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Fifth Circuit Court of Appeals Vacates Federal Energy Regulatory Commission Orders, Reaffirming Contract Rejection Powers in Bankruptcy

*By Ben Hoch and Marsha Sukach**

In this article, the authors discuss a recent decision by the U.S. Court of Appeals for the Fifth Circuit upholding a debtor's right to "reject" regulated energy contracts in bankruptcy, even over the objection of the Federal Energy Regulatory Commission.

The U.S. Court of Appeals for the Fifth Circuit added to a stream of recent decisions upholding a debtor's right to "reject" regulated energy contracts in bankruptcy, even over the objection of the Federal Energy Regulatory Commission ("FERC"). With its decision, the court vacated a pair of FERC orders entered prior to the actual bankruptcy proceeding that sought to require a natural gas producer to continue performing under agreements even if they were to be rejected in a bankruptcy case.¹

BACKGROUND

The Bankruptcy Code authorizes Chapter 11 debtors to "reject" executory contracts with court approval.² An executory contract is generally defined as a contract in which continued material performance is due on both sides. Contrary to many people's understanding, rejection does not constitute termination or rescission of a contract. Rather, rejection is treated as a breach, and while the debtor is freed from the obligation to continue performing under the contract, any unfulfilled obligations are converted into a claim for damages.

Outside of bankruptcy, the Federal Power Act and the Natural Gas Act give FERC broad jurisdiction to regulate the rates, terms, and conditions of contracts to move or sell power and natural gas, respectively. Asserting this jurisdiction, FERC has repeatedly challenged bankruptcy courts' ability to authorize the rejection of energy-related contracts unilaterally without its

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¹ *Gulfport Energy Corp. v. FERC*, No. 21-60017 (5th Cir. Jul. 19, 2022).

² 11 U. S. C. § 365(a).

consent. In an emerging consensus, multiple courts, including the U.S. Courts of Appeals for the Fifth and Sixth Circuits, have concluded that energy contracts may be rejected in bankruptcy over FERC's objection.³

THE GULFPORT ENERGY DECISION

Gulfport Energy Corporation ("Gulfport"), a producer of natural gas, had its gas transported by Rover Pipeline through its pipelines at rates set forth in certain transportation service agreements ("TSAs"). When the COVID-19 pandemic crushed demand for energy and depressed prices for oil and gas, Gulfport issued going concern warnings in its public filings. Anticipating a potential bankruptcy filing by Gulfport, and hoping to head off adverse consequences of any resulting rejection of the TSAs, Rover asked FERC to announce that it had exclusive jurisdiction over the TSAs, so that Gulfport would require FERC's approval before rejecting those contracts. Additionally, at Rover's request, FERC issued an order requiring Gulfport to continue performing under the TSAs. Gulfport did file a bankruptcy case shortly thereafter and sought to reject the TSAs. In the bankruptcy proceedings that followed, the bankruptcy court approved the rejection despite FERC's objections and assertion of jurisdiction via the prebankruptcy orders, and confirmed Gulfport's reorganization plan. The district court affirmed the bankruptcy court's authority to approve the rejection of the TSAs. Gulfport then petitioned the Fifth Circuit to vacate the FERC orders, which FERC continued to defend as having legal force.

These facts suggest that Rover sought to bypass adverse existing case law by obtaining the FERC orders prior to Gulfport's bankruptcy filing, and FERC asserted that the distinguishing factor of having issued orders prior to bankruptcy differentiated this fact pattern from previous rulings on the subject and supported its position that the TSAs could not be rejected without its consent. When it intervened in the Fifth Circuit appeal, Rover likewise argued that position. Rover further sought to distinguish this case on the grounds that the orders on appeal were not bankruptcy court orders, as in the precedent cases, but rather, FERC orders. As detailed below, the Fifth Circuit was unpersuaded by these arguments.

The Fifth Circuit vacated the FERC orders on the grounds that they "rested on an inexplicable misunderstanding of rejection." The unanimous three-judge

³ *Off. Comm. of Unsecured Creditors of Mirant Corp. v. Potomac Elec. Power Co. (In re Mirant Corp.)*, 378 F.3d 511, 515 (5th Cir. 2004); *FERC v. FirstEnergy Sols. Corp. (In re FirstEnergy Sols. Corp.)*, 945 F.3d 431, 446 (6th Cir. 2019); *FERC v. Ultra Res., Inc. (In re Ultra Petroleum Corp.)*, 28 F.4th 629, 634 (5th Cir. 2022).

panel observed that the FERC orders “assume that rejecting a contract changes or cancels the obligations under that contract,” pointing out: “That assumption is wrong.”

The court reiterated that “[w]ith filed-rate contracts, as with others, rejection is a breach and has only its consequences,” namely, transforming the debtor’s future performance into an unsecured claim for damages. The damages claim is valued at the filed rate, which does not change. Although Gulfport may be unlikely to pay that claim in full, rejection does not change the contract’s terms of the filed rate itself, and so FERC may not stand in the way of the bankruptcy proceedings.

The Fifth Circuit further denied Rover’s efforts to distinguish this case from prior decisions on procedural grounds. In denying any basis for distinction based on procedural posture, the court made clear that the proper forum for resolving FERC’s objections in any such matter is the bankruptcy court. Lastly, the court rejected Rover’s argument that the Supreme Court had overruled prior decisions on the issue in *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, which, as the court pointed out, had confirmed the view that rejection is nothing more than a breach.⁴

Concluding that FERC may only decide “whether actual modification or abrogation of a filed-rate contract would serve the public interest,” and noting its obligations to “set aside agency action” that is “not in accordance with law,”⁵ the Fifth Circuit vacated the orders at issue.

TAKEAWAYS

This decision marks another win for the bankruptcy regime in a series of disputes involving the interaction of the Bankruptcy Code and FERC’s regulatory authority. Although only a few courts of appeals have ruled on the issue, the emerging case law indicates that bankruptcy courts have significant jurisdiction over the rejection of FERC-regulated contracts in bankruptcy so long as the filed rate is used to calculate the damages claim upon rejection. Parties entering into filed-rate contracts should be mindful that the regulatory scheme most likely will not prevent such contracts from being rejected in a bankruptcy proceeding.

⁴ *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652 (2019).

⁵ 5 U.S.C. § 706(2)(A).