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ATTORNEYS FOR THE DEBTORS AND DEBTORS-IN-POSSESSION

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

In re)	
)	Chapter 11 Case
)	
MIRANT CORPORATION, <u>et al.</u> ,)	Case No. 03-46590 (DML)
)	Jointly Administered
Debtors.)	
)	Hearing Date and Time:
)	February 4, 2004; 12:00 p.m.
)	(Expedited Hearing Request Pending)

**DEBTORS' MOTION REQUESTING AUTHORITY TO: (i) ENTER INTO
CERTAIN SLEEVING TRANSACTIONS WITH THE CONDUIT
COUNTERPARTIES IN THE MARYLAND MARKET PURSUANT TO
SECTION 363 OF THE BANKRUPTCY CODE; AND (ii) GRANT TO SUCH
CONDUIT COUNTERPARTIES: (a) COLLATERAL PROTECTIONS; AND (b)
CERTAIN REMEDIES AND ENFORCEMENT RIGHTS**

TO THE HONORABLE D. MICHAEL LYNN, UNITED STATES BANKRUPTCY JUDGE:

Mirant Corporation ("Mirant") and its affiliated debtors (collectively, "Mirant" or the "Debtors"), as debtors-in-possession, file this motion (the "Motion") requesting authority to: (i) enter into one or more "sleeving transactions" for the sale of energy not to exceed a daily aggregate notional value of \$300 million (the "Sleeving Transactions") with the Conduit Counterparties (as defined below) in the Maryland market, pursuant to

section 363 of the Bankruptcy Code; and (ii) grant to such Conduit Counterparties: (a) collateral protections; and (b) certain remedies and enforcement rights. In support of the Motion, the Debtors respectfully represent as follows:

I. JURISDICTION AND VENUE

1. This Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 157 and 1334. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (B), and (O). Venue of this proceeding is proper in this district pursuant to 28 U.S.C. §§ 1408 and 1409.

II. PROCEDURAL BACKGROUND

2. The Cases. Commencing on July 14, 2003, and concluding in the early morning hours of July 15, 2003, (the “Petition Date”), certain of the Debtors (collectively, the “Initial Debtors”) filed voluntary petitions in this Court for relief under chapter 11 of title 11 of the United States Code, 11 U.S.C. §§ 101-1330, as amended (the “Bankruptcy Code”).¹ On August 18, 2003, Mirant EcoElectrica Investments I, Ltd. and Puerto Rico Power Investments, Ltd. (collectively, the “New Debtors”) commenced chapter 11 cases under the Bankruptcy Code. On October 3, 2003, the following additional Debtors filed voluntary petitions in this Court for relief under chapter 11: (i) Mirant Wrightsville Management, Inc.; (ii) Mirant Wrightsville Investments, Inc.; (iii) Wrightsville Power Facility, L.L.C.; and (iv) Wrightsville Development Funding, L.L.C. (collectively, the “Wrightsville Debtors”). On November 18, 2003, the following

¹ Concurrently, Mirant caused two of its Canadian subsidiaries, Mirant Canada Energy Marketing, Ltd and Mirant Canada Energy Marketing Investments, Inc. (collectively, the “Canadian Debtors”) to commence plenary insolvency proceedings (the “Canadian Proceedings”) in the Court of Queen’s Bench of Alberta Judicial District of Calgary (the “Canadian Court”) pursuant to the *Companies’ Creditors Arrangement Act*. The Canadian Debtors are subject to the sole and exclusive jurisdiction of the Canadian Court.

additional Debtors filed voluntary petitions in this Court for relief under chapter 11: (i) Mirant Americas Energy Capital, LP; and (ii) Mirant Americas Energy Capital Assets, LLC (the “MAEC Debtors” and collectively with the Initial Debtors, the New Debtors, and the Wrightsville Debtors, the “Debtors”). The Debtors continue to manage and operate their businesses as debtors-in-possession pursuant to sections 1107 and 1108 of the Bankruptcy Code.

3. The Cases are Jointly Administered. On July 15, 2003, this Court granted the motion for an order requesting that the bankruptcy estates of the Initial Debtors be jointly administered. On September 8, 2003, this Court entered an order approving joint administration of the cases of the New Debtors with those of the Initial Debtors. On October 20, 2003, this Court entered an order approving the joint administration of the cases of the Wrightsville Debtors with those of the Initial Debtors. On November 20, 2003, this Court entered an order approving the joint administration of the cases of the MAEC Debtors with those of the Initial Debtors.

4. The Committees. Three official committees have been appointed by the Office of the United States Trustee for the Northern District of Texas in these administratively consolidated cases. Specifically, an official unsecured creditors’ committee and an official committee of equity security holders have been appointed for Mirant Corporation and an official unsecured creditors’ committee has been appointed for Mirant Americas Generation, LLC (collectively, the “Committees”).

III. FACTUAL BACKGROUND

A. The Debtors' Business Operations.

5. The Debtors' merchant energy activities include their core business of electrical power generation and a traditional commodities, energy and financial product trading business.

6. Mirant and its direct and indirect subsidiaries comprise one of the world's largest generators and marketers of electricity. Through its direct and indirect subsidiaries, Mirant produces, sells and delivers reliable energy products and services to utilities, municipal systems, aggregators, electric-cooperative utilities, producers, generators, marketers and large industrial customers in North America, the Philippines and the Caribbean.

