



**Operating Committee Meeting Spring 2010
Park City**

WSPP TRAINING

Credit and the WSPP Agreement

Kimberly Gentle
Sr. Risk/Contracts Manager
Clark Public Utilities
1200 Ft Vancouver Way
Vancouver, WA 98663
360-992-3246
kgentle@clarkpud.com

Arnie Podgorsky
Wright & Talisman, P.C.
1200 G Street, N.W., Suite 600
Washington, D.C. 20005-3802
(202) 393-1200
podgorsky@wrightlaw.com

These training materials contain no legal opinions or formal interpretations of the WSPP Agreement



The Problem

- Different entities (banks, marketers, LSEs, publics) have different goals, but all consider:
 - What occurs if I need to make a termination payment to you?
 - What occurs if you need to make a termination payment to me?
 - Why? Because every entity must be prepared in the event of a default or a bankruptcy.



Contract Termination

- Event of Default, under 22.1, by a party or its guarantor, 22.2(b) provides--
 - Termination right is available only for all WSPP transactions, at once
 - Subject to exercise within 30 days after Event became known
 - Until notice given, remedies available under 21.3, Agreement, or at law or equity
 - Upon notice, performing party may withhold any payments due defaulting party, and has setoff rights



Liquidation

- 22.3: determine net present value of all terminated transactions. Owing party is to pay in 3 days the entire liquidated amount after all setoffs, which include amounts owing between the parties.
- Terminated transaction value + amounts due + amounts owing but not yet due.
- 22.3(e)(i): If non-defaulting party owes, then it may pay termination payment over the life(s) of the contract(s). Unique to WSPP.



Credit Events

- Amount due subject to credit assurance requirements of 27; failure to pay results in acceleration of payment requirement.
- Events include the obvious (bankruptcy) and more:
 - Failure to make timely payment
 - Reduction in creditworthiness for any number of reasons
 - Downgrade in debt rating
 - Caution: do not solely rely on credit ratings
 - Financial review (TNW or Debt Ratios, etc.)
 - local economy
 - News events
 - Pending merger
 - Substantial exposure to an at risk counterparty



Credit Events (more)

- What to do
 - Surveillance of problems (ear to rail)
 - 27 Credit Assurance: a party may require assurance because it is dissatisfied in its reasonably exercised discretion (see 27 for examples of dissatisfaction events). Generally tracks UCC 2-609.
 - Other party may assure with (its choice) LC, cash prepay; other collateral; acceptable Guarantee; agreed other method
 - Amount is estimate of damages resulting from failure to perform (which could be termination payment)
 - Must post 3 business days of request; failure is an Event of Default.
 - Possible strategy is move quickly to terminate prior to bankruptcy automatic stay (discussed below)



Credit Risk Management

- Factors to assess/rate counterparty's credit risk
 - Organizational Structure
 - Tangible net worth and quality of equity
 - Debt ratios
 - Debt ratings
 - Overall financial position
 - Cash flow
 - Risk management
 - Quality of earnings
 - Quality of assets



Tools to Manage Credit Risk

- Managing the relationship
- Obtaining current information
- Managing the transaction
 - Duration
 - Price
 - Offsetting transactions when necessary
 - Credit adders
- Managing Security
 - Be aware of drawdown restrictions and timing.
 - Be aware of timing for security arrangements (e.g. trust agreements, etc.)



Tools to Manage Credit Risk (more)

- Know all of your underlying agreements with the counterparty
- Security
 - Prepayment
 - Collateral and related agreements
 - ISDA CSA
 - WSPP or EEI Collateral Annex
- Credit Derivatives (credit default swaps)
 - A risk shifting device
 - No better than the creditworthiness of the counterparty
- Who uses what and why?



Bankruptcy Considerations

- Bankruptcy considerations may affect risk; in any event, be aware
- What happens in a bankruptcy
 - Stay to stop actions external to the bankruptcy proceeding
 - Marshalling of assets, including collection of amounts due to Debtor, recovery of preferential payments or fraudulent conveyances
 - Determination of liquidation or reorganization
 - For executory contracts, assumption or rejection (latter resulting in unsecured claims)
 - Evaluation of creditors' claims
 - If reorganization, allowing for operation during bankruptcy proceeding; negotiation/approval of a plan
 - Pay creditors by priority (secured creditors; IRS; employees; unsecured creditors)



Bankruptcy Considerations (more)

- Automatic Stay
 - Code 362(a): upon filing of bankruptcy petition, prohibits legal action and contract enforcement, including self help and actions to initiate or perfect remedies
 - Limited forward contract exception: Code 362(b)(6) makes stay inapplicable to exercise by a “forward contract merchant or financial institution (and limited others) ... under a forward contract ... to offset or net out any termination payment.”
 - Allows liquidation and setting of termination payment to occur, but does not provide for collection.
 - “Forward Contract” is commodity contract more than 2 days out, which becomes the subject of dealing in the forward contract trade.
 - “Forward Contract Merchant” is an entity in business in whole or part of entering into forward contracts with other commodity merchants, which “becomes the subject of dealing in the forward contract trade.”
 - End user not in trading business may be ruled not a “Forward Contract Merchant” (such that notice of termination could be violation of the stay)



Bankruptcy Considerations (more)

- Rejection of executory contracts
 - Code 365 allows rejection (termination) under business judgment rule
 - Bankruptcy courts may seek to cherry pick assumption of good contracts and rejection of bad deals. WSPP 35 “single agreement” language intended to address this risk.
 - Some nuanced issues of FERC pre-emption
- Preferences
 - Code 547 allows Debtor to recover payments made 90 days prior to bankruptcy filing, but not if for antecedent debt and payment was made in the ordinary course of business
- Protection against utilities
 - Code 366 prohibits termination of service due to bankruptcy filing, for 20 days after filing (30 in a reorganization), but allows utility to require furnishing of credit assurance



Bankruptcy Considerations (more)

- And a word about setoff
 - A “netting” of payment obligations provided for by contract.
 - Potential impact is reduction of creditor’s claim (and risk of dilution if unsecured).
 - Code 553 requires mutuality, that is, that ‘the debts must be in the same right and between the same parties, standing in the same capacity.’” *In re Drexel Burnham Lambert Group Inc.*, 113 B.R. 830, 847 (Bankr. S.D.N.Y. 1990). Another court explained that “courts construing the Code have long held that the debts to be offset must be mutual, prepetition debts[,]” and that “[t]he authorities are . . . clear that debts are considered ‘mutual’ only when ‘they are due to and from the same persons in the same capacity.’” *In re SemCrude, L.P.*, 399 B.R. 388, 393 (Bankr. D. Del. 2009).
 - Impact of the requirement on RTO billing is reflected in the FERC Credit NOPR.



Credit training in our industry

- NAPCO
 - http://www.rmgfinancial.com/NAPCO_overview.htm
- IECA
 - <http://www.ieca.net>
- RMG Financial
 - <http://www.rmgfinancial.com>