LJN LAW JOURNAL NEWSLETTERS

The Bankruptcy Strategist®

ALM.

Volume 39, Number 6 • April 2022

Fifth Circuit Resolves 'Clash' Between FERC and Bankruptcy Courts

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A Chapter 11 debtor's "rejection [(under Bankruptcy Code (Code) §365(a)] of a filed-rate [natural gas] contract … relieve[d] it of the obligation to continue performance absent the approval of FERC [(the Federal Energy Regulatory Commission]," held the U.S. Court of Appeals for the Fifth Circuit on March 14, 2022. *In re Ultra Petroleum Corp.*, 2022 WL 763836, *1 (5th Cir. Mar 14, 2022). Moreover, held the court in affirming the bankruptcy court on a direct appeal, Code §1129(a)(6) did not "require the bankruptcy court to seek FERC's approval before it confirmed [the debtor's] reorganization plan." *Ultra* followed, as expected, the reasoning of its precedent, *In re Mirant Corp.*, 378 F.3d 511 (5th Cir. 2004), and, more important, carefully balanced the power of FERC and the nation's bankruptcy courts.

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Relevant Statutes

The Fifth Circuit first acknowledged the text of Code §1129(a)(6): "a reorganization plan can be confirmed only if '[a]ny governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.'" FERC conceded "that Mirant allows a bankruptcy court to approve rejection of a filed-rate contract." *Ultra*, 2022 WL 763836, at *2, *4.

Mirant

For the relevant background, the court explained the reasoning of its governing precedent, *Mirant*. That case dealt with the rejection of an electricity-purchase contract governed by the Federal Power Act. Although *Ultra* dealt with a natural gas contract governed by the Natural Gas Act, both statutes are "substantially identical" and give FERC exclusive jurisdiction over rates. Courts cite decisions regarding the two statutes "interchangeably." *Ultra* at *2. n.1. The Fifth Circuit held in *Mirant* that "a district court [could] authorize the rejection of an executory contract for the purchase of electricity as part of a bankruptcy reorganization [and that] Congress [had not] granted [FERC] exclusive jurisdiction over those contracts." 378 F.3d at 514-15. The electric power contract there "included filed rates that could only be modified by FERC."

Although FERC had "exclusive authority to determine wholesale rates" and any modification of rates or the contract had to "go through FERC," *Mirant*'s "*rejection* of the [contract] is a *breach*" and "FERC [lacks] exclusive authority over a breach of contract claim." *Id.* at 519 (emphasis in original). "[D]istrict courts are permitted to grant relief [when] the breach of contract claim is based upon another rationale," held the Fifth Circuit, "so long as that rejection does not … challenge [the] agreement's filed-rate." "[R]ejection had only an 'indirect effect upon the filed rate' and 'is not a collateral attack upon [the filed rate]' …." *Ultra*, 2022 WL 763836, at *6, quoting *Mirant*, 378 F.3d at 519-20.

No Special Statutory Exception for Power Contracts

"[R]ejection of a power contract was allowed", too, because the "Code does not … include an exception prohibiting rejection of, or providing other special treatment for, wholesale electric contracts subject to FERC jurisdiction." 378 F.3d, at 521. Although Congress had enacted other "specific limitations on and exceptions to the §365(a) general authority," it said nothing about the rejection of power contracts. *Id.* To enable "the reorganization

process to proceed," and because FERC lacked "authority to compel continued performance and continued payment of the filed rate after a valid rejection," FERC also had to be enjoined from compelling the debtor "to perform under the" rejected contract, held the Fifth Circuit in *Mirant*. *Ultra*, 2022 WL 763836, at *6, citing 378 F.3d at 519-20, 522.

Higher Standard for Rejection Power

The *Mirant* decision further applied "a more rigorous standard" than "normal business judgment" for courts to use when resolving a debtor's rejection motion. *Id*. A court must "carefully scrutinize the impact of rejection upon the public interest and should … ensure that rejection does not cause any disruption in the supply of electricity to other public utilities or to consumers." *Id*. at 525. When applying this "careful scrutiny" test, courts should "welcome FERC's participation [in the case] … as a party in interest …." *Id*. at 525-26.

Mirant Holding Not *Dicta*

The Fifth Circuit in *Ultra* rejected FERC's argument that *Mirant*'s holding about the consequences of rejection were *dicta*. "The consequences of rejection of a filed-rate contract are central to the decision to allow rejection of said contracts, and the governing rules of law related to those consequences required explication … that … was not dicta." *Ultra*, 2022 WL 763836, at *5.

Other Circuit Precedent

The Sixth Circuit also followed *Mirant* in *In re First Energy Solutions Corp.*, 945 F.3d 431, 455-56 (6th Cir. 2019) (2-1) ("[W]hen a Chapter 11 debtor moves … to reject a filed energy contract that is … governed by FERC, via the FPA, the bankruptcy court must consider the public interest and ensure that the equities balance in favor of rejecting the contract, and it must invite the FERC to participate and provide an opinion within a reasonable time."). For the sake of uniformity in applying federal bankruptcy law and to avoid a "circuit split," the *Ultra* "result [was] straightforward," if not pre-ordained by *Mirant* and *First Energy*. *Id*. at *6.

The Key Facts in *Ultra*

"The bankruptcy court considered and granted rejection," which "did not collaterally attack the rate filed with FERC because the rate was still used to set the damage award … after rejection. [The debtor in] Ultra … did not seek to reject … because the rates were excessive (… a prohibited collateral attack on the rate itself) …. [The debtor] … wants out of the contract altogether [instead], given the suspension of its drilling program …. [The debtor's] "rejection" was "valid" because "under *Mirant*, [it did] not undermine FERC's exclusive authority to set rates." *Id*.

The bankruptcy court in *Ultra* also "explicitly considered the public interest in reaching its decision," when it determined "whether 'the equities balance in favor of rejecting' the filed-rate contract." *Id*. at *7, quoting *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 526 (1984), and *Mirant*, 378 F.3d at 525. "*Mirant* makes clear that *courts* should carefully scrutinize the impact of rejection upon the public interest, not FERC." *Id*. (emphasis in original). Specifically, there would be no "disruption in the supply of … whatever regulated commodity is the subject of the contract under consideration." *Id*.

Need for Expediency

Finally, the Fifth Circuit in *Ultra* refused to require the "bankruptcy court to halt its progress" for "FERC to hold a hearing on the public-interest ramifications of the rejection of a filed-rate contract." *Id*. In a Chapter 11 case, "time is of the essence and delay drains the coffers of all involved (except of course, for those lawyers who would be paid to hurry up and wait)." *Id*. The court's "approach balances the benefits of [gaining] FERC's insight with the necessity for [a] swift and efficient bankruptcy …." *Id*.

Comments

- The Fifth Circuit in *Ultra* delicately balanced the "clash of two congressionally constructed titans, FERC and the bankruptcy courts." *Id*. at *2.
- The nuanced analysis in *Ultra* undermines, if not rejects, the reasoning of *In re Calpine*, 337 B.R. 27, 38 (S.D.N.Y. 2006) ("[T]his court does not construe the filed rate doctrine [of Mirant] so narrowly as to only reach modifications of the rate …. FERC has exclusive jurisdiction to modify or terminate the Power Agreements, … an issue of great public interest [to] be heard in a branch accountable to the electorate in a forum that specializes in considering the public interest.").

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