7. Mirant's core business centers on the production and sale of electricity and electrical capacity (essentially the ability to produce electricity on demand). Mirant currently owns or controls more than 21,800 megawatts of electric generating capacity around the world, of which more than 18,000 megawatts is located in the United States. In 2002, Mirant produced 73 million megawatt-hours of electricity, sold 312 million megawatt-hours of electricity and sold or marketed an aggregate average of 21 billion cubic feet per day of natural gas.

B. The Trading Contracts.

8. As this Court is aware, the Debtors have also historically engaged in asset risk management and optimization activities as well as proprietary trading activities (collectively, the "Trading Activities") pursuant to their internal risk management policy,

as amended or modified from time to time (the “Risk Management Policy”).² In connection with their Trading Activities, the Debtors entered into with their counterparties various industry standard trading contracts (collectively, the “Prepetition Trading Contracts”).

9. On July 14, 2003, the Debtors filed a motion with this Court seeking: (a) an interim order authorizing them to: (i) comply with terms of Prepetition Trading Contracts, (ii) enter into postpetition trading contracts in the ordinary course of business, and (iii) provide credit support relating to both pre- and postpetition trading contracts; and (b) a final order authorizing on a final basis the relief set forth in the interim order and authorizing assumption of Prepetition Trading Contracts (the “Trading Motion”). The purpose of the Trading Motion was to request authority for the Debtors to continue trading in a manner consistent with their prepetition practice and provide certain protections to the non-Debtor counterparties to the Prepetition Trading Contracts.

10. On August 27, 2003, this Court entered the “Final Order Authorizing The Debtors To (I) Comply With Terms Of Pre-Petition Trading Contracts, (II) Enter Into Post-Petition Trading Contracts In The Ordinary Course Of Business, (II) Provide Credit Support Relating To Both Pre- And Post-Petition Trading Contracts, And (IV) Authorizing Assumption Of Pre-Petition Trading Contracts” (the “Final Order”).

11. The Final Order authorized the Debtors, *inter alia*, to: (a) engage in Trading Activities in the ordinary course of business pursuant to the terms of the Prepetition Trading Contracts; (b) assume numerous Prepetition Trading Contracts under

² On November 5, 2003, this Court entered the “Final Order Regarding Debtors’ Risk Management Policy” pursuant to which the Debtors were authorized to conduct their trading activities in accordance with the Mirant Global Risk Management Policy.

section 365(a) of the Bankruptcy Code; and (c) secure the Debtors' obligations under the Prepetition Trading Contracts with first-priority liens and security interests on any collateral.

C. Proceeding Before the Public Service Commission of Maryland.

12. Debtors Mirant Mid-Atlantic, LLC ("Mirant Mid-Atlantic") participated in a proceeding styled as "In the Matter of the Commission's Inquiry Into the Competitive Selection of Electricity Supplier/Standard Offer Service," Case No. 8908, Phase II, (the "Proceeding") before the Public Service Commission of Maryland ("PSC"). On September 30, 2003, the PSC entered "Order No. 78710" (the "Order") that set forth the requirements and processes of the Standard Offer Services (the "SOS")³ by Maryland's investor-owned electric utilities, which governs the sale of power to such utilities. The relevant pages of the Order are attached hereto as Exhibit "A."

13. The Order was entered in connection with the "Phase II Settlement"—consisting of the Phase II Settlement Agreement and attachments such as a Full Requirements Service Agreement (the "FSA")—which sets forth the terms of wholesale electric power supply procurement for the SOS in Maryland. Mirant Mid-Atlantic argued that the FSA unfairly discriminates against the Debtors by requiring that a prevailing bidder represents that it is not in, or contemplating, bankruptcy. Specifically, Mirant Mid-Atlantic argued that the prohibition of any supplier that is in, or contemplating, bankruptcy from executing the FSA operates to exclude it from selling

³ The SOS is transition generation service available to customers that have not selected to purchase electric supply from a competitive supplier. By law, the availability, procurement, and pricing of the SOS by Maryland utilities are overseen by the PSC.

power to the Maryland utilities.⁴ In determining that the FSA’s preclusion of bankrupt suppliers from directly bidding into the SOS process is reasonable, PSC was persuaded by expert testimony that while a bankrupt supplier may be prohibited from *directly* selling power to Maryland utilities, the nature of bulk power markets virtually guarantee that bankrupt suppliers will be able to *indirectly* participate in the market through the use of a practice commonly known as “sleeving.”

D. The Sleeving Transactions.

14. As is typical in the industry, a trading and marketing company must maintain an acceptable creditworthiness or provide acceptable credit support, generally in the form of letters of credit, collateral or prepayments. Given the Debtors’ impaired prepetition creditworthiness, these traditional forms of credit support were still unacceptable to certain counterparties. As such, the Debtors were sometimes foreclosed from transacting directly with those counterparties and required to utilize the common practice of “sleeving” in order to participate in desirable transactions.

