying the Traditional Regulatory Approach to OTC Derivatives Transactions*, 24 J. CORP. L. 379, 382 (1999); *see*

That formula is typically based on the change in price or rate of some specified asset or index (i.e., commodity prices, interest rates, exchange rates, etc.).[85] As such, industry participants typically enter into swap agreements to isolate and mitigate risks specific to their particular business operations.[86] Large-scale producers and purchasers of commodities often enter into swap agreements to specifically hedge against fluctuations in the price of that commodity and the costs associated with its extraction, production, and transportation.[87]

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also Interbulk, Ltd. v. Louis Dreyfus Corp. (*In re* Interbulk, Ltd.), 240 B.R. 195, 201 (Bankr. S.D.N.Y. 1999) (defining a swap agreement as "a bilateral agreement, frequently between a commercial entity involved with commodities or subject to interest rate, currency, or equity price fluctuations and a financial intermediary, whereby cash payments are exchanged periodically (or a lump sum at termination) between the parties based upon changes in the price of the underlying asset or index as determined by an agreed-upon benchmark" (quoting THE HANDBOOK OF EQUITY DERIVATIVES 527 (Jack C. Francis, William W. Toy & J. Gregg Whittaker eds., 1995))).

[85] *See, e.g.*, Thrifty Oil Co. v. Bank of Am. Nat'l Trust & Sav. Ass'n, 322 F.3d 1039, 1042 (9th Cir. 2003); *In re Interbulk*, 240 B.R. at 201. The Commodity Exchange Act's definition of a swap agreement is extremely broad and includes, among other things, "any agreement, contract or transaction . . . that provides for any purchase, sale, payment, or delivery . . . that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence." 7 U.S.C. § 1a(47)(A)(ii) (2012). Based on a number of exclusions specific to the Act, however, it would appear that many agreements that would be considered swap agreements under the Bankruptcy Code and in general financial parlance would not be swap agreements for purposes of the Commodity Exchange Act. *See* 11 U.S.C. § 101(53B)(B); *see also* Noah Melnick et al., *When Is a Swap Not a Swap? Navigating the Different Definitions of "Swap Agreement" Under the Bankruptcy Code and the Commodity Exchange Act*, FUTURES & DERIVATIVES L. REP., Sept. 2013, at 13.

[86] *See* Reed T. Schuster, *Sacrificing Functionality for Transparency? The Regulation of Swap Agreements in the Wake of the Financial Crisis*, 62 SYRACUSE L. REV. 385, 388 (2012).

[87] Gibson, *supra* note 84, at 386. Gibson provides the following summary of a standard commodity swap transaction:

> For example, suppose a crude oil producer produces an average of 8,000 barrels of oil per month and wants to fix the price it receives for oil for five years. Assume an oil refiner needs 12,000 barrels of oil per month and wants to fix the price it pays for oil for five years. The two parties can enter into a commodity swap agreement to fix the oil price.
>
> Since both parties have different notional requirements, it would be difficult for the parties to swap payments directly. However, the oil refiner can agree to make monthly payments to a swap dealer at $15.30 per barrel while the swap dealer agrees to pay the oil refiner the average daily price for oil in the preceding month. The swap dealer can enter into an offsetting swap agreement with the oil producer, who agrees to pay the swap dealer the average daily spot price for oil in the preceding month while receiving payments from the swap dealer at a rate of $15.20 per barrel. Under the commodity swap agreement, both parties achieve the desired price for the crude oil.

Id. at 386–87 (footnotes omitted). In this case, depending on the market price for the preceding month (i.e., whether it is in excess of or less than the fixed price), each of the counterparties to the swap (either the producer or refiner) may be in or out of the money under the swap agreement. *See also* Arch Coal, Inc., Annual Report (Form 10-K), at 20 (Feb. 28, 2014) [hereinafter Arch Coal, Annual Report]

B. Who is a Swap Participant?

A swap participant is defined as "an entity that, at any time before the filing of the petition, has an outstanding swap agreement with the debtor."[88] Based on the breadth of this definition, the only relevant inquiry in the swap context is whether a given contract is a swap agreement. If it is, both parties are necessarily swap participants in relation to that contract.[89]

C. What is a Commodity Forward Agreement?

1. *In re National Gas Distributors, LLC*

One of the many enumerated swap agreements identified in the non-exclusive list contained in section 101(53B) is a commodity forward agreement.[90] Consistent with the majority of the classes of transactions identified in section 101(53B), the Bankruptcy Code does not specifically define a commodity forward agreement.[91] In 2009, the Fourth Circuit Court of Appeals addressed the meaning of this term in the context of a physical supply contract between a producer and end-user of natural gas.[92] According to the Fourth Circuit's reasoning, forward contracts are merely a subset of the broader category of forward agreements and, therefore, if a contract is a forward contract (which, by definition, must involve a commodity), it is necessarily also a commodity forward agreement.[93] Stated another way, according to the Fourth Circuit, all forward contracts are commodity forward agreements, but not all commodity forward agreements are forward contracts.[94]

In order to provide additional guidance to the bankruptcy court on remand, the Fourth Circuit also identified four specific elements that all

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(explaining use of "forward, futures or option contracts, swap agreements or other financial instruments" to manage exposure to market risks); Peabody Energy Corp., Annual Report (Form 10-K), at 71 (Feb. 21, 2014) [hereinafter Peabody Energy, Annual Report] (explaining use of "forwards, futures and swaps" to mitigate commercial risks associated with the coal industry).

88 11 U.S.C. § 101(53C).

89 *See, e.g.*, *In re Interbulk*, 240 B.R. at 200 n.6.

90 11 U.S.C. § 101(53B)(A)(i)(VII).

91 *See* Michael H. Weiss, *Using Derivatives to Create Bankruptcy Proof Loans*, 30 CAL. BANKR. J. 207, 213–16 (2010).

92 *See* Hutson v. E.I du Pont de Nemours & Co. (*In re* Nat'l Gas Distribs., LLC), 556 F.3d 247 (4th Cir. 2009).

93 *Id.* at 256. "[T]he term 'agreement,' although frequently used as synonymous with the word 'contract,' is really an expression of greater breadth of meaning and less technicality. Every contract is an agreement; but not every agreement is a contract." *Id.* at 255 (quoting BLACK'S LAW DICTIONARY 74 (8th ed. 2004)) (internal quotation marks omitted).

94 *See id.* at 255–56.

commodity forward agreements (even those that are not forward contracts) must possess: (1) The subject of the contract must be a commodity; (2) the contract must require payments more than two days after contracting; (3) the price, quantity and time elements must be fixed; and (4) the contract must have a relationship with the financial markets (although it need not be traded on an exchange or even assignable).[95] This guidance includes certain elements (i.e., the third and fourth elements) that some courts have ruled are irrelevant to a determination of a contract's status as a forward contract.[96] Because all forward contracts are necessarily forward agreements, one must assume that the Fourth Circuit has adopted a more restrictive definition of forward contracts than many other courts. This, in and of itself, is not problematic, but by failing to appreciate this distinction (i.e., by treating the *In re National Gas Distributors* commodity forward agreement factors as wholly independent of the definition of a forward contract), certain courts have used these same factors to reach decisions that are internally inconsistent and contrary to the Fourth Circuit's logic.[97]

The most critical consequence of the Fourth Circuit's commodity forward agreement ruling, however, is that it effectively writes the forward contract merchant requirement in sections 556 and 546(e) out of the Bankruptcy Code. If a forward contract is also a swap agreement and the swap agreement safe harbors apply to anyone who is a party to a swap agreement (as explained in Part IV.B), then anyone who is a party to a forward contract, whether they are a forward contract merchant or not, can now obtain access to the safe harbors.[98] This overlap arguably creates a disconnect from the applicable legislative history because it is the forward contract merchant requirement, rather than the definition of forward contract, that serves to prevent standard supply agreements from becoming subject to the financial contract safe harbors.[99] If one adopts the Fourth Circuit's reasoning, there is no longer any basis for counterparties to forward contracts to utilize sections 556 or 546(e) of the Bankruptcy Code;

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95 *Id.* at 259–60.

96 *See supra* Part III.A.

97 *See, e.g.*, Superior Livestock Auction, Inc. v. E. Livestock Co. (*In re* E. Livestock Co.), Bankruptcy No. 10-93904-BHL-11, Adversary No. 11-59088, 2012 WL 4210347, at *6 (Bankr. S.D. Ind. Apr. 5, 2012) (holding that contract was a forward contract but denying summary judgment on whether it was a swap agreement because there was no evidence that the contract had a relationship to the financial markets as required by *In re National Gas Distributors*).

98 *See* Morrison & Riegel, *supra* note 51, at 652 ("This shift in the Code effectively eliminates the concept of protected parties with respect to forward and commodity contracts. Any counterparty to these contracts is a 'swap participant' and, therefore, protected.").

99 *See supra* Part III.B.3; *see also* Mirant Ams. Energy Mktg., L.P. v. Kern Oil & Ref. Co. (*In re* Mirant Corp.), 310 B.R. 548, 566–67 (Bankr. N.D. Tex. 2004).

sections 560 and 546(g) provide the same relief, and unlike sections 556 and 546(e), they do not obligate the moving party to prove merchant status before accessing their protections.[100] Therefore, in circuits that have adopted the broad definition of a forward contract, adopting the Fourth Circuit's reasoning could result in applying the safe harbors to what might otherwise be considered standard supply agreements between producers and end-users of commodities.

