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No. of Pages: 5

Date: March 1, 2000

FOR IMMEDIATE DELIVERY

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Dear Norm:

As we previously discussed, Enron has revised its proposed amendments and report language to the Bankruptcy Reform Act. I have attached the current version for review and consideration by the Financial Products Working Group. We expect ISDA and the Bond Market Association to agree to these provisions, as they had approved the earlier draft.

We would appreciate discussing these amendments with you early next week. Please let me know a time that would be most convenient.

Sincerely,



Ellen S. Levinson

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February 14, 2000

**AMENDMENTS TO THE FINANCIAL CONTRACT PROVISIONS
of the
BANKRUPTCY REFORM BILL, H.R. 833**

Background and Summary

In 1990, amendments were made to the Bankruptcy Code to give legal certainty to the treatment of certain financial transactions in the case of bankruptcy. The amendments particularly addressed transactions, such as swaps and other over-the-counter derivatives, that are subject to fluctuations because they derive their value from an underlying commodity, rate, index or other item. The insolvency of a party to such a transaction could pose systemic risks.

Both the House and Senate Bankruptcy Reform Bills update the financial contract provisions of the Code. Among other things, the purposes are to catch up with new developments in the market, to anticipate continued innovation and growth of derivatives and to provide greater legal certainty that financial transactions can be closed out, netted and settled in a timely manner in case of bankruptcy.

The following amendments and report language to H.R. 833 are needed (1) to revise the definition of "swap agreements" to accommodate the introduction of new swap products, (2) to avoid any confusion regarding the netting rights for different types of transactions by providing consistency in the statutory language, and (3) to clarify how the "cross-product" netting provisions should be applied.

The Amendments, Report Language and Explanations

The amendments and report language below refer to Section 1007 of the House-passed bill.

1) Revise the definition of "swap agreements" in the bills to accommodate the introduction of new swap products.

a) Amend the definition of "swap agreement" in Section 1007(a)(1)(E) by:

- OK* i) on page 299, line 16, deleting "or" after "agreement;" ;
- OK* ii) on page 299, line 18, inserting after "agreement;" the following: "or a weather swap, weather derivative, or weather option;" ;
- AD* iii) on page 299, lines 23 and 24, deleting the words "in the swap market" and inserting instead "by swap participants";
- OK* iv) on page 300, line 8, inserting "or other" after the word "economic"; and
- OK* v) on page 300, line 9, inserting "or other" after the word "economic".

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b) Conference Report Statement of Managers:

The current statutory definition of "swap agreement" in Section 101(53B) includes an enumerated list of products and a catch-all phrase for "any similar agreement." The catch-all phrase was included in the 1990 Amendments to ensure that the definition would be broad enough to encompass future types of swaps that the financial marketplace would develop. The revised definition in H.R. 833 also adopts this approach.

- i) The conferees believe that a swap definition limited to specifically enumerated transactions would soon be rendered obsolete by the ingenuity of financial engineers. The conferees have taken the approach used in the 1990 Amendments a step further, however. Specifically, the revised catch-all phrase in Section 1007(a)(1)(E) of H.R. 833 refers to "any agreement or transaction similar" to one of the enumerated types of transaction that, "is presently, or in the future becomes, regularly entered into by swap participants ... and ... is a forward, swap, future or option on one or more rates, currencies, commodities, equity securities, or other equity instruments, or on an economic or other index or measure of economic or other risk or value".
- ii) The additional language in the catch-all phrase is for purpose of clarification only. It is not designed to limit the circumstances in which a transaction may qualify as a "swap agreement." The conferees in no way intend to exclude from this revised definition any transaction or agreement that is considered a swap agreement under the version of the definition adopted in 1990.
- iii) The use of the phrase "regularly entered into" in clause A(ii)(I) of the definition of "swap agreement" is not intended to preclude from the scope of sections 362(b), 560, 561(a)(5), and other provisions relating to swap agreements, transactions that have as their underlying items novel or unusual rights, services, interests or other measures of value, whether or not such rights, services, interests or other measures of value have previously been used or are thereafter used in any other transaction or by any other parties. The conferees believe and intend that so long as the transaction or the underlying item is vulnerable to market fluctuations, the same systemic risks sought to be avoided by permitting non-debtor counterparties to liquidate, terminate and accelerate swap agreements pursuant to contractual rights apply to such transactions.

c) Explanation:

In both the House and Senate bills the statutory definition of "swap agreement," which was established in 1990, is updated by (i) adding to the existing list of swap products, types of transactions that have been introduced since 1990, and (ii) modifying the "catch-all" phrase to provide flexibility to avoid the need to amend the definition as the nature and uses of swap agreements matures.