15. A sleeving transaction (also known as a “back-to-back” transaction) is a method that allows a company to indirectly participate in desirable transactions for the purchase or sale of energy when the creditworthiness of such entity would otherwise prevent direct participation. Simply put, a party with lesser credit (“Party X”) would pay a fee⁵ (the “Sleeving Fee”) to a party with good credit (“Party Y”) (the “Conduit

⁴ Mirant Mid-Atlantic argued before the PSC that precluding the Debtors from selling directly to Maryland utilities, solely because of their bankruptcy cases, violated federal Bankruptcy law. The PSC disagreed. Mirant Mid-Atlantic requested a rehearing on the matter, which was denied. The Debtors have determined, at this time, not to incur additional time and expense to appeal that decision, but rather, to simply conduct their business within the parameters of the Order.

⁵ The amount of a sleeving fee is negotiated between the Debtors and the Conduit Counterparty. It is typically calculated by multiplying a monetary sum by the amount of megawatt hours under the contract. At this time, the number of megawatt hours used to calculate the amount of the sleeving fee cannot be

Counterparty”) so that Party Y would stand in the middle between Party X and a third party (“Party W”). Party Y would enter into a transaction directly with Party W and an almost identical transaction with Party X.

16. As with ordinary trading contracts, the Debtors will be required to post collateral in connection with the Sleeving Transaction. The amount of collateral that the Debtors expect to be required to post may be based upon two separate concepts. First, the Conduit Counterparty may require an initial amount of collateral to be posted which amount will be commercially reasonable and consistent with the Debtors’ past practices and similar market transactions. Second, if the contract becomes “out of the money” as to the Debtors, the Debtors may be required to post additional collateral according to a formula agreed upon by the parties and described in the contract. At this time, the Debtors cannot determine with certainty the amount of collateral that will be posted. However, if the Debtors enter into a Sleeving Transaction the amount of collateral the Debtors would post would be commercially reasonable, consistent with their ordinary course of business, their past transactions, the Final Order, and the Risk Management Policy approved by this Court.

17. Upon commencement of their chapter 11 cases, certain counterparties have indicated an unwillingness to conduct business with the Debtors because of their chapter 11 cases. Given the exclusion by certain markets of participation by entities in bankruptcy, other counterparties—such as those in the Maryland market subject to the Phase II Settlement Agreement for SOS—have been unable to conduct business with the

determined because it is impossible to know in advance what the megawatt hours of a contract (especially one not yet in existence) will be. However, the Debtors will enter into a Sleeving Transaction only if it is commercially reasonable and consistent with the Debtors' ordinary course of business and their past sleeving transactions.

Debtors. Thus, in order to operate their business, the Debtors have regularly executed sleeving transactions in order to fully participate in the marketplace.

E. The Maryland Auction.

18. On February 9, 2004, an auction (the “Maryland Auction”) will begin (conducted by the PSC) whereby wholesale sellers of energy (such as the Debtors) will bid for the right to supply energy to Maryland utilities. The Debtors seek to participate in that process through one or more Sleeving Transactions. Participation in the Maryland Auction is important as that is the only way for the Debtors to sell energy to the Maryland market; thereby allowing the Debtors to hedge the generation created by their assets. A bid, once accepted, becomes a binding contract. The Debtors do not have the ability to obtain an accepted bid and thereafter file a motion to have that bid approved by this Court. The Debtors must obtain approval (within the specific parameters requested herein) prior to the Maryland Auction to ensure Conduit Counterparties that: (a) the Debtors have the authority to submit bids that, if accepted, will be valid and enforceable contracts; and (b) the associated Sleeving Fees are approved.

IV. RELIEF REQUESTED

19. By the Motion, the Debtors respectfully request that the Court enter an order, pursuant to section 363 of the Bankruptcy Code: (a) authorizing the Debtors to enter into the Sleeving Transactions for the sale of energy to the Maryland utilities not to exceed a daily “notional value”⁶ of \$300 million, in the aggregate, with the Conduit Counterparties and pay the associated Sleeving Fees; and (b) granting such Conduit Counterparties the following collateral protections and rights:

⁶ The notional value is the maximum exposure under a contract assuming that the terms of the contract are fully utilized.

- Conduit Counterparties will each be granted, for their own benefit, effective without the necessity of the execution by the Debtors, or filing, of security agreements, pledge agreements, mortgages, financing statements or otherwise enforceable first-priority liens and security interests on any collateral, including, without limitation, initial, maintenance or variation margin or payments in advance and whether in the form of cash, letters of credit under the existing debtor-in-possession facility or otherwise provided to such Conduit Counterparty whether prior to, on, or after the date of the order approving the Motion.
- Solely with respect to Conduit Counterparties, the automatic stay provisions of section 362 of the Bankruptcy Code will be vacated and modified to the extent necessary to allow immediate and unconditional enforcement of remedies by any Conduit Counterparty upon the occurrence of any default under the Sleeving Transactions by the Debtors and the Conduit Counterparties rights thereunder will not be modified, stayed, avoided or otherwise limited by order of the Bankruptcy Court or any court proceeding under title 11 of the United States Code. The Debtors will waive the right and will not seek relief, including without limitation under section 105(a) of the Bankruptcy Code, to the extent that any such relief would in any way restrict or impair the rights of any Conduit Counterparties under the Sleeving Transactions or an order approving the Motion; provided that such waiver will not preclude the Debtors from contesting⁷ whether a default has occurred under any Sleeving Transaction.

20. Nothing herein will relieve the Debtors of their obligation to report to the Committees under the Risk Management Policy had they otherwise entered into the transaction without sleeving. Attached hereto as Exhibit “B” is a copy of the proposed order.

