What Latest Ruling In FERC, Bankruptcy Court Turf War Means

By **Sara Abner** (July 7, 2022)

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The U.S. Court of Appeals for the Fifth Circuit recently weighed in on the hotly contested issue of whether the Federal Energy Regulatory Commission or the bankruptcy court has controlling jurisdiction when it comes to the question of a bankruptcy debtor's ability to reject contracts regulated by FERC.

FERC-regulated contracts include electricity power purchase contracts, as well as transportation services agreements involving oil and gas. The issue arises in Chapter 11 business reorganization bankruptcy actions, which are designed to enable troubled businesses to restructure so that they might operate successfully in the future.

In the quest to reorganize, the Bankruptcy Code entitles a debtor to exercise its discretion in assuming and rejecting its executory contracts. The Chapter 11 debtor is given the ability to cull through its contracts, identifying those that are beneficial to the debtor and those that are burdensome.

Those that are beneficial are typically assumed, while those that are burdensome are typically rejected. The bankruptcy court then must confirm the assumption or rejection using the business judgment standard of review. In this manner, the debtor can rid itself of burdensome contracts in order to successfully reorganize.

This situation has perpetuated a decades-old jurisdictional battle between FERC and the bankruptcy courts when the contracts involved are energy-related contracts over which FERC has regulatory jurisdiction.

FERC has taken the position that it has, at a minimum, concurrent jurisdiction with the bankruptcy court, possessing the authority to thwart a debtor's rejection of an energy-related contract coming within its regulatory scope if it determines rejection would endanger the public interest.

There is a dearth of jurisdictional and legislative guidance on the issue. In fact, Section 365 of the Bankruptcy Code, which governs the assumption and rejection of contracts in bankruptcy, does not address the issue at all.

This has led to shifting decisions and inconsistent outcomes, setting off alarm bells when a party to a FERC-regulated contract files for bankruptcy. The counterparty to the contract is faced with questions such as whether its contract can be rejected by the debtor, whether it can fight rejection, and whether it can seek relief with FERC.

The issue has yet to be conclusively decided, and the decisions range from a holding at one end of the spectrum that FERC's jurisdiction exclusively controls — In re: Calpine Corp. in the U.S. District Court for the Southern District of New York — to a holding at the other end of the spectrum that the bankruptcy court's jurisdiction exclusively controls, In re: PG&E Corp. in the U.S. Bankruptcy Court for the Northern District of California.[1][2]

In the middle are a number of decisions finding that FERC and the bankruptcy court have concurrent jurisdiction.[3]

The most recent circuit court decisions, however, have taken a slightly different view of FERC's role, finding that the bankruptcy court has the sole and final say, but requiring that FERC have input as a party-in-interest with respect to the public interest. Thus, under those recent decisions, FERC's role has shifted from that of a decision maker to a litigant weighing in on the issue.

A March decision from the Fifth Circuit, In re: Ultra Petroleum Corp., joins with that view, finding there is a role for FERC to play, but the bankruptcy court's jurisdiction prevails.[4]

The debtor in the Ultra Petroleum case was a producer of oil and natural gas. The debtor had a pipeline contract for transportation of the gas pursuant to which the debtor was obligated to pay $169 million over the seven-year term of the contract, regardless of whether any gas was actually transported.

After filing for bankruptcy, the debtor moved to reject the contract as it was no longer producing and shipping gas. FERC objected on the basis that its approval was required for rejection of the contract.

The bankruptcy court authorized the rejection and confirmed the debtor's plan of reorganization, and FERC appealed. The court drew upon an earlier Fifth Circuit decision, In re: Mirant Corp., for the following three principles:[5]

First, the bankruptcy court's power to authorize rejection of a filed-rate contract does not conflict with FERC's authority to regulate rates for the sale of electricity, as long as the rejection does not represent a collateral attack on the rate contained in the agreement.

The rate is not deemed to be the subject of a collateral attack if the debtor's reasons for the rejection of the contract are unrelated to the rate. That is, the debtor is not rejecting the contract simply because it wants a lower rate.

In the case of the Ultra Petroleum debtor, the debtor was no longer producing and shipping gas, and therefore no longer needed the contract. Thus, the reason for its rejection was unrelated to the rate and did not constitute a collateral attack.[6]

Second, when a contract is rejected, the counterparty is entitled to assert a rejection claim based on the damages it would have been entitled to upon a breach of the contract. The contract's filed rate must be given full effect when determining those breach of contract damages.

Third, in ruling on the debtor's rejection request, the bankruptcy court must consider "whether rejection harms the public interest or disrupts the supply of energy, and must weigh those effects against the contract's burden on the bankruptcy estate." Thus, a higher standard of review than the usual business judgment standard is required.