It is a basic principle of statutory construction that a statute must be interpreted to give meaning to all of its parts and should not be construed in a manner that would render any provision meaningless or superfluous.[101] As such, it could be argued that the Fourth Circuit's interpretation of the term commodity forward agreement is flawed because it renders the Bankruptcy Code's forward contract merchant requirement irrelevant. The potential difficulty with this argument, however, is that the legislative history surrounding the 2005 Bankruptcy Code amendments, which expanded the definitions of swap agreement and swap participant, seems to evidence a recognition that the amendments would, in fact, create an overlap between sections 556 and 560.[102] According to commentators, the 2005 amendments were specifically intended to shift the Bankruptcy Code's focus from the protection of market participants to the protection of the broader markets themselves.[103] As such, any diminution of the significance of the Bankruptcy Code's forward contract merchant requirement is arguably not the result of a flaw in the Fourth Circuit's legal reasoning, but is the intended result of the 2005 amendments to the safe harbor provisions. If this is true, there is little meaningful basis on which to contest the Fourth Circuit's exercise in statutory construction. It is interesting to consider, however, whether the Fourth Circuit would have reached this same result if they were bound by (or had elected to adopt) the Fifth Circuit's more expansive definition of the term forward contract.

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[100] *See In re Mirant Corp.*, 310 B.R. at 568–70.

[101] *See, e.g.*, TRW Inc. v. Andrews, 534 U.S. 19, 31 (2001).

[102] *See* H.R. REP. NO. 109-31, pt. 1, at 122 (2005) ("The use of the term 'forward' in the definition of 'swap agreement' is not intended to refer only to transactions that fall within the definition of 'forward contract.' Instead, a 'forward' transaction could be a 'swap agreement' even if not a 'forward contract.'"); *see also id.* at 131 ("The definition of 'financial participant' (as with the other provisions of the Bankruptcy Code relating to 'securities contracts,' 'forward contracts,' 'commodity contracts,' 'repurchase agreements,' and 'swap agreements') is not mutually exclusive, i.e., an entity that qualifies as a 'financial participant' could also be a 'swap participant,' 'repo participant,' 'forward contract merchant,' 'commodity broker,' 'stockbroker,' 'securities clearing agency,' and/or 'financial institution.'"); Morrison & Riegel, *supra* note 51, at 651–52.

[103] *See* Morrison & Riegel, *supra* note 51, at 652 ("[T]he amendments to 'swap agreement' move the Code from protecting particular parties . . . to protecting entire derivatives markets."); *see also* Gilbane, *supra* note 3, at 251 (same).

2. Market Definitions as Determining Factor

In contrast to the Fourth Circuit's approach, a number of courts and commentators have relied solely on financial industry norms to determine whether a given agreement constitutes a swap agreement.[104] This approach appears to comport, in some sense, with the legislative history. However, it would seem to require a court to either ignore the specific transaction examples listed in section 101(53B), or to hold that each of the stated examples is ambiguous as a matter of law, necessitating an analysis of extrinsic evidence (i.e., industry norms) to determine its meaning. This is obviously contrary to the judicial approach exercised in most situations and seems gratuitous where, as with the definition of commodity forward agreement, a term's meaning can be easily discerned from basic principles of statutory construction and dictionary definitions.[105] From a practical perspective, this approach would also mean that no court could rule on the applicability of the swap agreement safe harbor in the summary judgment context because, absent a prior ruling in the same industry, classification as a swap agreement would always be an issue of fact. This level of uncertainty may be acceptable in the context of a purported swap agreement that fits only within the definition's catch-all provision,[106] but seems unsustainable when a specific enumerated example, such as a commodity forward agreement, is implicated.

Although viable arguments can be made on both sides of the issue, the Fourth Circuit's decision in *In re National Gas Distributors* remains the only circuit-level decision defining the term commodity forward agreement and is the only decision to address the issue in any significant detail.[107] As such, any party who wishes to argue that a particular forward contract is not

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[104] *See, e.g.*, McKittrick v. Nat'l Fuel Mktg., No. 11-3039, 2011 WL 2078527, at *1–2 (Bankr. D. Or. May 25, 2011) (denying summary judgment because neither party established whether the relevant industry would consider the subject contract a swap agreement or an ordinary commercial transaction); *see also* Superior Livestock Auction, Inc. v. E. Livestock Co. (*In re* E. Livestock Co.), Bankruptcy No. 10-93904-BHL-11, Adversary No. 11-59088, 2012 WL 4210347, at *6 (Bankr. S.D. Ind. Apr. 5, 2012); Enron Corp. v. Credit Suisse First Bos. Int'l (*In re* Enron Corp.), 328 B.R. 58, 70 (Bankr. S.D.N.Y. 2005); Morrison & Riegel, *supra* note 51, at 644 ("By relying on broad market definitions, the Act gets judges out of the (largely futile) business of second-guessing financial contracts.").

[105] *See* Hutson v. E.I du Pont de Nemours & Co. (*In re* Nat'l Gas Distribs., LLC), 556 F.3d 247, 255–56 (4th Cir. 2009).

[106] *See* 11 U.S.C. § 101(53B)(A)(ii) (2012). In addition to specific enumerated examples, subsection (A)(ii) of the definition of swap agreement expands the definition to include "any agreement or transaction that is similar to any other agreement or transaction referred to in this paragraph and that . . . is of a type that has been, is presently, or in the future becomes, the subject of recurrent dealings in the swap or other derivatives markets." *Id.*

[107] *See In re National Gas Distributors*, 556 F.3d at 256–58.

a swap agreement will necessarily be starting from a significant disadvantage. To the extent that the applicable bankruptcy case is filed in Maryland, North Carolina, South Carolina, Virginia, or West Virginia (jurisdictions within the Fourth Circuit), that argument would seem to be foreclosed completely. Therefore, any efforts to exclude a contract from the safe harbors will likely need to focus on the underlying forward contract factors themselves, rather than disputing the inclusion of forward contracts within the definition of swap agreements.

D. "In Connection" with a Swap Agreement

In order for the avoidance action safe harbor of section 546(g) to apply to a particular transfer, that transfer must also have been made "in connection with" a swap agreement.[108] According to the courts that have interpreted this section, the phrase "in connection with" a transfer simply means that the transfer must be "related to" a swap agreement.[109] A transfer is "related to" and, thus, "made in connection with" a swap agreement even if the transfer was not specifically mandated by the terms of the swap agreement itself.[110] This qualification is unlikely to be relevant in the coal supply agreement context.

Taken together, the forward contract and swap agreement safe harbors provide significant protections to non-debtor counterparties to such agreements.[111] The cases cited above provide a general framework for analyzing whether a given agreement or the parties to that agreement are subject to the safe harbors. None of this case law, however, specifically addresses the Bankruptcy Code classification of long-term coal supply agreements. The following Part summarizes certain unique features of coal supply agreements and examines these features in the context of the existing safe harbor case law.

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[108] 11 U.S.C. § 546(g).

[109] *See, e.g.*, Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (*In re* Madoff Sec.), 505 B.R. 135, 145 (S.D.N.Y. 2013); Peterson v. Enhanced Investing Corp. (*In re* Lancelot Investors Fund, L.P.), 467 B.R. 643, 656 (Bankr. N.D. Ill. 2012); Interbulk, Ltd. v. Louis Dreyfus Corp. (*In re* Interbulk, Ltd.), 240 B.R. 195, 202 (Bankr. S.D.N.Y. 1999).

[110] *See In re Madoff Securities*, 505 B.R. at 145–48 (determining that transfers based on hedges against, and synthetic collateral positions determined by, a swap agreement were "in connection with" that agreement); Casa de Cambio Majapara S.A. de C.V. v. Wachovia Bank, N.A. (*In re* Casa de Cambio Majapara S.A. de C.V.), 390 B.R. 595, 598–99 (Bankr. N.D. Ill. 2008) (finding pre-judgment attachment "in connection" with swap agreement). *But see* EPLG I, LLC v. Citibank, N.A. (*In re* Qimonda Richmond, LLC), 467 B.R. 318, 322 (Bankr. D. Del. 2012).

[111] *See* Morrison & Riegel, *supra* note 51, at 650–52.

V. PHYSICAL COAL SUPPLY AGREEMENTS

The North American coal industry extracts, processes, and sells approximately one billion tons of coal per year.[112] This production can be roughly divided into two broad classifications: "steam" or "thermal" coal sold to utilities or industrial users to generate power; and "metallurgical" coal sold to steel producers or refiners to produce "coke" for steel production.[113] Long-term supply contracts play a critical role in both the steam and metallurgical coal markets, although steam coal contracts are typically of longer duration than those for metallurgical coal.[114] Long-term contracts (i.e., contracts of one year or more) are particularly prevalent in the coal industry because of the large capital investment required to commence mining operations, high transportation costs, the limited universe of potential consumers, and price volatility.[115]

The terms of most long-term coal supply agreements result from competitive bidding procedures,[116] or extensive negotiations between coal

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[112] *See* U.S. ENERGY INFO. ADMIN., U.S. DEP'T OF ENERGY, ANNUAL COAL REPORT 2013, at 12 tbl.6 (2013), *available at* http://www.eia.gov/coal/annual/pdf/acr.pdf.

