

# Potential Enhancements to Mitigate Bankruptcy Risk

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- PJM has made enhancements to its credit and risk management policies that may be impacted by bankruptcy laws.
- Federal bankruptcy law gives rights to persons and imposes prohibitions on creditors upon the filing of a bankruptcy. These rights and prohibitions impact pre-petition contractual rights.
- Two common bankruptcy provisions are the debtor's right to assume, assign or reject contracts and the automatic stay, which prohibit creditors from exercising certain contractual rights they have prior to the bankruptcy.
- The bankruptcy code provides an exemption from the automatic stay for forward contracts permitting forward contract merchants the ability to liquidate and set off contracts.
- The bankruptcy code and Attachment Q currently have several measures to help prevent bankruptcy losses; however, there are areas that PJM would like to explore to better protect PJM markets from losses, should a member file for bankruptcy.

Bankruptcy laws ***generally*** trump preexisting contractual obligations.

- Bankruptcy Code is the uniform law that governs all bankruptcy cases.
- They are governed by the Federal Rules of Bankruptcy Procedure.
- Parties typically file Chapter 7 (liquidation), Chapter 11 (reorganization) or Chapter 13 (Individual reorganization).
- There is tension between FERC and bankruptcy court (especially with respect to commercial contracts).
- FERC's police powers over FERC-regulated public utilities and tariffs are preserved.

A bankruptcy filing imposes an automatic stay on a creditor's efforts to collect from a debtor outside of the bankruptcy proceeding § 362a. The stay **generally**:

- Precludes affirmative acts that would alter the status quo as of the time a bankruptcy petition is filed
- Requires persons in possession of estate assets to turn over assets to the bankruptcy trustee
- Prohibits acts to create, perfect or enforce liens against the estate property
- Prohibits acts to collect, assess or recover claims against the debtor

PJM's documents **should** clearly establish the ability to restrict the access of the bankrupt member, request collateral as a condition of future service, retain pre-petition revenues and the right of recoupment

Under Chapter 11 procedures, creditors – holders of bankruptcy claims – are categorized into the following classes, ranked from highest to lowest priority:

Secured Claims

Unsecured Priority Claims

Unsecured Non-Priority Claims (General Unsecured)

Equity Security Interests

Security agreement will elevate PJM claims from Unsecured to Secured.

PJM and other entities designated as “forward merchants” who have “forward contracts” and “swap agreements” are **exempt** from automatic stay and transfer avoidance provisions of the bankruptcy code **but not all** provisions of the bankruptcy code.

## Forward Contract Merchants may:

- Liquidate forward contracts
- Set off margin and settlement payments against other obligations
- Terminate agreements

Forward contracts generally are contracts for the purchase, sale or transfer of commodity, subject to trade in the forward contract industry and have a maturity of more than 2 days 11 USC §101

Current Bankruptcy Protections	Protection Afforded
<p>Att. Q states all PJM contracts constitute a master netting agreement.</p>	<ul style="list-style-type: none"> <li>▪ Prevents debtor from cherry-picking certain PJM contracts to assume, assign or reject.</li> <li>▪ Att.Q states documents are intended to be an integrated agreement constituting a master netting agreement.</li> <li>▪ For purposes of the Bankruptcy Code, <b>all transactions</b>, including but not limited to FTR transactions, between PJM, on the one hand, and a Market Participant, on the other hand, are intended to be part of a single integrated agreement, and together with the agreements constitute a "master netting agreement."</li> </ul>
<p>PJM is designated a Forward Contract Merchant. Since FTR agreements are designated as forward contracts, they are thus exempt from automatic stay provisions.</p>	<ul style="list-style-type: none"> <li>▪ Forward contracts (like FTRs) are exempt from automatic stay prohibitions.</li> <li>▪ This permits PJM to set off, liquidate and request collateral.</li> <li>▪ Notwithstanding the CFTC RTO/ISO Order, for purposes of the United States Bankruptcy Code ("Bankruptcy Code"), all FTR transactions constitute "swap agreements" and/or "forward contracts," and PJM and each FTR Participant is a "forward contract merchant" and/or a "swap participant" within the meaning of the Bankruptcy Code for purposes of FTR transactions.</li> </ul>

- 1 Upon the voluntary or involuntary filing of bankruptcy by an MP, PJM should have immediate self-effecting rights, including a right to retain and segregate pre-petition collateral and revenues and require post-petition collateral as condition for future participation.
- 2 Add language to Att. Q, Section X to grant PJM a priority security interest and lien on cash, collateral and pre-petition revenues.
- 3 Add recoupment as a right in the tariff.
- 4 Condition continued access to PJM markets upon PJM being declared a critical vendor in the First Day Motion Bankruptcy orders.



## Rights Upon Bankruptcy

- Require post-petition collateral as condition for future participation included in First Day Bankruptcy orders
- PJM must determine collateral amount and not bankruptcy trustee
- Right to retain pre-petition collateral and apply against pre-petition debts and obligations
- Bankruptcy Participant should not have unsecured collateral

Add language to grant PJM a priority security interest and lien on collateral and pre-petition revenues.

- A security interest on collateral would permit PJM to take possession of collateral held by PJM and revenues due to the Petitioner prior to the bankruptcy.
- Automatic stay would prevent a creditor from seeking a security interest post-petition.
- Security interest is an enforceable claim or lien on collateral that has been pledged to participate in PJM markets.
- Priority refers to the order Creditors are repaid from bankruptcy assets.
- Establishing PJM has priority claimant increases PJM's ability to be repaid from estate assets.

Add  
recoupment as  
a right in the  
tariff.

- Recoupment is a **creditor's right to apply a debt owing to it by the debtor against a debt it owes to the debtor**, if the parties owe each other mutual debts arising from the same transaction
- Recoupment is not stayed by the provisions of the automatic stay.
- Strengthens PJM's rights as a Forward Contract Merchant under the automatic stay by explicitly providing right to recoup.

## Critical Vendor Status

- Debtor would be required to declare PJM as critical vendor
- Debtor would be permitted to continue operations but must provide assurance that obligations would be paid (collateral)

## Presenter

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