The Fifth Circuit concluded that it is the bankruptcy court, rather than FERC, which should

> carefully scrutinize the impact of rejection upon the public interest and should, inter alia, ensure that rejection does not cause any disruption in the supply of electricity to other public utilities or to consumers.[7]

In fully embracing this principal, the Fifth Circuit went one step further than Mirant this time around by expressly adding that the bankruptcy court "must invite FERC to participate in

the bankruptcy proceedings as a party-in-interest."[8] The court rejected the notion that FERC proceedings must precede a contract rejection decision.

But the court determined that FERC has valuable expertise that should be considered when rejection of a filed-rate contract is at issue. Thus, FERC is entitled to weigh in on the impact of rejection upon the public interest.

In the end, however, it is the bankruptcy court which gets to scrutinize that information and make the final decision.

This decision falls in line with the U.S. Court of Appeals for the Sixth Circuit's 2019 opinion, In re: FirstEnergy Solutions Corp., which addressed the very same issue.[9] In that decision, the Sixth Circuit also ruled that the rejection of certain FERC-regulated wholesale power contracts requires a heightened standard of review above that of the business judgment standard.

The bankruptcy court must additionally consider the impact of the rejection upon the public interest, and in doing so must invite FERC to participate in that process by providing an opinion on the issue. FERC is entitled to a reasonable amount of time to assess the impact of the contract rejection on the public interest.

The bankruptcy court should then consider that assessment when reaching a decision as to whether the contract rejection should be permitted. But ultimately, it is the bankruptcy court that makes that final decision.

In reaching their decisions, the Fifth Circuit and the Sixth Circuit recognized that "in a Chapter 11 bankruptcy, time is of the essence and delay drains the coffers of all involved," as stated in Ultra Petroleum.

Allowing FERC to weigh in, but recognizing the bankruptcy court as having the final authority over the contract rejection process, "balances the benefits of providing the bankruptcy court with FERC's insight with the necessity for swift and efficient bankruptcy proceedings."[10]

While courts have reached, and continue to reach, mixed decisions regarding the interplay of FERC's jurisdiction with that of the bankruptcy court when it comes to authorizing the rejection of FERC-regulated contracts in the bankruptcy sphere, the two circuit courts to address the issue have agreed that FERC should play some role.

FERC continues to take the position that its role should be that of a decision maker, while the circuit courts have relegated FERC's role to that of a party-in-interest litigant with the right to weigh in on the issue of public interest. The bankruptcy court retains sole jurisdiction as the final decision maker.

These decisions have implications for not only FERC-regulated contracts, but also for other types of contracts for which there is federal oversight. An example would include contracts falling within the Federal Communications Commission's regulatory authority.

Thus, until the issue is finally decided, the uncertainty has the potential to extend beyond FERC-regulated contracts.

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[1] In re Calpine, Corp. , 337 B.R. 27 (S.D.N.Y. 2006).

[2] In re PG&E Corp. , 603 B.R. 471 (Bankr. N.D. Cal. June 7, 2019). Amended and direct appeal certified, 2019 WL 2477433 (Bankr. N.D. Cal. June 12, 2019), permission to appeal granted, No. 19-71615 (9th Cir. Sept. 17, 2019), vacated as moot, D.C. No. 3:19-bk-30088 (9th Cir. Oct. 7, 2020).

[3] See In re Boston Generating, LLC , 2010 WL 4616243 (S.D.N.Y. Nov. 12. 2010); and ETC Tiger Pipeline, LLC, 171 FERC ¶ 61,248 (2020), reh'g denied, 172 FERC ¶ 61,155 (Aug. 21, 2020).

[4] In re Ultra Petroleum Corp. , 2022 WL 763836 (5th Cir. Mar. 14, 2022).

[5] In re Mirant Corp. , 378 F.3d 511 (5th Cir. 2004).

[6] Interestingly, In re Calpine, mentioned above as the sole decision to find that FERC has exclusive jurisdiction over FERC-regulated contracts, involved a direct attack on the rate. Specifically, the reasonableness of the rate was the stated reason for the debtor's proposed rejection. Thus, a narrow reading of the decision is technically in line with the Mirant holding. But the Calpine Court went further in its holding, finding that in instances in which there is jurisdictional conflict, the power of the bankruptcy courts must yield to the power of a federal agency. 337 B.R. at 27.

[7] Mirant, 378 F.3d at 525-26.

[8] In re Ultra Petroleum Corp. , 2022 WL 763836 (5th Cir. Mar. 14, 2022).

[9] In re FirstEnergy Solutions Corp. , 945 F.3d 431 (6th Cir. 2019), reh'g denied, No. 18-3787 (6th Cir. 2020).

[10] Id.; see also, In re FirstEnergy Solutions Corp. , 945 F.3d at 431.