[113] *See* Alpha Natural Res., Inc., Annual Report (Form 10-K), at 8–9 (Feb. 28, 2014) [hereinafter Alpha Natural Resources, Annual Report]; Declaration of Seth Schwartz in Support of Debtors at 3–4, *In re* Patriot Coal Corp., 493 B.R. 65 (Bankr. E.D. Mo. 2013) (No. 12-51502-659) [hereinafter Schwartz Declaration].

[114] *See, e.g.*, Arch Coal, Annual Report, *supra* note 87, at 19 ("As is customary in the coal industry, we enter into fixed price, fixed volume long-term supply contracts, the terms of which are more than one year, with many of our customers."); Alpha Natural Resources, Annual Report, *supra* note 113, at 15 (same); CONSOL Energy Inc., Annual Report (Form 10-K), at 21, 31 (Feb. 7, 2014) [hereinafter CONSOL Energy, Annual Report] (same). Most metallurgical coal contracts of recent vintage are for periods of less than one year, but typically fix the sales price for periods of at least one month at a time, if not longer. *See* Schwartz Declaration, *supra* note 113, at 12–13; *see also* Arch Coal, Annual Report, *supra* note 87, at 75. This timeframe is more than sufficient to meet the two day requirement of the forward contract definition. *See* 11 U.S.C. § 101(25) (2012); Buchwald v. Williams Energy Mktg. & Trading Co. (*In re* Magnesium Corp. of Am.), 460 B.R. 360, 379 (Bankr. S.D.N.Y. 2011) ("Decisions to set prices for a month or 6 months or a year in advance are merely matters of degree . . . particularly in the context of a statute that considers those decisions material when prices are set for periods beyond 2 days.").

[115] *See, e.g.*, Kevin W. Bates, *Litigating Long Term Coal Supply Agreements*, 25A ROCKY MTN. MIN. L. SPECIAL INST. 6 (1989); Bruce S. Marks & Jay G. Martin, *Minerals Supply Contracts When the Market Goes South or North—Enforcement, Avoidance, and Renegotiation*, 32 ROCKY MTN. MIN. L. INST. § 5.01, § 5.02[2][b] (1986); *see also* James River Coal Co., Annual Report (Form 10-K), at 8 (Mar. 8, 2013) [hereinafter James River Coal, Annual Report].

[116] *See, e.g.*, FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 144 (D.D.C. 2004). Utilities purchase the majority of their coal by issuing a request for proposal (RFP). *Id.*; *see also* Arch Coal, Annual Report, *supra* note 87, at 19 ("We typically sell coal to customers under long-term arrangements through a 'request-for-proposal' process."). In the typical RFP, coal producers are asked to submit confidential bids for the stated supply of coal, including the requisite quality characteristics of the coal to be shipped. *See, e.g.*, *Request for Proposals*, AM. ELECTRIC POWER (Sept. 14, 2011), http://www.aep.com/newsroom/resources/docs/9-14-2011_AEPSCCoalRFP.pdf.

producers and their customers.[117] As a result, the terms of these contracts often vary in many respects and are specifically tailored to the needs of the particular parties.[118] There has been some recent movement towards the use of standard form supply agreements in an effort to both reduce costs and to expand liquidity in the futures markets, but most industry participants still utilize individualized agreements that permit application of Article 2 of the Uniform Commercial Code.[119] Regardless of a given contract's specific features, however, there are certain common provisions in long-term coal supply agreements that bear on the classification of such agreements as either forward contracts or swap agreements. These provisions are described in more detail below.[120]

A. Coal Characteristics and Quality Specifications

The price that an end-user is willing to pay for a particular shipment of coal, and whether that coal is even adequate for the customer's intended use, depends in primary part on the geological characteristics of the subject coal.[121] As such, most coal supply agreements contain provisions requiring the seller to deliver coal meeting specific quality thresholds for characteristics,[122] such as: British thermal units (BTUs);[123] sulfur content;[124]

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[117] *See generally* Jeffrey J. Scott, *Coal Supply Agreements*, 23 ROCKY MTN. MIN. L. INST. 4 (1977); Alliance Res. Partners, L.P., Annual Report (Form 10-K), at 9 (Feb. 28, 2014) [hereinafter Alliance Resource Partners, Annual Report]; Alpha Natural Resources, Annual Report, *supra* note 113, at 15; Arch Coal, Annual Report, *supra* note 87, at 19.

[118] *See generally* Scott, *supra* note 117 (characterizing a coal supply agreement as a highly individualized document); *see also* Arch Coal, Annual Report, *supra* note 87, at 15; Rhino Res. Partners LP, Annual Report (Form 10-K), at 10 (Mar. 8, 2013) [hereinafter Rhino Resource Partners, Annual Report].

[119] *See* Frank B. Harrington, *Form Over Substance: Potential Pitfalls in Coal Trading Form Contracts*, 28 ENERGY & MIN. L. FOUND. § 12.01, §§ 12.01–12.02, 12.13 (2007).

[120] Perhaps the most frequently litigated provision of the typical coal supply agreement is its *force majeure* provision. *See generally* Robert M. Stonestreet, *Force Majeure For Sure?: Contractual Coal Supply Obligations in a Changing World*, 30 ENERGY & MIN. L. FOUND. § 5.01 (2009). Notwithstanding the prevalence of this issue in the coal industry, it does not bear on an agreement's classification as a forward contract or swap agreement and, therefore, is not discussed further.

[121] *See, e.g.*, Arch Coal, Annual Report, *supra* note 87, at 5, 18; Peabody Energy, Annual Report, *supra* note 87, at 21.

[122] *See, e.g.*, Arch Coal, Annual Report, *supra* note 87, at 20.

[123] *See* Alpha Natural Resources, Annual Report, *supra* note 113, at 8 ("The heat value of coal is commonly measured in British thermal units or [BTUs]. A [BTU] is the amount of heat needed to raise the temperature of one pound of water by one degree Fahrenheit.").

[124] *See id.* at 9 ("When coal is burned, it produces sulfur dioxide, the amount of which varies depending on the chemical composition and the concentration of sulfur in the coal."). Sulfur purportedly results in environmental degradation, and the level of sulfur produced by power plants is heavily regulated at the state, local, and federal levels. *See* Arch Coal, Annual Report, *supra* note 87, at 5; CONSOL Energy, Annual Report, *supra* note 114, at 32.

ash content; grindability; ash fusion temperature; volatility;[125] and reflectance.[126] These specifications are not simply a matter of a particular customer's subjective preferences. A specific power plant, for example, may only be able to burn coal with a sulfur content below 1.0% and BTUs in excess of 12,000 because of the physical limitations of its boilers or emissions restrictions set by its state or local regulators.[127] Even supply contracts with stated quality specifications typically permit some level of variance from those specifications (i.e., bands) and often provide for price penalties or escalators in the event that a particular shipment fails to meet or exceeds the requisite quality thresholds.[128] If a coal shipment or shipments fall outside of the permitted band, however, the recipient may typically elect to terminate the contract rather than obtain a price reduction from the seller.[129]

B. Mine/Seam Requirements and Replacement Coal

Whether a piece of coal contains the characteristics required by a particular contract depends, almost exclusively, on the location from which that coal was mined.[130] Certain regions of the country produce coal with similar characteristics: Coal from the Powder River Basin tends to be low in both sulfur (0.2% to 0.9%) and heat value (8,000–9,500 BTUs); coal from the Central Appalachian Region tends to be higher in heat value (11,400–13,200 BTUs) with similar sulfur levels (0.2% to 2.0%); and coal from the Illinois Basin tends to be high in both sulfur (1.0% to 4.3%) and heat value (10,100–12,600 BTUs).[131] In fact, specific mines within the same geographical area, and even geological coal seams within the same mining

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[125] *See* Peabody Energy, Annual Report, *supra* note 87, at 21. "Volatility refers to the loss in mass . . . when coal is heated in the absence of air." Alpha Natural Resources, Annual Report, *supra* note 113, at 9. The volatility of metallurgical coal determines the percentage of the coal that can be converted into coke for steel production. *See id.*

[126] *See* Alpha Natural Resources, Annual Report, *supra* note 113, at 37; Arch Coal, Annual Report, *supra* note 87, at 5, 18; Peabody Energy, Annual Report, *supra* note 87, at 21.

[127] *See In re* Patriot Coal Corp., 493 B.R. 65, 93 (Bankr. E.D. Mo. 2013); *see also* Bruce W. Radford & David R. Hammond, *The NYMEX Coal Contract: A Clouded Future?*, PUB. UTIL. FORT., June 1, 1999, at 29, 32–33 ("[C]oal-fired steam boilers typically have been designed for a specific coal or range of coals."); CONSOL Energy, Annual Report, *supra* note 114, at 32 (explaining emissions restrictions).

[128] *See* Alpha Natural Resources, Annual Report, *supra* note 113, at 37; Arch Coal, Annual Report, *supra* note 87, at 20; Peabody Energy, Annual Report, *supra* note 87, at 21.

[129] *See* Alpha Natural Resources, Annual Report, *supra* note 113, at 37; Arch Coal, Annual Report, *supra* note 87, at 20; Peabody Energy, Annual Report, *supra* note 87, at 21.

