



Energy and Telecommunications Interim Committee

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58th Montana Legislature

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September 4, 2003

TO: Energy and Telecommunications (ET) Committee Members

FR: Todd Everts, Legal Staff

RE: Additional Northwestern Bankruptcy Issues

The purpose of this memo is to address the following bankruptcy issues and questions raised by ET Committee members:

1. What could happen to qualifying facility contracts if NorthWestern Energy files for bankruptcy?
2. Is there anything that the Legislature can do to protect universal system benefit funds during a bankruptcy proceeding?
3. What is the state's role with respect to a bankruptcy restructuring plan in a NorthWestern bankruptcy proceeding?

In the interest of non duplication, I will not be providing a primer on utility bankruptcy law in this memo. For an excellent over-all analysis of utility bankruptcy law, dig out the memo that Mary Vandebosch sent you authored by PSC attorney Al Brogan entitled: "General Information on Utility Bankruptcy". Ms. Vandebosch also emailed each ET Committee Member an excellent synopsis on utility bankruptcy law on July 10, 2003.

1. What could happen to qualifying facility contracts if NorthWestern Energy files for bankruptcy?

Under the U.S. Bankruptcy Code (11 U.S.C. sec. 365(a)), a bankruptcy trustee or a debtor in possession can reject any executory contract of a debtor, subject to bankruptcy court approval. If a trustee or debtor in possession "rejects" a contract, both parties to the contract are released from further obligations under the contract. A rejection of a contract constitutes a breach of the contract and the breach is determined to occur at the time the

bankruptcy petition was filed. In determining whether to reject a contract or not, a bankruptcy trustee or debtor in possession will evaluate whether the contract is burdensome to the debtor's estate. Specifically, the trustee or debtor in possession, using "reasonable business judgement", will evaluate whether the cost of the contract is more than the contract is worth (In re Bullet Jet Charter, Inc., 177 B.R. 601 (N.D. Ill. 1995).

Given the status of bankruptcy law on rejection of contracts, qualifying facility contracts are very vulnerable. It is quite likely, given the above market costs of most qualifying facility contracts, that a bankruptcy trustee or debtor in possession would use reasonable business judgement and reject those contracts. An argument could be raised that because these qualifying facility contracts were entered into under the federal Public Utility Regulatory Policies Act and the Montana Small Power Production Facilities laws (69-3-601 through 69-3-604, MCA), these contracts would be protected from bankruptcy rejection. However, the U.S. Bankruptcy Code is very specific in allowing rejection of "any" executory contract, regardless of whether a contract was entered into pursuant to federal or state law (11 U.S.C. sec. 365(a)). The bottom line is that qualifying facility contracts, like any other contract, could be subject to rejection if NorthWestern Energy files for bankruptcy.

2. Is there anything that the Legislature can do to protect universal system benefit funds during a bankruptcy proceeding?

Recently, there have been administrative steps taken by the PSC at the request of the Consumer Counsel, working in conjunction with Energy Share and the Large Customer Group, to help protect universal system benefit (USB) funds under a potential bankruptcy proceeding. Is there anything that the Legislature could do to help protect USB funds? If the Legislature convened prior to NorthWestern Energy filing for bankruptcy, the Legislature could statutorily designate or classify USB funds as explicit trust funds that are dedicated for a specific purpose. This classification could potentially help protect existing USB funds from being used for the debtor's bankruptcy estate. Legislative action regarding USB funds that occurred after NorthWestern Energy filed for bankruptcy would not help protect existing USB funds, but could prospectively help protect USB funds from other bankruptcy proceedings in the future. Another option for the Legislature to protect USB funds would be to statutorily require that USB funds flow to an entity or entities other than the utility for disbursement.

3. What is the state's role with respect to a bankruptcy restructuring plan in a NorthWestern bankruptcy proceeding?

Al Brogan's memo does a great job of outlining the bankruptcy restructuring plan process. There are three ways that state entities can participate in a NorthWestern bankruptcy proceeding -- as a creditor, as a party-in-interest, or as an intervenor. Being formally

designated as a creditor provides the most leverage in a bankruptcy proceeding. The goal of a bankruptcy court in a Chapter 11 bankruptcy is to organize and classify all creditors' claims and interests and subsequently discharge those claims and interests. Initially, the debtor in bankruptcy has an exclusive period in which to file a bankruptcy plan. After that period has expired, a creditor, a party-in-interest or even an intervenor (if the court allows it) can propose a restructuring plan. Only creditors are entitled to vote on whether to accept the restructuring plan. The bankruptcy court must ensure that the plan is in the best interests of the creditors and that the plan is fair and equitable to each class of creditors.

The obvious question is how can the state of Montana be designated as a creditor? Under the U.S. Bankruptcy code, a creditor is "an entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor" (11 U.S.C. sec. 101(10)). The likely scenario here would be that NorthWestern Energy would owe the Department of Revenue (DOR) back taxes entering into a bankruptcy proceeding. If back taxes were owed, a bankruptcy court could designate DOR as a creditor and the state would have its proverbial foot in the bankruptcy proceeding door. Absent being designated a creditor, the DOR or other state entities like the Public Service Commission (PSC), the Consumer Counsel, or the Attorney General's Office could request a party-in-interest designation or intervenor status from the bankruptcy court.

What is unclear is whether different state entities would have different interests or roles in a bankruptcy proceeding. This issue highlights a potential need for a coordinated state effort. A potential option would be to establish a state task force to coordinate the state's interests and role in a NorthWestern bankruptcy proceeding.

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