⁷ These protections are similar to those afforded to Protected Counterparties (as defined in the Final Trading Order) in the Final Trading Order. Mirant expects the Conduit Counterparties to demand similar security and assurance of the Debtors’ obligations as those afforded to Protected Counterparties.

V. BASIS FOR RELIEF

A. The Court Should Authorize the Debtors' Entry Into the Sleeving Transactions.

(i) *Entry into the Sleeving Transactions Is In the Debtors' Ordinary Course of Business.*

21. The Debtors believe that entry into sleeving transactions is within their ordinary course of business and, thus, the Court should authorize the Debtors' entry into the Sleeving Transactions pursuant to section 363 of the Bankruptcy Code. Nevertheless, given the large daily aggregate notional value of \$300 million, the Debtors are, out of an abundance of caution, seek an order authorizing them to enter into the Sleeving Transactions. Moreover, the Conduit Counterparties have indicated a strong desire for Court approval to ensure that the Sleeving Fee and the posting of collateral are authorized.

22. Section 363 of the Bankruptcy Code provides, in relevant part, that a debtor in possession "may enter into transactions . . . in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing." 11 U.S.C. § 363(c)(1).

23. The two tests ordinarily applied by the courts to determine the ordinary course of business are the "horizontal" test and the "vertical" test. *Denton County Elec. Coop., Inc. v. Eldorado Ranch (In re Denton County Elec. Coop., Inc.)*, 281 B.R. 876, 882 and n.12 (Bankr. N.D. Tex. 2002). "The 'horizontal test' focuses on the way businesses operate within a given industry. The 'vertical test' focuses on the expectations of creditors." *Denton County Elec. Coop.*, 281 B.R. at 882 n. 12.

24. Creditors' reasonable expectations of a debtor's "ordinary course of business" are based on the debtor's specific pre-petition business practices and norms, and the expectation that the debtor will conform to those practices and norms while operating as a debtor in possession. *Garofalo's*, 186 B.R. at 425. Thus, a fundamental characteristic of an "ordinary" post-petition business transaction is its similarity to a pre-petition business practice. *Marshack v. Orange Commercial Credit (In re National Lumber & Supply, Inc.)*, 184 B.R. 74, 79 (9th Cir. B.A.P. 1995); *James A. Phillips*, 29 B.R. at 394.

25. Prior to the Petition Date, the Debtors were, at times, required to utilize sleeving transactions given their impaired creditworthiness. As of the Petition Date, given the unwillingness of certain counterparties to conduct business, the Debtors have regularly entered into sleeving transactions in order to participate in the marketplace. In connection with the sleeving transactions, the Debtors paid commercially reasonable sleeving fees and posted collateral as reasonably requested by the Conduit Counterparties.

26. Sleeving is also common practice in the wholesale energy marketplace. Notably, in connection with the Proceeding, Peter E. Schaub, a witness for Pepco and Delmarva, testified that sleeving transactions are common in the industry:

It is common practice in the wholesale market place to make arrangements through a third party who has better credit or more liquidity in a transaction...who can make these representations, to provide power.

Order No. 78710, p 37 (citing Transcript, p. 1634-35). Indeed, it is the ordinary and common nature of sleeving transactions in the energy marketplace that justified the

PSC's decision to exclude entities under bankruptcy protection from participating directly in the Maryland energy market.

27. Thus, businesses in similar situations as the Debtors typically enter into sleeving transactions; suggesting that the Debtors' entry into the Sleeving Transactions is within the Debtors' ordinary course of business. *Creditors' Rights Handbook* (CBC 1993), (quoting *In re Johns-Manville Corp.*, 60 B.R. 612, 618 (Bankr. S.D.N.Y. 1986) (suggesting that "a comparison of this debtor's business to other like businesses" is the appropriate inquiry concerning ordinary course transactions). *See also In re Atlanta Retail, Inc.*, 287 B.R. 849, 856 (Bankr. N.D. Ga. 2002).

(ii) *Alternatively, the Court Should Authorize Entry Into the Sleeving Transactions Outside of the Ordinary Course of Business Under Section 363(b).*

28. Even if the Court does not find that the Debtors' entry into the Sleeving Transactions is in the ordinary course of business, the Debtors should still be permitted to enter into the Sleeving Transactions without further order of the Court. Such relief is appropriate under the Court's authority to approve non-ordinary course transactions under section 363(b) of the Bankruptcy Code.

29. Section 363(b) provides in pertinent part that a debtor "after notice and hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b). A debtor must demonstrate a sound business justification for a sale or use of assets outside the ordinary course of business. *See, e.g., In re Continental Air Lines, Inc.*, 780 F.2d 1223, 1226 (5th Cir. 1986).

30. As discussed above, the Debtors are in the business of producing, selling, and delivering energy products and services to purchasers of such products, including

utilities. The Debtors currently own a substantial amount of megawatts of electric generating capacity in and around the Maryland market. Accordingly, transactions—such as the Sleeving Transactions—represent a valuable and substantial opportunity for the estates to hedge their asset base in the Mid-Atlantic region.

31. For the reasons stated above, it is clearly an exercise of sound business judgment for the Debtors to enter into the Sleeving Transactions. Without such authority, the Debtors' ability to hedge their asset generation will be diminished and, thus, expose the Debtors to unnecessary risk.