[130] *See In re Patriot Coal*, 493 B.R. at 80; *see also* Harrington, *supra* note 119, § 12.02.

[131] *See* Arch Coal, Annual Report, *supra* note 87, at 8; FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 117–18 (D.D.C. 2004).

complex, may contain coal of varying qualities.[132] As such, in order to ensure consistent quality specs, many coal supply agreements provide for the sale of coal from a particular seam or a particular mine owned and operated by a producer.[133] As a result of this desired specificity, some coal contracts obligate the producer to provide the buyer with mine plans, reserve studies, and other information related to the operation of the specific mine that will be the subject of that contract.[134] In fact, many coal producers commence operations on undeveloped reserves based solely on the execution of long-term supply contracts with its customers.[135] Whether a contract is truly tied to a particular mine, however, will depend upon the presence and scope of any "replacement" or "substitute" coal provisions contained in the agreement. If the agreement does not permit the substitution of coal, grants the purchaser the option to terminate the contract in the event that substitution is required, or only permits substitutions upon the occurrence of certain events or within a specified period, one can make a legitimate case that the customer is specifically contracting for coal from an identified geographic location.[136] If, under the contract, coal of similar quality can be readily substituted for coal from the stated mine or seam, it is difficult to assert that the customer is truly contracting for coal from that specific mine or seam, as opposed to coal of a type similar to that which is present in the identified mine or seam.[137]

C. Price Reopeners, Escalators, and Cost-Plus Provisions

Long-term coal supply agreements, by their very nature, subject the parties to price risks, both as to the market price of the subject coal and the

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[132] *See, e.g.*, Harrington, *supra* note 119, § 12.02.

[133] *See, e.g.*, George E. Glasier, *Energy Minerals*, 17A ROCKY MTN. MIN. L. SPECIAL INST. 12 (1985); Alliance Resource Partners, Annual Report, *supra* note 117, at 8 ("[M]ost of the contracts specify the approved seams and/or approved locations from which coal is to be mined."); Cloud Peak Energy Inc., Annual Report (Form 10-K), at 8 (Feb. 14, 2014) [hereinafter Cloud Peak Energy, Annual Report] ("Our coal is primarily sold on a mine-specific basis."); Rhino Resource Partners, Annual Report, *supra* note 118, at 10.

[134] *See generally* Scott, *supra* note 117.

[135] *See* Alpha Natural Resources, Annual Report, *supra* note 113, at 32 ("The execution of a satisfactory long-term coal supply agreement is frequently the basis on which we undertake the development of coal reserves."); Peabody Energy, Annual Report, *supra* note 87, at 21 (same).

[136] *See* Gulf Power Co. v. Coalsales II, L.L.C., 661 F. Supp. 2d 1270, 1276–78 (N.D. Fla. 2009) (analyzing whether contract was a "single source agreement"), *aff'd per curiam*, 522 F. App'x 699 (11th Cir. 2013).

[137] *See* Arch Coal, Annual Report, *supra* note 87, at 20 ("In most of our contracts, we have a right of substitution . . . allowing us to provide coal from different mines . . . as long as the replacement coal meets quality specifications.").

costs necessary to ship and produce that coal.[138] As such, multiple-year coal supply agreements often provide parties with the opportunity to periodically adjust the contract price through pricing mechanisms, such as a fixed price contract with pre-established prices, periodic price re-negotiation based upon time or market triggers, base-price plus escalation methods that allow for periodic price adjustments based on fixed percentages or pass-through of actual cost changes, or some combination of the above.[139] A market reopener provision is designed to provide a mechanism to adjust the contract price to a level more closely aligned with the current market price for the subject coal.[140] Such provisions are typically triggered by the passage of time, market price thresholds, or a showing of "gross inequity" or "economic hardship."[141] Once the provision is triggered, the parties typically have a stated period of time to re-negotiate a new contract price.[142] If no agreement can be reached, the contract either terminates or provides a specific mechanism to determine the new price (e.g., comparable contracts, bid solicitation, etc.).[143] Cost and profit based reopeners, by contrast, "provide for periodic price adjustments designed to assure that the coal supplier is paid its cost plus a payment representing some sort of margin, profit, or return on investment."[144] Provisions of this type are typically focused on changes in certain production costs, such as labor, blasting materials, or diesel fuel.[145] Because each coal supply agreement is separately negotiated, however, the specific reopener provisions utilized therein tend to vary from contract to contract.[146] Regardless, each of these mechanisms is typically enforceable as a matter of basic contract law so long as the relevant provision contains a reasonably

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[138] *See, e.g.*, Chauncey S.R. Curtz, *Market Price Reopeners in Long-Term Coal Supply Contracts: The Lessons of Recent Litigation and Arbitration*, 15 ENERGY MIN. L. FOUND. § 6.01, § 6.02 (1994); Michael J. Gallagher, *Arbitration and the Price Term in Long-Term Coal Supply Contracts: Law, Practice, and Getting the Right Answer*, 53 ROCKY MTN. MIN. L. INST. § 29.01, § 29.02 (2007); Mark Sievers, *An Economic Analysis of Utility-Coal Company Relationships*, 8 J. ENERGY L. & POL'Y 27, 38–39 (1987).

[139] *See* Gallagher, *supra* note 138, § 29.04; *see also* Ky. Utils. Co. v. S. E. Coal Co., 836 S.W.2d 392 (Ky. 1992) (discussing contract with both market reopeners and cost and profit adjustment provisions); Arch Coal, Annual Report, *supra* note 87, at 19; CONSOL Energy, Annual Report, *supra* note 114, at 21; James River Coal, Annual Report, *supra* note 115, at 9.

[140] *See, e.g.*, PSI Energy, Inc. v. Exxon Coal USA, Inc., 991 F.2d 1265, 1266–71 (7th Cir. 1993) (Easterbrook, J.) (discussing market reopener mechanism); Curtz, *supra* note 138, § 6.03; Gallagher, *supra* note 138, § 29.04[1].

[141] *See* Curtz, *supra* note 138, § 6.03; Gallagher, *supra* note 138, § 29.04[1].

[142] *See* Curtz, *supra* note 138, § 6.03; Gallagher, *supra* note 138, § 29.04[1].

[143] *See* Curtz, *supra* note 138, § 6.03; Gallagher, *supra* note 138, § 29.04[1].

[144] Gallagher, *supra* note 138, § 29.02[2].

[145] *See* Curtz, *supra* note 138, § 6.02[1]; Sievers, *supra* note 138, at 39–40.

[146] *See, e.g.*, Gallagher, *supra* note 138, § 29.04.

certain description of how the new price will ultimately be determined by the parties.[147]

D. Requirements and "Take or Pay" Contracts

Generally speaking, most coal supply agreements fix a specific quantity of coal that is to be delivered under the contract and a specific delivery schedule for that coal.[148] In some instances, however, parties may elect to enter into contracts predicated on the specific customer's consumption demands or the production capabilities of the supplier.[149] Contracts of these types are not nearly as prevalent as they were in the 1970s, 1980s, and 1990s, but are still relevant given the existence of certain long-term legacy contracts from that era.[150] Under a "requirements" contract, a coal producer is obligated to supply coal in an amount sufficient to satisfy the tonnage requirements of the purchaser for the full term of the agreement.[151] Under a "take or pay" contract, by contrast, the purchaser agrees to purchase and pay for a specific quantity of coal, regardless of whether the purchaser ultimately elects to accept delivery of that tonnage from the supplier.[152] Contracts of these types are frequently utilized where the supply contract is tied to a particular mine and, more specifically, where development of that mine (or financing for such development) was predicated upon execution of the underlying supply contract.[153]

VI. APPLICATION OF SAFE HARBORS TO COAL SUPPLY AGREEMENTS

A typical long-term coal supply agreement, as described above, differs in many respects from the standard oil and gas or electricity supply contract. Contracts for the long-term supply of natural gas or electricity

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147 *See id.* § 29.03 (discussing open price terms and U.C.C. § 2-305(1) (2003)).

148 A typical coal supply agreement may provide for monthly deliveries in some fixed amount with a fluctuating amount reflective of the capacity of the producer and the needs of the buyer. *See generally* Arch Coal, Annual Report, *supra* note 87, at 20; Alliance Resource Partners, Annual Report, *supra* note 117, at 7–8.

149 *See* Utah Intern., Inc. v. Colorado-Ute Elec. Ass'n, 425 F. Supp. 1093, 1096–98 (D. Colo. 1976).

150 *See, e.g.*, *id.* at 1096–97 (discussing one such contract from the 1970s). *See generally* Scott, *supra* note 117 (discussing provisions of coal supply agreements); Patrick W. Mattingly et al., *So You Would Like to Export Some Coal?*, 32 ENERGY & MIN. L. FOUND. § 22.01, § 22.05 (discussing modern provisions).

151 *See* United States v. Gen. Dynamics Corp., 415 U.S. 486, 499 (1974).

152 *See generally* Paul Strohl, *The Rules of the Game: Recent Developments in Take-or-Pay Litigation*, 21B ROCKY MTN. MIN. L. SPECIAL INST. 10 (1988) (discussing theories of recovery, defenses, and remedies involved in take-or-pay provisions).

