"King Coal: Dethroned but No Demise" from Novack and Macey's Energy Update

The first edition of Energy Update, an e-newsletter for Novack and Macey's clients and friends in the energy industry, was published in July 2016 and featured the article "King Coal: Dethroned but No Demise" by Stephen J. Siegel, Energy Disputes Practice Group Chair. It also included other updates on the firm's activities in various energy sectors. The full text of the Update
King Coal: Dethroned but No Demise

When you’re up you’re up. And when you’re down . . . well, we know where that saying leads.

Today, no energy sector knows “down” like coal does. Indeed:

- Four leading U.S. coal companies have sought bankruptcy protection in the past year – Walter Energy in July 2015, Alpha Natural Resources in August 2015, Arch Coal in January 2016 and Peabody Energy in April 2016 [PBS];
- Producers that have filed for bankruptcy protection account for roughly 45 percent of United States coal output [Reuters];
- Coal now fuels less than one-third of the electricity in the U.S. – whereas, until about a decade ago, coal’s portion was about one-half [EIA 1];
- Domestic coal production – after dropping by more than 10% from 2014 to 2015 – declined in the first four months of 2016, compared to the same period in 2015, by about 33% [EIA 2].

Many of the conditions that have contributed to the sharp contraction of the U.S. coal industry are well known:

- First and foremost, plentiful natural gas at low prices [Bloomberg];
- Declines in Chinese demand for coal in 2014 and 2015 that were not widely anticipated in the United States [Vox; Scientific American];
- No growth in U.S. electricity consumption [EIA3];
- Government policies that promote the adoption and use of
renewable energy [Indiana Public Media]; and
- Coal-fired power plants that are too old and/or expensive to retrofit to meet current environmental regulations [EIA1].

These developments have left U.S. coal producers facing something akin to a “hundred-year storm” of unfavorable market and regulatory conditions.

Yet, coal is likely to survive, albeit as a smaller industry that no longer holds the top spot in the domestic power industry's fuel mix. In fact, some analysts project that sector heavyweights Peabody Energy, Arch Coal and Alpha Natural Resources will “emerge [from bankruptcy] stronger as they’ll have dramatically improved balance sheets and will still be operating low-cost mines.” [Motley Fool.]

Others are not so sanguine about U.S. coal’s future, yet estimate nonetheless that “maintaining a reliable supply of electricity to the US power system into the next decade is projected to still require some 665 million tons a year of domestic thermal coal.” [McKinsey.]

Dramatic, and seemingly unique, as coal’s contraction has been, there are lessons in it for those who buy, sell and trade not only coal but also other energy commodities and derivatives thereof.

When insolvency is prevalent in a fuel supply sector, market participants must consider how their contracts and the Bankruptcy Code (Code) allocate the associated risks between them and their counterparties. For example, when a fuel supplier is insolvent, the Code protects its counterparties who are “forward contract merchants” or “swap participants” by
enabling them—notwithstanding a bankruptcy filing and the resulting “automatic stay” – to terminate certain “forward contracts” and “swap agreements” entered into with the debtor. [11 U.S.C. §§ 362(b)(6)&(17), 546(e)&(g), 556 & 560.]

In general terms, the Code defines a forward contract as “a contract (other than a commodity contract . . .) for the purchase, sale, or transfer of a commodity . . . or any similar good, article, service, right, or interest 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,” as well as options, master agreements and security agreements related to such contracts. The Code’s definition of swap agreement is very broad, encompassing, among other things, “an interest rate swap, option, future, or forward agreement” and “a commodity index or a commodity swap, option, future, or forward agreement.” [11 U.S.C. §§ 101(25)&(53B).]

The Code’s so-called “safe harbor” provisions may enable a counterparty to a fuel supply agreement to “argue that the contract is a ‘forward contract’ or ‘swap’ that qualifies as a ‘protected contract’ under the Bankruptcy Code, permitting the party to terminate an ‘in the money’ contract upon a bankruptcy filing without any liability to the debtor.” [“Distress in the Energy Industry,” Am. Bankr. Inst. VALCON 2015, 022414 ABI-CLE 457.]