32. Moreover, the Debtors will enter into a Sleeving Transaction only if it is commercially reasonable to do so (even considering the payment of the Sleeving Fee). If the Debtors are successful at the Maryland Auction, the Sleeving Transactions will greatly benefit the estates by hedging their asset generation.

C. The Relief Requested In the Motion Is Consistent With the Debtors' Risk Management Policy.

33. It should also be noted that the relief requested in the Motion is consistent with the Risk Management Policy, as of March 2003, which has been approved by this Court.

VI. CONCLUSION

WHEREFORE, the Debtors respectfully request that this Court enter an Order granting the relief requested herein.

Dated: January 23, 2004

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ATTORNEYS FOR THE DEBTORS AND
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that he has authorized BSI as service agent to cause to serve a true and correct copy of the foregoing upon all parties on the Limited Service List via email, facsimile or overnight courier on the 23rd day of January, 2004 in accordance with the Federal Rules of Bankruptcy Procedure.

/s/ Ian T. Peck

EXHIBIT A

a review of the procurement” and work will be paid for that is “deemed appropriate by the Commission.”⁸⁸

The Commission accepts the representation of the parties’ witnesses that the language in the Phase II settlement in no way limits what the Commission consultant will do or the utilities will pay for, and so finds in this proceeding.

G. Article 15.1(e) of the Full Requirements Service Agreement properly operates to exclude bankrupt suppliers from participation in the SOS bidding process.

During the second day of hearings on August 26, 2003, questions arose for the first time in this proceeding concerning whether Article 15.1(e) of the Full Requirements Service Agreement (“FSA”) operates to exclude suppliers in bankruptcy from participation in the SOS bidding process. Article 15.1(e) requires a prevailing bidder to represent that it is not in or contemplating bankruptcy. BGE Witness Pino testified that, in his opinion, a bankrupt bidder could bid, although if successful, the supplier would be in default under the FSA immediately upon execution. Mr. Pino further suggested that the default could be addressed as a Special Remedy under paragraph 38 of the Phase II Settlement.⁸⁹ When presented with the same issue in cross-examination, CPS Witness Lynch stated that the matter was a legal question but believed that a bankrupt supplier could not make the necessary warranty to enter into the FSA.⁹⁰ As a result of these discussions, the Commission requested the parties address the issue directly in their post-hearing briefs.⁹¹

⁸⁸ Brief of BGE at 14-15. Docket No. 251.

⁸⁹ Tr. 1631-1634.

⁹⁰ Tr. 1675-1676.

⁹¹ Tr. 1721-1722.

Upon consideration of the legal arguments of the parties, the Commission finds that Article 15.1(e) of the FSA operates to exclude bankrupt suppliers and those contemplating bankruptcy from bidding for SOS supply. The Commission further finds that such an exclusion is appropriate and in the public interest.

1. Bankrupt Supplier Participation in SOS Bidding Process

Pursuant to the Phase II Settlement, each successful wholesale bidder must execute a FSA with each utility purchasing that supply. Article 15.1 – Representations and Warranties – of the FSA requires that:

each Party represents and warrants to the other Party that:

* * *

(e) it is not Bankrupt and there are no proceedings pending or being contemplated by it or, to its knowledge, threatened against it which would result in it being or becoming Bankrupt.

* * *

In its Initial Brief filed on September 8, 2003, Mirant, a company currently the subject of a bankruptcy proceeding in the United States Bankruptcy Court for the Northern District of Texas, Forth Worth Division, states that the plain meaning of Article 15.1(e) unfairly prohibits it and any other supplier that is in or contemplating bankruptcy from executing a FSA.⁹² Since Mirant cannot represent that it is not in bankruptcy, it argues that as a practical matter, it is precluded from direct participation in the SOS bidding process.⁹³ While providing the Commission with no legal or policy justification as to why such a prohibition is unwarranted, Mirant recommends that the Commission make a number of alterations to the settlement package. The company proposes a

⁹² Initial Brief of Mirant, at 1-3.

lengthy set of specific modifications to Article 15.1(e) of the FSA and suggests that other general alterations may be required to the Phase II Settlement in order to ensure its participation in the process.⁹⁴

Of the other parties that commented on the issue in their initial briefs, all agree with Mirant that Article 15.1(e) of FSA effectively operates to prohibit bankrupt suppliers from direct participation in the SOS bidding process.⁹⁵ Nevertheless, with the exception of Mirant, the parties contend that such a prohibition is both appropriate and in the public interest. The basic argument of those opposing bankrupt supplier participation is that it would be harmful to the financial protections the FSA seeks to provide to utilities and SOS customers.⁹⁶ In reply briefs filed on September 12, 2003, these parties also argue that bankrupt supplier participation would add an unwarranted level of uncertainty and unpredictability to the bidding process, and could wreak havoc upon the tight time periods for filling the utilities' SOS load obligation in each bid tranche.⁹⁷ These parties contend that Mirant's proposed modifications would result in the potential surrender of control over Maryland's SOS RFP bidding process to the jurisdiction of any bankruptcy court presiding over any bankrupt supplier that might wish to bid.⁹⁸

Even Mirant acknowledges that depending on the magnitude and term of the bid award, a bankruptcy court may be required to review and approve a bankrupt supplier's FSA prior to the bid becoming final.⁹⁹ This determination may depend upon whether the bankruptcy court considers the supplier's bid to be in the "ordinary course" of its

⁹³ *Id.*

⁹⁴ *Id.* at 4-5.

