The ABC’s of EFCs: Eligible Financial Contracts and Energy Company Insolvency Proceedings

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What is an EFC?

- *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* define “eligible financial contract” as “an agreement of a prescribed kind”
- The current regulations of the BIA/CCAA provide a list of certain types of agreements that are considered to be an EFC, which include:
  - Derivative agreement that trades on futures or options, or is the subject of recurrent dealings in the derivatives markets
- Legislative definition expands what is commonly understood to be a “derivatives agreement”
What is a “derivatives agreement”?

- "a financial agreement whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as interest rates, indices, currencies, commodities, securities, [...] or other macroeconomic data and includes:

  ...  
  – (e) a spot or forward.“
What is important about an EFC in insolvency?

• Stay of proceedings
  – prevents contractual counterparties to the debtor from terminating agreements, netting and setting-off obligations and dealing with financial collateral, irrespective of what the terms of the contract say

• General ability to disclaim its uneconomical contracts
  – CCAA (s. 32)
  – BIA (s. 65.1),
  – Model template form of Receivership Order (Alberta)

• These do not apply to an EFC
Judicial interpretation of EFCs and gas supply contracts

• **Blue Range**
  – Attempted disclaimer of natural gas supply agreements
  – ABCA found contracts were EFCs as they served an important financial purpose as risk management tools

• **Androscoggin**
  – Disclaimer of gas supply contracts
  – The essential relationship between Androscoggin Energy and the companies was the physical delivery of gas
  – Contracts carried none of the "hallmarks" of an EFC
Judicial interpretation of EFCs and gas supply contracts

• *Calpine*
  – Call on Production Agreement
  – COP Agreement, as a whole, lacked the characteristics or hallmarks of an EFC

• *Bellatrix*
  – First decision to consider the requirements for gas supply contracts to qualify as an EFC since the 2007 amendments
  – GasEDI Agreement was found to be an EFC
    • physically settled contracts are not disqualified from being eligible financial contracts
    • a fixed price is not required for a gas supply contract to be considered an EFC
Is it an EFC?

- *Pro forma* provisions are not determinative

- Courts will consider whether the essence of any contract is set up to serve an underlying financial purpose
Remedies are limited

• *BIA* and *CCAA* provide certain, limited, special protections for EFCs
  – Exemption from the stay of proceedings preventing contractual counterparties from terminating an agreement because of a contractual counterparty's insolvency
  – The netting or setting off of obligations between the company and the other parties to the eligible financial contract
  – The dealing in any financial collateral
• EFC provisions do not permit enforcement actions to recover net termination values once they are determined
• Netting or setting off of obligations is only permitted if the EFC is terminated
Bellatrix 2

- Priority dispute arose between the first lien lenders and BP Canada to certain sale proceeds from Bellatrix's estate and certain funds held in trust by the Monitor.
- The Chambers Court found the protections for EFCs did not require the insolvent party to perform an EFC that has not been terminated, nor do the provisions provide the solvent counterparty with any priority for its claim.
- Solvent counterparties cannot rely upon the disclaimer exception for EFCs under the insolvency statutes to demand continued performance of an EFC.
Terms of the contract matter

- Characterization of an energy trading contract as an EFC provides the non-insolvent counterparty with certain rights.
- The enforcement of such rights will be subject to the terms of the EFC.
- Adequate security or credit support will be important to protect rights.
Performance assurances

- Letter of credit
- Performance bond
- Guarantee
- Security
- Cash collateral
- Set-off
Questions

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