153 *See generally* Scott, *supra* note 117 (discussing provisions of coal supply agreements).

have been determined by most courts to constitute forward contracts or swap agreements for purposes of the Bankruptcy Code.[154] As such, the critical inquiry, for purposes of this Article, is whether the numerous distinctions between coal supply agreements and natural gas and electricity contracts are sufficient to take coal supply agreements outside of the scope of the Bankruptcy Code safe harbors. At a minimum, the unique characteristics of these contracts necessitate a more nuanced analysis of the relevant safe harbor elements, particularly: whether coal is a commodity; whether price reopener and requirements provisions constitute fixed price and quantity terms; the market effect, if any, of such agreements; and the merchant status of certain coal contract counterparties. Each of these issues is discussed in more detail below.

A. Coal as a "Commodity"

1. Fungible Nature of Commodities

There are no published cases addressing whether coal is a "commodity" for purposes of the Bankruptcy Code. The notion that coal (or, more accurately, specific types of coal) may not constitute a commodity was first raised (but not passed upon) by Judge Howard in *In re Clearwater Natural Resources*.[155] According to Judge Howard (and as described in Part V.A–B), due to discrepancies in burn rates and sulfur content between regions (and even between mines within the same region), coal may not be sufficiently fungible to constitute a commodity as defined in the Bankruptcy Code.[156]

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[154] *See, e.g.*, DeGirolamo v. McIntosh Oil Co. (*In re* Laurel Valley Oil Co.), Bankruptcy No. 05-64330, Adversary No. 12-6014, 2013 WL 832407 (Bankr. N.D. Ohio Mar. 5, 2013) (oil contract); Clear Peak Energy, Inc. v. S. Cal. Edison Co. (*In re* Clear Peak Energy, Inc.), 488 B.R. 647 (Bankr. D. Ariz. 2013) (electricity contract); BCP Liquidating LLC v. Bridgeline Gas Mktg., LLC (*In re* Borden Chems. & Plastics Operating L.P.), 336 B.R. 214 (Bankr. D. Del. 2006) (natural gas contract).

[155] *In re* Clearwater Natural Res., LP, No. 09-70011, 2009 WL 2208463, at *3 (Bankr. E.D. Ky. July 23, 2009) ("Whether coal is sufficiently fungible to serve as a commodity subject of a forward contract need not be addressed here.").

[156] *See* Transcript of Hearing at 9–10, *In re Clearwater Natural Resources*, 2009 WL 2208463 (No. 09-70011). The following is the relevant excerpt from the hearing transcript:

> THE COURT: Is there a difference between gas and coal because gas is almost a fungible commodity whereas coal like the real estate it comes from is somewhat unique? The coal you take from this hill won't burn in that power plant because of the way their burners are set and the ash content and the sulfur content. The coal you take from this mine may be perfect for blending only with the coal from that mine to sell to this utility because it got in just over the maximum-minimum BTU and just under the sulfur when blended that way to maximize all the factors. So, coal is not necessarily fungible as we all [k]now. So, does

In the non-bankruptcy context, fungibility is often cited as one of the defining features of a commodity.[157] For Bankruptcy Code purposes, however, commodity is a defined term, and that definition (the Commodity Exchange Act definition) does not impose an express fungibility requirement.[158] To be a commodity for purposes of the Bankruptcy Code, a product (or, more accurately, contracts for that product) need only be the subject of trading in the futures market.[159] Thus, regardless of whether a product is technically fungible, if its futures are traded on an exchange or through a registered clearinghouse, it is a commodity. This does not mean that the concept of fungibility plays no role. All contracts that are traded on futures exchanges must necessarily be fungible.[160] In order to create a standard fungible contract, the subject of that contract must also be relatively homogenous.[161] Therefore, if a particular product is not fungible, contracts for the sale of that product are unlikely to be traded on a futures exchange and, as such, the underlying product would not be considered a commodity for purposes of the Bankruptcy Code.

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that have a bearing?

Id.; *see also* Coal Exps. Ass'n of U.S., Inc. v. United States, 745 F.2d 76, 84 (D.C. Cir. 1984) (parties agree coal is not fungible); Montana-Dakota Utils. Co. v. Mont. Dep't of Pub. Serv. Reg., 752 P.2d 155, 157 (Mont. 1988) ("[C]oal is not a fungible commodity."); Harrington, *supra* note 119, § 12.02[3] ("Unlike natural gas and electricity, coal is not aptly characterized as a 'homogenous' good or 'commodity.'").

[157] *See, e.g.*, Minn-Chem, Inc. v. Agrium, Inc., 683 F.3d 845, 848 (7th Cir. 2012) (en banc) ("[P]otash is a homogenous commodity: One manufacturer's supply is interchangeable with another's."), *cert. dismissed*, 134 S. Ct. 23 (2013); *In re* Hydrogen Peroxide Antitrust Litig., 401 F. Supp. 2d 451, 456 (E.D. Pa. 2005) ("[B]ecause hydrogen peroxide is a homogenous product, it is a fungible commodity."); USEC, Inc. v. United States, 25 Ct. Int'l Trade 49, 53 (2001) ("Uranium is a fungible commodity product and interchangeable with uranium of the same form produced anywhere in the world."), *aff'd*, 34 F. App'x 725 (Fed. Cir. 2002). In analyzing the financial contract safe harbors included in the Canadian Companies' Creditors Arrangement Act (which are comparable to those found in the Bankruptcy Code), the Alberta Court of Appeal defined commodities as "fungible in nature—each unit is interchangeable for another. They have no specific or defining characteristics and may be easily replaced." Enron Capital & Trade Res. Can. Corp. v. Blue Range Res. Corp., 2000 ABCA 239, 266 A.R. 98, para. 43 (Can.).

[158] *See* 7 U.S.C. § 1a(9) (2012).

[159] *See supra* Part III.A.3.a.

[160] *See, e.g.*, Commodity Futures Trading Comm'n v. Erskine, 512 F.3d 309, 319 (6th Cir. 2008) (futures contract is a "fungible promise to buy and sell" (quoting Commodity Futures Trading Comm'n v. Zelener, 373 F.3d 861, 864 (7th Cir. 2004) (Easterbrook, J.))).

[161] *See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353, 358 (1982) (holding that, in the context of the futures contact market, "[n]ecessarily the commodities subject to such contracts were fungible"); Dunn v. Commodity Futures Trading Comm'n, 519 U.S. 465, 469–70 (1997) (stating that the Commodity Exchange Act governs "the market in futures contracts in fungible commodities").

2. Coal Futures Markets

Given the above, to determine whether a coal supply agreement is a forward contract one must first determine whether the coal that is the subject of that contract is traded on a futures exchange or cleared over-the-counter through a registered clearinghouse.[162] In 2001, the New York Mercantile Exchange (NYMEX) introduced the first exchange-traded futures contract for North American coal.[163] This NYMEX future was tied to coal from the Central Appalachian Region with quality characteristics of 12,000 BTUs, 13.5% ash, 1% sulfur, and 10% moisture.[164] As of the date of this Article, there are currently three North American coal futures subject to domestic exchange trading: Central Appalachian Coal Futures (NYMEX Contract); Powder River Basin Coal (Platts OTC Broker Index) Futures; and CSX Coal (Platts OTC Broker Index) Futures.[165] Each of these futures is tied to coal from a particular region (either Central Appalachia or the Powder River Basin) with stated quality specifications and a fixed delivery point.[166] In addition to these exchange-traded futures, standardized over-the-counter futures contracts exist for each of the three coal types referenced above.[167] Notwithstanding the dramatic expansion of the coal

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[162] *See supra* Part III.A.3.

[163] *See Thermal Coal Derivatives Discussion*, CME GROUP (Apr. 4, 2014), http://www.cmegroup.com/education/files/thermal-coal-derivatives-discussion.pdf.

[164] *See CME Group U.S. Coal*, CME GROUP, http://www.cmegroup.com/trading/energy/coal/central-appalachian-coal_contract_specifications.html (last visited Mar. 21, 2015).

[165] *See id.* In addition to these domestic futures, there are a number of coal futures and options tied to international shipments (primarily to Australia, England, and China). *See Thermal Coal: International*, CME GROUP, http://www.cmegroup.com/trading/energy/thermal-coal-international.html (last visited Mar. 21, 2015). For purposes of this Article, the commodity analysis is limited to futures traded on domestic exchanges.

When this Article was initially drafted, a standardized futures contract for Illinois Basin coal had not yet been introduced to the market. During the period between drafting and publication, however, standardized futures trading on Illinois Basin coal was introduced, and active trading is now conducted on such contracts. Due to the timing of this development, this Article does not discuss the treatment of Illinois Basin coal.

[166] *See* CME GROUP, *CME Group U.S. Coal*, *supra* note 164. The inclusion of specific transportation hubs within each exchange-traded coal future does not provide a basis, in and of itself, to exclude a specific coal shipment from the definition of a commodity. *See, e.g.*, United States v. Futch, 278 F. App'x 387, 395 (5th Cir. 2008) ("The Henry Hub clause in the NYMEX futures contracts merely specifies the location for gas delivery and does not in any way limit the type of commodity in question, natural gas.").