⁹⁵ Brief of People's Counsel, at 21-23; Brief of BGE, at 8; Brief of Staff, at 21-23; Brief of Pepco, at 13; Brief of AP at 4, fn. 2.

⁹⁶ *See e.g.*, Brief of Staff at 22.

⁹⁷ *See e.g.*, Reply Brief of BGE at 4.

⁹⁸ *See* Reply Brief of BGE at 4.

business as defined by the Bankruptcy Code.¹⁰⁰ Due to the potential role a bankruptcy court could play in this process, Mirant seeks a further clarification from the Commission that should a bankruptcy court not approve the FSA, through no fault of the supplier, the bid assurance collateral would be returned to the supplier.¹⁰¹

Several parties further argue that because of the complete lack of support in the record, the Commission is precluded, by Mirant's own actions, from being able to conclude that Mirant's proposals are either necessary or in the public interest.¹⁰² Mirant elected not to present any testimony at the hearing to address any of its concerns, or to lend support for its suggested modifications, thereby depriving the Commission of any evidentiary basis to support Mirant's positions.¹⁰³ Mirant offered no witness who could be cross-examined as to the merits of its proposals.¹⁰⁴ Furthermore, Mirant failed to provide the Commission with any policy or legal justification as to why either the FSA or any other provision of the Phase II Settlement is illegal, unreasonable, or contrary to the public interest.¹⁰⁵

Several witnesses noted during their testimony that while a bankrupt supplier may be prohibited from directly bidding into the SOS bid process, the nature of bulk power markets virtually guarantee that bankrupt suppliers will participate, albeit

⁹⁹ Initial Brief of Mirant at 5.

¹⁰⁰ See 11 U.S.C. 363(c). Mirant initially raised the issue that Bankruptcy Court approval might be necessary following a bid award. (Mirant Initial Brief p. 5.). BGE also argued in its brief that Bankruptcy Court approval might be necessary following a successful bid by a bankrupt supplier. (BGE Initial Brief, p. 9). Mirant argued in its reply brief that Bankruptcy Court approval would only be necessary if the bid award was of a size or term that would enable a third party to argue that the contract was outside the 'ordinary course of business.' Mirant proffers that the company would only submit bids for which approval would be granted. (Mirant Reply Brief, p. 5, footnote 3). The Commission does not have jurisdiction to determine whether Bankruptcy Court approval would be necessary, and makes no finding in this regard.

¹⁰¹ Brief of Mirant at 5.

¹⁰² See Reply Brief of BGE at 3; Reply Brief of Pepco/Delmarva at 4.

¹⁰³ *Id.*

¹⁰⁴ *Id.*

indirectly, in the provision of SOS. Peter E. Schaub, a witness for Pepco and Delmarva, testified there are mechanisms by which Mirant could indirectly participate in Maryland's SOS bid process:

It is a common practice in the wholesale market place to make arrangement through a third party who has better credit or more liquidity in a transaction, so it is possible, for instance a generation [generator] that could not meet this representation [Article 15.1 (e)], to contract through a third party who is creditworthy, . . . who can make these representations, to provide power.¹⁰⁶

Commission Staff Witness Timmerman further explained why it is highly likely that electricity produced by bankrupt generation companies within the PJM service territory would be available in the wholesale market:

[T]he market is designed, no matter what, to entice load from the generator to serve demand. . . . [T]he whole fundamental of the PJM world is this system of sticks and carrots, that try to ensure that power plants will produce electricity if they are able to do so to serve the demand that requires electricity. So all these things we talked about, bankruptcies and whatever, those are financial discussions, they are not physical discussions. The plants don't stop running, demand doesn't go away. . . . [G]enerally speaking, in all these bankruptcies . . . for all of our energy resources, gas wells don't stop producing, electric power plants don't stop running.¹⁰⁷

Therefore, Mr. Timmerman later explained,

[G]iven the fact you have a rough equilibrium between generation and demand . . . it is hard to conceive of an owner of substantial generation, no matter how bad their credit rating might be, being locked out of the market, because their generation needs to be used and the other

¹⁰⁵ *Id.*

¹⁰⁶ Tr. at 1634-35.

¹⁰⁷ Tr. at 1404-05.

participants in the market don't have enough generation to fill that void.¹⁰⁸

MEA witness Kahal concurred explaining that if a bankrupt supplier is precluded from formally bidding,

the power is going to go somewhere, it is going to go into the market, whether it goes into the spot market or other wholesale bilateral transactions, it is going to be power that is out there in the market to be procured by others who would prevail in the competitive bidding process, even if this company doesn't happen to participate.¹⁰⁹

The Commission is persuaded by the testimony and briefs of the parties on this issue that the Settling Parties' decision to exclude bankrupt suppliers from *directly* bidding into the SOS process is reasonable and addresses their legitimate concerns about the financial integrity of SOS suppliers. The Commission finds that Article 15.1(e) of the FSA operates to bar bankrupt supplier participation in this process, and as described below, the Commission finds that Article 15.1(e) is in the public interest. In so finding, we reject Mirant's belated requests to modify the FSA or any other provision of the Phase II Settlement.