By contrast, the debtor might oppose termination of a fuel supply contract on grounds that, for example, the subject fuel is not a “commodity” under the Code, the supply contract is not a forward contract or a swap agreement, and the counterparty is
not a “forward contract merchant,” “financial participant” or “commodity broker,” and neither party is a “swap participant.” Notwithstanding the spate of recent coal bankruptcies, the application of the Code’s “safe harbor” provisions to coal supply agreements remains unsettled. [Id.; Shipping Coal Through Safe Harbors.]

Novack and Macey LLP has substantial experience with contract termination disputes under the “safe harbor” provisions of the Code, including, for example, controversies regarding whether these Code provisions apply and the calculation of settlement payments allegedly due on termination to an “in the money” counterparty. Please keep in touch with us as you navigate the swells and troughs of today’s energy markets.

– Stephen J. Siegel, Chair, Energy Disputes Practice Group

Novack and Macey’s Energy Practice Recognized in Chambers USA

Chambers and Partners USA, a leading international law firm and lawyer ranking service, has again ranked Novack and Macey LLP in 2016. Novack and Macey was ranked in the Illinois General Commercial Litigation category and given special mention for its handling of energy disputes:

"What the team is known for: Well-regarded litigation firm that assists plaintiffs and defendants with an assortment of complex and significant matters. Proficient at handling litigation involving sectors such as real estate, financial services and energy."

Chambers quoted our clients, saying "They're litigation-focused
and they have a great track record" and "A wonderful boutique firm. I would give them the highest marks."

**Novack and Macey at the Annual Meeting of the Energy Bar Association’s Midwest Chapter**

In March, Partners Eric Macey and Michael Weinberg attended the Annual Meeting of the Energy Bar Association’s Midwest Chapter in Indianapolis. More than 50 energy attorneys attended – including federal and state utility regulators, private practitioners, utility counsel and lawyers employed by Independent System Operators (ISOs) and Regional Transmission Operators (RTOs).

Panel discussions and presentations during the two-day conference covered such topics as Energy Trading in Organized Energy Markets, the potential impact of the Clean Power Plan on electricity supply, and a new business model for tomorrow’s utilities. Attendees also visited the Midwest Independent System Operator (MISO), where they toured the control room, got an overview of how MISO operates and heard about MISO’s plans for the future.

**Novack and Macey with the Energy Litigation Committee at the ABA’s Section of Litigation Annual Conference**

Partner Rich Douglass is a membership chair for the Energy Litigation Committee of the American Bar Association’s (ABA) Section of Litigation. The Energy Litigation Committee aims to provide its members with up-to-date litigation-focused information on the production, transportation and marketing of oil, natural gas and electricity, as well as federal regulation of those industries. In April, the Energy Litigation Committee met at the ABA Section of Litigation’s Annual Conference in
Chicago. Rich organized a joint dinner between the Energy Litigation and Pre-Trial Practice Committees at the classic Chicago steakhouse, Gene and Georgetti.

Novack and Macey at the Energy & Mineral Law Foundation’s Winter Workshops on Energy Law
Partner Steve Siegel attended the Energy & Mineral Law Foundation’s (EMLF) Winter Workshops on Energy Law, held on February 29 and March 1, 2016 in Fort Lauderdale, Florida. The EMLF Winter Workshops address legal issues, business considerations and public policy affecting the energy industry. Programs at the 2016 Winter Workshops focused on the USEPA’s Clean Power Plan, the natural gas and coal markets, and renewables.

Best regards,

The Energy Disputes Practice Group
- Stephen J. Siegel, chair
- Brian E. Cohen, associate
- Richard G. Douglass, partner
- John Haarlow, Jr., partner
- Eric N. Macey, founding partner
- Courtney D. Tedrowe, partner
- Michael A. Weinberg, partner

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