The updated definition of swap agreements in H.R. 833 inadvertently did not cover some legitimate transactions, and this amendment remedies this problem. First, the list of swaps is amended to include "weather derivatives," an important type of transaction that allows end-users, such as energy companies, agricultural producers and agribusinesses, to

manage their weather-related business risks. Second, the catch-all clause is revised to ensure that the new definition (a) is not limited to products that address "economic" risk, which could inadvertently narrow the current definition, and (b) refers to transactions entered into "by swap participants" rather than "in the swaps market" since swap transactions do not take place on federally-regulated markets; swaps are entered into by agreements between parties "over-the-counter."

To ensure that the intent of the amendments to the swap definition is clear, report language in the Statement of Managers is necessary.

2) Protection of netting rights for commodity, securities and forward contracts and repurchase agreements.

a) At the appropriate place in each bill add the following amendments to the Bankruptcy Code:

Amend 11 U.S.C. § 362(b)(6) by (i) replacing "a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, arising out of" in the sixth through eighth lines thereof with "any payment or transfer due from the debtor under or in connection with" and (ii) inserting between the words "against" and "cash" in the eighth line thereof: "against any payment due to the debtor from a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency under or in connection with commodity contracts, forward contracts or securities contracts or against".

Amend 11 U.S.C. § 362(b)(7) by (i) replacing "a margin payment, as defined in section 741 or 761 of this title, or settlement payment, as defined in section 741 of this title, arising out of" in the third through fifth lines thereof with "any payment or transfer due from the debtor under or in connection with" and (ii) inserting between the words "against" and "cash" in the fifth line thereof "against any payment due to the debtor from such repo participant under or in connection with repurchase agreements or against".

b) Explanation:

Under current law, a safe harbor from the application of the automatic stay in bankruptcy proceedings is provided for several types of financial transactions. This safe harbor is intended to provide legal certainty to the enforceability of netting rights in the case of bankruptcy of a counterparty to one of these types of transactions. For swap agreements, netting rights in connection with "any payment or transfer" arising in connection with the transactions are protected in current law. However, for commodity, securities and forward contracts and for repurchase agreements, under current law the protection is more limited -- it only applies to netting rights related to "margin payments" and "settlement payments." This inconsistency in statutory language can create legal uncertainty about the exercise of netting rights in bankruptcy.

To remedy this problem, the amendment would apply the same protection for commodity, securities and forward contracts and repurchase agreements that is already provided for swap agreements.

3) Conference Report Statement of Managers ("cross-product" netting).

a) Language:

Sections 561(a) and (a) of the Code; Section 1007(k) of H.R. 833
Section 362(b)(32) of the Code; Section 1007(d)(1)(F) of H.R. 833

Section 561(a) will protect the exercise of any "contractual right" to "offset or net termination value, payment amounts or other transfer obligations" in connection with certain enumerated types of transactions free from any stay or any order of a court or administrative agency. Under subsection (c), "the term contractual right includes ... a right, whether or not evidenced in writing, arising by reason of normal business practice".

- i) Section 561(a), therefore, will protect netting and setoff rights between, e.g., repurchase agreements and swap agreements, swap agreements and forward contracts, and cash-settled and physically-settled forward contracts, even without implementation of an umbrella "master master" agreement tying the agreements together, as long as such netting and setoff is consistent with "normal business practice". The determination of what constitutes "normal business practice" in any particular case will, of course, depend on the facts and circumstances. Nevertheless, the drafters anticipate that where the normal practice in an industry is not to implement master master agreements, but the participants in the industry nevertheless rely on the enforceability of their "cross product" netting rights when entering into transactions and making attendant credit determinations, such participants will be protected under Section 561.
- ii) The new Section 362(b)(32) established under Section 1007(d)(1)(F) will complement Section 561 by protecting netting and setoff and collateral foreclosure rights in connection with master netting agreements. The protections afforded by Section 362(b)(32), on the one hand, and Section 561, on the other, are cumulative. Accordingly, the absence in Section 362(b)(32) of explicit protection for rights arising by virtue of "normal business practice" is not in derogation of such rights arising under Section 561.

b) Explanation:

Both bills have provisions to protect netting and setoff rights between different types of agreements, such as repurchase agreements and swap agreements, swap agreements and forward contracts, and cash-settled and physically-settled forward contracts, even without implementation of an umbrella agreement tying the agreements together, as long as such netting and setoff is consistent with "normal business practice." To clarify the intent of these provisions the report language states that where the normal practice is not to implement umbrella agreements, but the participants in the industry nevertheless rely on the enforceability of their "cross-product" netting rights when entering into transactions and making attendant credit determinations, such participants will be protected.