The Commission recognizes that allowing bankrupt supplier participation in the SOS bid process could subject the process to the jurisdiction of the United States bankruptcy courts and attendant uncertainties therein. The bidding process embodied in this Phase II Settlement is, by design, intended to operate with rigid rules and tight bidding schedules. The Commission believes that given the amount of money and financial risk involved, utilities and suppliers participating in the bidding process need a

¹⁰⁸ Tr. at 1411-12.

¹⁰⁹ Tr. at 1454.

concrete and certain process. Without such certainty, suppliers may not be interested in bidding into Maryland's SOS procurement.

In addition to the concern above, the Commission is of the view that altering the Phase II Settlement, as suggested by Mirant, would give bankrupt suppliers privileges that are not afforded to other suppliers. For example, Mirant believes a bankrupt supplier should be entitled to the return of its bid assurance collateral, should the bankruptcy court not approve its bid. If the Commission were to agree with this request, it would not only bestow upon a bankrupt supplier a special advantage not granted to solvent suppliers, but would deny customers the benefits that such collateral could provide to mitigate any damages to customers resulting from the supplier's failure to make good on its bid. Furthermore, our acceptance of Mirant's proposals at this late date could, without justification, disrupt the complex bidding structure developed by the parties through a series of extensive negotiations and delicate compromises.

The Commission also believes that the supplier financial integrity provisions are necessary and appropriate reliability safeguards for SOS customers. Electricity is a vitally important commodity in today's society. All classes of SOS customers, but particularly the residential SOS customers, need assurances that suppliers will be able to adequately meet demand for electricity through the term of the contract. SOS customers should not be subjected to any substantial or unwarranted risks that a supplier might fail or abandon its contract. The Commission finds that the financial integrity provisions of the Phase II Settlement generally, and § 15.1(e) of the FSA in particular, are in the public interest.

2. *11 U.S.C. §525(a)*

The Commission rejects as untimely and procedurally defective Mirant's latest argument that the approval and enforcement of Article 15.1(e) of the FSA violates §525 (a) of the Bankruptcy Code. It was wholly inappropriate for Mirant to use its reply brief as a means to assert a completely new argument for the first time at the end of this lengthy and exhaustive process. This new argument is in no way responsive to any position asserted by the parties in their initial briefs. Furthermore, Mirant's actions at such a late juncture, deprives the Commission and the parties of a fair opportunity to fully and reasonably explore the merits of the argument.

On September 15, 2003, the Commission received Mirant's reply brief dated September 12, 2003.¹¹⁰ In its reply brief, Mirant raises a new argument, that the "Commission's adoption and enforcement of the FSA may be considered a violation of §525(a) of the Bankruptcy Code-Protection Against Discriminatory Treatment. . . ." ¹¹¹ Mirant claims that §525(a) may prevent the Commission, as a governmental unit, from enforcing Article 15.1(e) of the FSA because it inappropriately prohibits a bankrupt supplier from entering into the FSA "based solely on the entity's status as a debtor."¹¹² Mirant asserts that Article 15.1(e) of the FSA is "tantamount to an automatic disqualification which is impermissible under the Bankruptcy Code" and therefore, unenforceable as a matter of law.¹¹³

¹¹⁰ The Commission notes its Order of August 26, 2003, directing parties wishing to file reply briefs to do so by September 12, 2003. Tr. at 1721. Furthermore, the Commission specifically denied Mirant's request to file reply briefs on September 15, 2003. Tr. at 1723-1724.

¹¹¹ Reply Brief of Mirant at 2-4.

¹¹² *Id.* at 3.

¹¹³ Reply Brief of Mirant at 3-4.

On September 17, 2003, the Commission received a Motion to Strike Mirant's Reply Brief filed by Pepco and Delmarva and a similar Motion to Strike presented as a joint filing on behalf of Staff, OPC and BGE. Both motions request that Mirant's latest argument be stricken as procedurally defective because it is a new argument that is "unresponsive" to any position asserted by parties in their initial briefs. Both motions also go on to rebuke Mirant's contention that the Commission's approval of the FSA would constitute a violation of §525(a) of the Bankruptcy Code. Essentially, these parties contend that §525(a) does not apply to the FSA because by its nature, the FSA is a private contract between the utility and the winning supplier, neither of which are governmental units.¹¹⁴ Section 525(a) only involves a prohibition against certain specific governmental discriminatory actions which are simply not at issue in this private transaction.¹¹⁵

Reply briefs serve a limited purpose. A party is supposed to use its reply brief to respond to the points and issues asserted in an opposing party's initial brief. If a party is permitted to inject new claims or issues in a reply brief, this may well result in a fundamental injustice upon opposing parties, who would then have no opportunity to respond in writing to the new questions raised. Accordingly, the Commission finds that the argument asserted by Mirant in its Reply Brief relative to the alleged violation of §525(a) of the Bankruptcy Code was untimely presented, was unresponsive to the positions asserted by parties in the initial briefs, and is therefore stricken.

The Commission takes this opportunity to note that Mirant's argument would also fail on substantive grounds. First, § 525(a) only applies to a governmental unit taking

¹¹⁴ See e.g., Pepco/Delmarva Motion to Strike at 5.