[167] *See Coal Markets: United States*, EVOLUTION MARKETS, http://www.evomarkets.com/energy/coal_markets/markets/united_states (last visited Mar. 21, 2015). Although futures contracts can be traded over-the-counter on a non-standardized basis, it is difficult (if not impossible) to ascertain the specifics of such contracts, and it is unlikely that the market for such contracts is extensive enough, at least in the coal context, to expand the range of coal types subject to the Commodity Exchange Act's definition of a "commodity."

futures markets since 2001, the trading of coal futures is still insignificant when compared to traditional commodities like natural gas, oil, and copper,[168] likely because of "differences in quality and usage that exist between different types of coal products mined in different regions," limited transportation options for physical deliveries, minimal liquidity, and the idiosyncratic requirements of specific end-users of coal.[169]

Given the existence of the futures contracts cited above, there is no question that, in generic terms, coal is subject to trading in the futures market. Based on the extensive differences between specific types of coal, and the futures market's use of coal contracts with specified characteristics, the appropriate inquiry for purposes of the commodity definition is whether coal, as defined in a particular contract, is subject to trading on a futures exchange.[170] To the extent that a specific coal supply agreement contemplates, for instance, the delivery of Central Appalachian coal with 12,200 BTUs, 0.90% sulfur content, 12% ash content, and 9% moisture, that coal meets or exceeds the requirements of the standard NYMEX contract and is, therefore, traded in the futures market.[171] This is true even if there is some disparity in the relative quality figures, provided that the exchange-traded quality specifications are within the range of figures permitted by the applicable contract.[172] At present, standardized futures contracts only exist for thermal coal from Central Appalachia and the Powder River Basin, with slightly varying specifications and delivery points.[173] There are no standardized futures contracts for metallurgical coal (either from Central Appalachia or any other region), or for coal of any type from the Northern Appalachia or the Rocky Mountain region.[174] As such, absent the inclusion of abnormal coal quality specifications, the majority of

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[168] *See* Harrington, *supra* note 119, § 12.03[3]; Peabody Energy, Annual Report, *supra* note 87.

[169] Harrington, *supra* note 119, § 12.02; *see also* Radford & Hammond, *supra* note 127, at 33.

[170] *See, e.g.*, United States v. Valencia, No. Civ.A. H-03-024, 2003 WL 23174749, at *8 (S.D. Tex. Aug. 25, 2003) ("The issue raised by Valencia of whether 'West Coast gas' [as opposed to natural gas generally] is a commodity 'in which contracts for future delivery are presently or in the future dealt in' is a fact question."), *vacated in part on reconsideration*, No. CRIM.A. H-03-024, 2003 WL 23675402 (S.D. Tex. Nov. 13, 2003), *rev'd*, 394 F.3d 352 (5th Cir. 2004). *But see* Superior Livestock Auction, Inc. v. E. Livestock Co., L.LC. (*In re* E. Livestock Co.), Bankruptcy No. 10-93904-BHL-11, Adversary No. 11-59088, 2012 WL 4210347, at *4 (Bankr. S.D. Ind. Apr. 5, 2012) (refusing to look at specific characteristics of livestock because "livestock" is an enumerated commodity under the Commodity Exchange Act).

[171] *See* CME GROUP, *CME Group U.S. Coal*, *supra* note 164.

[172] *See supra* Part V.A; *see also* FTC v. Arch Coal, Inc., 329 F. Supp. 2d 109, 121–22 (D.D.C. 2004) (determining that 8,400 BTU and 8,800 BTU Powder River Basin coal are part of the same market for antitrust purposes).

[173] *See supra* notes 164–67 and accompanying text.

[174] *See supra* notes 164–67 and accompanying text.

coal contracts for the delivery of thermal coal from Central Appalachia or the Powder River Basin will be contracts for the sale of a commodity. By contrast, contracts for the sale of coal from Northern Appalachia or for metallurgical coal from Central Appalachia will not be contracts for the sale of a commodity due to the lack of an exchange-traded or standardized over-the-counter futures contract for such coal.

These generalizations may not represent the complete picture, however, where the applicable supply contract contemplates the delivery of coal from a specific mine, even if the remaining contract specifications are identical to a standardized futures contract. As previously discussed, even coal with similar quality specifications may react differently when burned in particular boilers or blended with existing coal supplies, depending upon the source of that coal.[175] It is for this reason that utilities often engage in pre-purchase testing of coal and contract for coal from a particular mine or geological seam.[176] As such, if a contract is limited to coal from a specific mine (and does not contain a broad substitute coal provision), there will not be a standardized futures contract for that coal. There are, for example, no exchange-traded futures contracts for coal from the Coalburg seam of the Coal-Mac mine located in Logan County, West Virginia.[177] So long as the end-user has a specific reason for restricting the source of coal under its contract to a particular mine (e.g., extensive pre-sale testing), there is a legitimate basis to narrow the commodity inquiry from the general characteristics of the coal (the typical approach) to the specific source of the coal that is the subject of the applicable contract. Under this second approach, coal from the Coal-Mac mine, as an example, would not be a commodity for purposes of the Bankruptcy Code even if it would otherwise fit within the specifications of the standard NYMEX contract.

3. Forward Contract Trade

Even if coal, as defined in a particular contract, is not subject to trading on a futures exchange or through a registered clearinghouse, it can still be the subject of a forward contract if it is or "becomes the subject of dealing in the forward contract trade."[178] As mentioned earlier, the only existing

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[175] *See supra* Part V.B; *see also* Radford & Hammond, *supra* note 127, at 32–33 ("The coal may meet the standards of the NYMEX contract, but the contract doesn't talk about burn characteristics, other than heating value, moisture, ash percentage and so on. It doesn't address how ash is going to form in a particular boiler.").

[176] *See supra* Part V.B.

[177] *See* Arch Coal, Annual Report, *supra* note 87, at 15–16.

[178] 11 U.S.C. § 101(a)(25) (2012).

judicial definition of the forward contract trade is the "customary course of action for forward contracts."[179] This definition is not particularly helpful, however, as it does not identify, for example, the number of similar contracts that must be entered into or the number of parties that must enter into such contracts before a contract of that type becomes part of the forward contract trade.[180] From a practical perspective, however, if coal of a particular type is not traded on a futures exchange or through a registered clearinghouse, but there is a significant physical market for that coal, it would seem that contracts for such coal are a part of the forward contract trade and that the coal itself is the proper subject of a forward contract. For example, although Northern Appalachian thermal coal and Central Appalachian metallurgical coal are not technically commodities (i.e., they are not traded on a futures exchange),[181] they can still be the subject of a forward contract if the stated specifications under the relevant contracts are consistent with the typical coal supply agreement for that region. To the extent that a particular type of coal from a particular region is frequently purchased and sold through supply contracts with terms in excess of two days, that coal is "the subject of dealing in the forward contract trade" and the proper subject of a forward contract for purposes of the Bankruptcy Code.[182]

If a coal contract is not traded on a futures exchange or over-the-counter because the contract limits the source of the subject coal to a particular mine, and the full output of that mine is committed to the relevant contract, that coal would not appear to be the subject of trading in the forward contract trade.[183] The result may be different, however, if a coal producer has entered into multiple contracts for coal produced from the same mining facility. In that case, it is at least arguable that there is a customary course of action for long-term, fixed-price contracts (i.e., forward contracts) for the particular coal at issue. Obviously, this would

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[179] Clear Peak Energy, Inc. v. S. Cal. Edison Co. (*In re* Clear Peak Energy, Inc.), 488 B.R. 647, 661 (Bankr. D. Ariz. 2013).

[180] *See supra* Part III.A.3.

[181] *See supra* Part VI.A.2.

[182] 11 U.S.C. § 101(25)(A).

[183] This assumes, of course, that execution of a single forward contract for coal from a particular source is insufficient to constitute a "customary course of action" for the sale of such coal. Bankruptcy courts have reached conflicting conclusions on the related question of whether a single transaction is sufficient to constitute an "ordinary course of business" for purposes of section 547(c)(2) of the Bankruptcy Code. *Compare* Warsco v. Household Bank F.S.B., 272 B.R. 246, 251 (Bankr. N.D. Ind. 2002) ("[I]solated or first time transaction *may* be in the ordinary course of business or financial affairs of the debtor and the transferee."), *aff'd sub nom.* Kleven v. Household Bank F.S.B., 334 F.3d 638 (7th Cir. 2003), *with* Miller v. Kibler (*In re* Winters), 182 B.R. 26, 29 (Bankr. E.D. Ky. 1995) (holding that ordinary course defense "does not apply to single, isolated transactions").

require a far broader definition of the forward contract trade than would be necessary for contracts with standard regional quality specifications. In summary, provided that it has standard quality characteristics for its region of origin and is not directly linked to production from a particular mine, most coal produced in the United States will be the proper subject of a forward contract (and, under the Fourth Circuit's analysis, a swap agreement) because it is either a commodity (i.e., thermal coal from Central Appalachia), or is similar to a commodity and is the subject of dealing in the forward contract trade (i.e., metallurgical coal from Central Appalachia).