¹¹⁵ *Id.*

adverse action against a bankrupt entity relative to a license, permit or similar grant. The terms of the FSA simply do not involve such conduct on the part of the Commission. Second, the FSA is a contract between the utility and a winning supplier and does not involve any improper discriminatory action by a governmental unit.

H. The Commission will adopt new regulations in a timely manner to implement the continued provision of a SOS option.

WGES asserts that the Phase I Settlement and §7-510(e) require the Commission to institute a rulemaking and propose regulations that implement the Electric Customer Choice and Competition Act of 1999 (“Electric Act”) and the policies underlying the Phase I and Phase II Settlements based on the procedures of the Administrative Procedure Act (“APA”).¹¹⁶ Paragraphs 6, 25, 44 and 62 of the Phase I Settlement provide that the Settling Parties will propose regulations that implement the Settlements and will submit them to the Commission for approval after Phase II.¹¹⁷ In Order No. 78400 the Commission stated that it will implement appropriate regulations following the Phase II proceedings.¹¹⁸ The Commission affirms that decision in this Order.

WGES’s argument on Brief is premature and not ripe for review. Since the Phase I Settlement, it has been clear that regulations would come *after* Phase II is concluded. The Commission is mindful of the Court’s holding in *Delmarva Power & Light Company v. Public Service Commission of Maryland* 370 Md. 1 (2002) (“*Delmarva Decision*”). The Commission intends to promulgate regulations implementing those elements of the Phase II Settlement to the extent they require codification in the Code of Maryland Regulations (COMAR). Nevertheless, notwithstanding the *Delmarva Decision*, §7-

¹¹⁶ Brief of WGES at 12.

¹¹⁷ See also Appendix I of the Phase I Settlement. Docket No. 119.

EXHIBIT B

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

In re)	
)	Chapter 11 Case
MIRANT CORPORATION, <u>et al.</u> ,)	Case No. 03-46590(DML)
Debtors.)	Jointly Administered
)	
)	
)	

**ORDER GRANTING DEBTORS' MOTION REQUESTING AUTHORITY TO:
(i) ENTER INTO CERTAIN SLEEVING TRANSACTIONS WITH THE CONDUIT
COUNTERPARTIES IN THE MARYLAND MARKET PURSUANT TO SECTION 363
OF THE BANKRUPTCY CODE; AND (ii) GRANT TO SUCH CONDUIT
COUNTERPARTIES: (a) COLLATERAL PROTECTIONS; AND (b) CERTAIN
REMEDIES AND ENFORCEMENT RIGHTS**

Upon the motion, dated January 23, 2004 (the "Motion"),¹ filed by Mirant Corporation and its affiliated debtors (collectively, the "Debtors") for the entry of an order for authorization to: (i) enter into one or more "sleeving transactions" for the sale of energy not to exceed a daily aggregate notional value of \$300 million (the "Sleeving Transactions") with the Conduit Counterparties in the Maryland market, pursuant to section 363 of the Bankruptcy Code; and (ii) grant to such Conduit Counterparties: (a) collateral protections; and (b) certain remedies and enforcement rights; and it appearing that the Court has jurisdiction over this matter; and it appearing that due notice of the Motion has been provided, and that no other or further notice need be provided; upon all of the proceedings had before the Court; and after due deliberation and sufficient cause appearing therefor,

It is hereby:

¹ Any capitalized term not otherwise defined in this order will have the meaning ascribed to such term in the Motion.

ORDERED that the Motion is hereby GRANTED as set forth herein; it is further

ORDERED that the Debtors are authorized to enter into the Sleeving

Transactions for the sale of energy to the Maryland utilities not to exceed a daily notional value of \$300 million, in the aggregate, with the Conduit Counterparties; it is further

ORDERED that the Debtors are authorized to pay the associated Sleeving Fees to the Conduit Counterparties; it is further

ORDERED that, as security and assurance of the Debtors' obligations arising under the Sleeving Transactions, the Debtors are authorized to grant to the Conduit Counterparties the following collateral protections and rights:

- for the benefit of the Conduit Counterparties, effective without the necessity of the execution by the Debtors, or filing, of security agreements, pledge agreements, mortgages, financing statements or otherwise enforceable first-priority liens and security interests on any collateral, including, without limitation, initial, maintenance or variation margin or payments in advance and whether in the form of cash, letters of credit under the existing debtor-in-possession facility or otherwise provided to such Conduit Counterparty whether prior to, on, or after the date of this order.
- the automatic stay provisions of section 362 of the Bankruptcy Code will be vacated and modified to the extent necessary to allow immediate and unconditional enforcement of remedies by any Conduit Counterparty upon the occurrence of any default under the Sleeving Transactions by the Debtors and the Conduit Counterparties rights thereunder will not be modified, stayed, avoided or otherwise limited by order of the Bankruptcy Court or any court proceeding under title 11 of the United States Code. The Debtors will waive the right and will not seek relief, including without limitation under section 105(a) of the Bankruptcy Code, to the extent that any such relief would in any way restrict or impair the rights of any Conduit Counterparties under the Sleeving Transactions or this order; provided that such waiver will not preclude the Debtors from contesting whether a default has occurred under any Sleeving Transaction; it is further

ORDERED that nothing herein will relieve the Debtors of their obligations to comply with the Mirant Global Risk Management Policy.

Dated: February ____, 2004

D. Michael Lynn,
United States Bankruptcy Judge