B. Fixed Price and Quantity

The majority of bankruptcy courts outside of the Fourth Circuit do not require that a forward contract contain fixed quantity and price terms.[184] Courts within the Fourth Circuit, and those courts that have adopted its approach, however, require the presence of both elements for a contract to be considered a forward contract.[185] Whether a requirements contract, output contract, or a contract with a price reopener contains sufficiently fixed terms to satisfy the Fourth Circuit's forward contract elements is a matter of some dispute. The United States Bankruptcy Courts for the District of Arizona and for the Western District of Wisconsin have ruled that contracts with variable price terms are sufficiently "fixed" to fit within the forward contract definition,[186] and the Fifth Circuit Court of Appeals has said, in dicta, that requirements contracts can be forward contracts.[187] The reasoning utilized by these courts appears to be consistent with general principles of contract law, which sanction open-price terms so long as a reasonable formula or method for ascertaining price is agreed on,[188] and on the U.C.C., which validates the use of requirements contracts.[189]

The Bankruptcy Court for the Eastern District of North Carolina, by contrast, has required strict adherence to the fixed quantity and price

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[184] *See supra* Part III.A.4.

[185] *See supra* Part III.A.4.

[186] *See* U.S. Bank Nat'l Ass'n v. Plains Mktg. Can. LP (*In re* Renew Energy, LLC), 463 B.R. 475, 481–82 (Bankr. W.D. Wis. 2011); Clear Peak Energy, Inc. v. S. Cal. Edison Co. (*In re* Clear Peak Energy, Inc.), 488 B.R. 647, 658–59 (Bankr. D. Ariz. 2013).

[187] *See* Lightfoot v. MXEnergy Elec., Inc. (*In re* MBS Mgmt. Servs., Inc.), 690 F.3d 352, 357 (5th Cir. 2012) (opining that most forward contracts for electricity are "generally for the entire needs or demands of the purchaser").

[188] *See* Trident Const. Co. v. Austin Co., 272 F. Supp. 2d 566, 576 (D.S.C. 2003), *aff'd per curiam*, 93 F. App'x 509 (4th Cir. 2004).

[189] *See* U.C.C. § 2-306 (2003).

elements of the *In re National Gas Distributors* factors and has not permitted any variation from such terms.[190] According to that court, the fact that a contract with open price or quantity terms may be an enforceable contract under the U.C.C. does not mean that the price and quantity provisions are sufficiently certain for it to constitute a forward contract for Bankruptcy Code purposes.[191] Under this court's approach, the typical utility's coal requirements contract would clearly not be a forward contract for purposes of the Bankruptcy Code.[192]

The appropriate classification of a contract with one of the variable price terms described in Part V.C is somewhat less clear, however, given that a fixed price is technically set at the time of contracting and for various periods of time throughout the term of the contract.[193] If one assumes that the purpose of the Fourth Circuit's fixed price requirement is to ensure that the contract has a legitimate market effect (i.e., it is intended to protect against commodity price risk), it would seem that a coal contract with a price reopener provision predicated on the increased costs of production (e.g., labor, diesel fuel, etc.) would be far more likely to pass muster than a reopener provision tied to changes in the market price of the underlying commodity.[194] Given its inherent protection against price volatility, a market price reopener would seem to minimize the likelihood that the contract itself was entered into to hedge against market fluctuations.[195]

C. Effect on Market

A minority of bankruptcy courts have indicated that a contract cannot be a forward contract unless it has "financial characteristics" or some effect on the financial markets.[196] According to these courts, any contract that is intended, at least in part, to protect against fluctuations in the market price of an underlying commodity has the requisite market effect.[197] Recent annual reports for each of the largest publicly-traded domestic coal producers demonstrate that all of these companies enter into long-term coal

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[190] *See* Hutson v. M.J. Soffe Co. (*In re* Nat'l Gas Distribs., LLC), 412 B.R. 758, 764–67 (Bankr. E.D.N.C. 2009).

[191] *Id.* at 766 ("A contract in which the parties *agree* that a number may be left open may well be a viable contract, but that agreement is not one for a 'fixed' quantity.").

[192] *See id.* at 765–66.

[193] *See supra* Part V.C; *see also In re National Gas Distributors*, 412 B.R. at 765–66.

[194] *See* BCP Liquidating LLC v. Bridgeline Gas Mktg., LLC (*In re* Borden Chems. & Plastics Operating L.P.), 336 B.R. 214, 221 (Bankr. D. Del. 2006).

[195] *See id.* at 220–21.

[196] *See supra* Part III.A.5.

[197] *See supra* Part III.A.5.

supply agreements, not only to generate a profit, but also to manage commodity price risk.[198] Some of these producers, particularly those with discrete trading divisions, also purchase derivative instruments or futures contracts to hedge against potential losses under their long-term physical supply agreements.[199] Even these companies, however, only engage in limited hedging activity in the derivatives markets.[200] Given the minimal showing required by the courts referenced above, any contract that a party asserts was entered into to protect against fluctuations in the market price of coal (or based on which that party has elected to enter into a physical or financial hedge) will necessarily exhibit the requisite financial characteristics to constitute a forward contract.[201]

To the extent that the requisite market effect is an impact on the financial markets as a whole (rather than simply the coal markets), long-term coal supply agreements (and even derivative products derived from such contracts) would not appear to generate sufficient trading volume to impact these markets in any meaningful way.[202] In a presentation to the Commodity Futures Trading Commission (CFTC) in 2010, Peabody Energy Corporation, the "world's largest private-sector coal company," informed the CFTC that the "financial coal markets are de minimis" and that coal "futures, options and swap trading activities are not material enough to

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[198] *See, e.g.*, Alpha Natural Resources, Annual Report, *supra* note 113, at 89 ("We manage our commodity price risk for coal sales through the use of coal supply agreements."); Arch Coal, Annual Report, *supra* note 87, at 75–76; Cloud Peak Energy, Annual Report, *supra* note 133, at 79; Peabody Energy, Annual Report, *supra* note 87, at 73. The bankruptcy court in *In re Borden Chemicals & Plastics* cited similar annual report language and determined, in dicta, that such language described an attempt to hedge against possible fluctuations in the price of a commodity and, therefore, had a sufficient market effect to constitute a forward contract. *See In re Borden Chemicals & Plastics*, 336 B.R. at 221.

[199] *See* Arch Coal, Annual Report, *supra* note 87, at 76 ("We are exposed to fluctuations in the fair value of coal derivatives that we enter into to manage the price risk related to future coal sales . . . ."); Cloud Peak Energy, Annual Report, *supra* note 133, at 100 ("We use domestic coal futures contracts . . . to help manage our exposure to market changes in domestic coal prices."); Peabody Energy, Annual Report, *supra* note 87, at 71.

[200] *See, e.g.*, Peabody Energy, Annual Report, *supra* note 87, at 72 ("We predominately manage our commodity price risk for our non-trading long-term coal contract portfolio through the use of long-term coal supply agreements . . . rather than through the use of derivative instruments.").

[201] *See, e.g.*, Hutson v. E.I du Pont de Nemours & Co. (*In re* Nat'l Gas Distribs., LLC), 556 F.3d 247, 257 (4th Cir. 2009) ("A business can enter into a forward agreement with a party who then, in reliance on that forward agreement, enters into another contract with yet another market participant, who in turn may enter into even other contracts. And so a simple forward agreement may readily become tied into the broader markets that Congress aimed to protect in BAPCPA.").

[202] *See* Peabody Energy Corp., *Meeting with the CFTC on the Implementation of the Dodd-Frank Act*, U.S. COMMODITY FUTURES TRADING COMMISSION 9–10 (Nov. 15, 2010), http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmissionmult_111510-pe.pdf.

impact" the domestic economy.[203] According to the data provided in Peabody's presentation, the sum total of coal futures, options, and swaps traded in 2010 represent less than .001% of the over-the-counter derivative market; less than .01% of the volume of the cleared futures, options, and swaps market; and less than .05% of the cleared energy futures, options, and swaps market.[204] If the financial contract safe harbors were intended to "protect the financial markets from the destabilizing effects of bankruptcy proceedings,"[205] this goal would not seem to be implicated by a trading market, such as coal, which does not possess a sizeable enough market share to generate actual market instability. As noted above, however, notwithstanding the purported legislative basis for the market effect requirement, no court has required an evidentiary showing that the failure of the particular contract market at issue would have a cognizable effect on the financial and commodity markets more generally.[206]

D. Which Coal Counterparties are Forward Contract Merchants?

To the extent that the forward contract merchant requirement is still relevant post-*In re National Gas Distributors*,[207] the identity of the parties to a coal supply agreement may ultimately determine whether that agreement is protected by the Bankruptcy Code safe harbors. A supply contract between a coal producer and a utility (assuming that such coal was mined by the producer and will be used by the utility to generate electricity) is the classic example of a contract where neither party to the contract is a forward contract merchant.[208] A supply contract between a coal producer and a coal trading or brokerage firm (or a subsequent contract between that same brokerage firm and a utility), by contrast, is the most obvious example of a contract where one of the parties (the brokerage firm) is, in fact, a forward contract merchant.[209] If one alters either of these fact patterns, even only slightly, however, the classification of the parties becomes far less clear.[210]

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[203] *Id.* at 5, 10.

[204] *Id.* at 10.

[205] Morrison & Riegel, *supra* note 51, at 642.

[206] *See In re National Gas Distributors*, 556 F.3d at 257–58 (demonstrating the low evidentiary burden for proof of market effect).

[207] *See supra* Part IV.C.1.

[208] *See supra* Part III.B.

[209] Mirant Ams. Energy Mktg., L.P. v. Kern Oil & Ref. Co. (*In re* Mirant Corp.), 310 B.R. 548, 567–69 (Bankr. N.D. Tex. 2004).

[210] *See supra* Part III.B. Many coal companies, in addition to marketing and selling their own coal, also purchase and resell coal mined by third parties. *See, e.g.*, Alpha Natural Resources, Annual Report,

1. Blended Coal and Substitute Coal

In order to satisfy precise coal quality specifications, coal producers frequently purchase coal from third parties to blend with their own coal.[211] In any such transaction, the coal producer is likely a forward contract merchant because it is purchasing coal that, after blending, will be resold to a third party for a profit (meaning that the producer is not an end-user of that coal).[212] A more difficult question is whether, in any subsequent sale of the blended coal, the seller is merely acting as a coal producer or rather as a forward contract merchant. As to the portion of the blended coal that was extracted from the seller's own mine, the seller is clearly not a merchant, but that same seller likely is a merchant as to the portion of the blended coal that was purchased from a third party. Whether the relative percentages of mined-versus-purchased coal is the determining factor (similar to the "predominant factor" test under the U.C.C.),[213] or whether the use of any purchased coal taints the seller's status as to the entire shipment is an issue that has yet to be analyzed, even tangentially, by any court.

A similar issue arises where a coal producer elects to fill an existing supply contract with coal purchased from a third party.[214] The determination of whether a contract counterparty is a forward contract merchant appears to be tied to the party's status at the time that it entered into the subject contract.[215] Therefore, if a coal producer enters into a coal supply agreement with the intention of fulfilling the requirements of that contract with its own production, the producer would not be a forward contract merchant in relation to that contract, even if it later elected to utilize only purchased coal to satisfy the remainder of its contractual

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supra note 113, at 14. As noted *supra* Part III.B, the critical inquiry for purposes of the forward contract merchant requirement is in what capacity the company was acting in relation to the particular contract at issue.

[211] *See, e.g.*, Daniel Mahr, *Coal Quality Control*, INDUS. FUELS & POWER (June 2010), http://www.energy-pc.com/IFandP_Coal_Quality_ControlV2a.pdf; Alpha Natural Resources, Annual Report, *supra* note 113, at 42 ("The majority of the coal that we purchase from third parties is blended with coal produced from our mines prior to resale . . . ."); Cloud Peak Energy, Annual Report, *supra* note 133, at 4.

[212] *See supra* Part III.B.

[213] *See* BMC Indus., Inc. v. Barth Indus., Inc., 160 F.3d 1322, 1329 (11th Cir. 1998) ("Most courts follow the 'predominant factor' test to determine whether such hybrid contracts [i.e., contracts for both a good and a service] are transactions in goods, and therefore covered by the UCC, or transactions in services, and therefore excluded.").

[214] *See* Buchwald v. Williams Energy Mktg. & Trading Co. (*In re* Magnesium Corp. of Am.), 460 B.R. 360, 375–76 (Bankr. S.D.N.Y. 2011).

[215] *See, e.g.*, *id.* (stating that the counterparty must show that it acted as a forward contract merchant "in enter[ing] into 'a forward contract *with the debtor*'" (alteration in original) (quoting Mirant Ams. Energy Mktg., L.P. v. Kern Oil & Ref. Co. (*In re* Mirant Corp.), 310 B.R. 548, 569–70 (Bankr. N.D. Tex. 2004)) (internal quotation marks omitted)).

obligations. This approach appears reasonable (and perhaps the only workable approach) in the context of section 556, which addresses the treatment of forward contracts in a general sense, but seems somewhat counterintuitive in regard to section 546(e), which deals with specific shipments and payments under a forward contract.[216] The United States Bankruptcy Court for the Northern District of Texas appears to have utilized the shipment-by-shipment or payment-by-payment approach when it denied a fraudulent transfer defendant's motion for summary judgment pursuant to section 546(e).[217] According to that court, summary judgment was not appropriate because an issue of material fact existed as to, among other things, whether the petitioning party "was acting as a forward contract merchant when it received *the June transfer* from" the debtor.[218] In conducting its analysis, the court did not inquire as to whether the petitioning party was acting as a forward contract merchant when it executed its contract with the debtor over a year earlier, but only the capacity in which it was acting when it actually received the challenged transfer.[219] Notwithstanding the facial appeal of this approach in the section 546 context, there does not appear to be any statutory basis to alter the focus of the forward contract merchant inquiry depending on the particular safe harbor implicated by a given transaction. As noted above, section 556 (with its focus on the contract as a whole) simply does not lend itself to a shipment-by-shipment analysis and, therefore, the viability of this approach is (at a minimum) questionable.[220]

2. Coal Sales Subsidiaries

Many large coal producers segment their business operations into distinct legal entities in order to minimize enterprise-wide liability and to generate tax benefits (e.g., a land-holding subsidiary, an operating subsidiary, a sales subsidiary, etc.).[221] As such, even if a company (in the broadest sense of the term) mined the coal that is the subject of a supply contract, a separate (albeit affiliated) legal entity may be the actual

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[216] *Compare* 11 U.S.C. § 556 (2012), *with id.* § 546(e).

[217] *See* Newhouse v. Tex. E. Transmission Corp. (*In re* Aurora Natural Gas, LLC), 316 B.R. 481, 484 (Bankr. N.D. Tex. 2004).

[218] *Id.* (emphasis added).

[219] *Id.* at 484–85.

[220] *See supra* note 216 and accompanying text.

[221] *See, e.g.*, Alpha Natural Resources, Annual Report, *supra* note 113, at Exhibit 21 (listing subsidiaries, including Alpha Coal Sales Co., LLC; Alpha European Sales, Inc.; Alpha Land & Reserves, LLC; Alpha Wyoming Land Company, LLC; Big Bear Mining Company; and Brooks Run Mining Company, LLC).

counterparty to the relevant coal supply agreement. If that legal entity's sole function is the sale of coal for a profit (e.g., a sales or brokerage subsidiary), that entity would appear to be a forward contract merchant.[222] To the extent that the consolidated enterprise accounts for any sale of coal from the producing subsidiary to the sales subsidiary and reverses the transaction when payment from the counterparty is received (less a sales commission), that conclusion appears to be well-founded.[223] If the sales subsidiary is a party to the contract in name only, however, and never takes title to or receives a commission for the sale of that coal, one could argue, at least for purposes of analyzing the legal status of the parties, that the entity's separate corporate existence should be disregarded and the producer be considered the real party in interest. In that case, any analysis would need to be based on the characterization of the coal producer itself and would likely result in a determination that the entity is not a forward contract merchant. Whether one can disregard the existence of a sales subsidiary solely for purposes of the forward contract merchant analysis without satisfying the elements necessary to pierce the corporate veil or impose alter ego liability is, however, an entirely separate question.

VII. CONCLUSION

The Bankruptcy Code's financial contract safe harbors provide significant benefits to those contract counterparties who are eligible for its protections.[224] Parties to such contracts can enforce their contract's ipso facto clauses, are not bound by the automatic stay, and have an exemption from any potential avoidance action liability.[225] Although long-term supply contracts are not what one would typically consider financial contracts, bankruptcy courts have uniformly ruled that certain long-term supply agreements are, in fact, protected by the Bankruptcy Code's safe harbors as either forward contracts or swap agreements.[226] Long-term coal supply agreements share many characteristics with these protected supply contracts and, as such, counsel for coal suppliers, coal brokers, or end-users of coal

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[222] *See supra* Part III.B.

[223] *See supra* Part III.B (discussing the definition and interpretation of forward contract merchant). In the event that the sales subsidiary is merely an agent for the producer-principal (and never takes title to the coal), the question of whether the sales subsidiary or the producer-principal is the appropriate party to utilize for the forward contract merchant analysis would seem to turn on general principles of agency. *See* RESTATEMENT (THIRD) OF AGENCY §§ 6.01–6.03 (2006) (discussing liability and status of principal as disclosed or undisclosed).

[224] *See* Lubben, *supra* note 1, at 322.

[225] *See* 11 U.S.C. §§ 362(b)(6), (b)(17), 546, 556, 560 (2012).

[226] *See supra* Parts III–IV.

must be cognizant of the potential application of the safe harbors in any bankruptcy filing in the coal, steel, or power generation industries. This is particularly true given the potential nullification of the Bankruptcy Code's forward contract merchant requirement occasioned by the 2005 Bankruptcy Code amendments and the Fourth Circuit's decision in *In re National Gas Distributors*.[227] The unique features of coal supply agreements, and particularly the focus on coal quality specifications, however, present a viable basis to argue against application of the safe harbors in relation to particular contracts. This Article identifies the arguments that can be made against application of the safe harbors—that contract coal is not a commodity, or that the contract price is not fixed because of a price reopener provision, for example—and the jurisdictions in which these arguments are most likely to succeed. It is important to note, however, that as of the date of this Article there are no reported decisions addressing the Bankruptcy Code classification of long-term coal supply agreements and no definitive answers to certain questions posed herein. Given the absence of any direct precedent, and the conflicting case law on certain forward contract and swap agreement elements, counsel to coal contract counterparties can make strong arguments either for or against application of the safe harbors in a given case depending on the needs of his or her client.

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[227] *See* Hutson v. E.I du Pont de Nemours & Co. (*In re* Nat'l Gas Distribs., LLC), 556 F.3d 247 (4th Cir. 2009); *see also supra* Parts IV.C.1, VI.D.