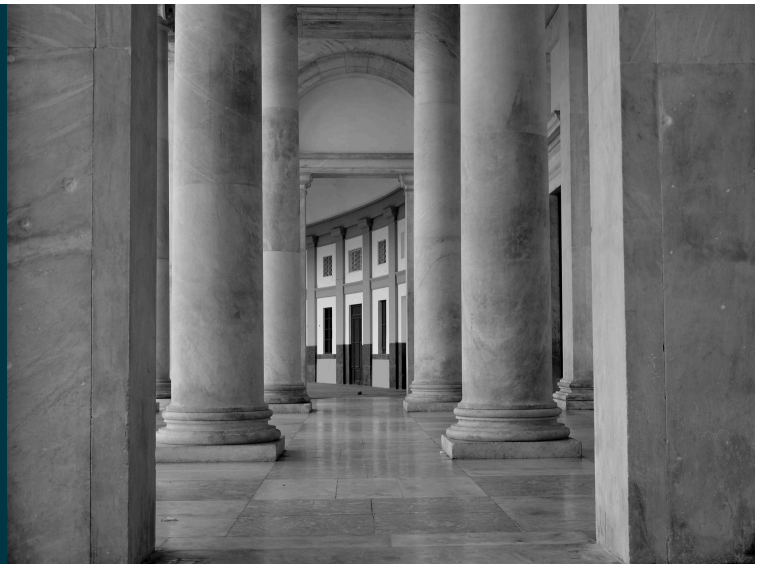
WILSON SONSINI

Sixth Circuit Affirms Bankruptcy Courts' Jurisdiction over Rejection of Energy Contracts, Subject to Certain Constraints



CONTRIBUTORS

Ben Hoch

Marsha Sukach

ALERTS

December 17, 2019

On December 12, 2019, a divided panel of the U.S. Court of Appeals for the Sixth Circuit ruled that the bankruptcy court in the bankruptcy proceedings of FirstEnergy Solutions Corp. (FES) has jurisdiction to decide whether FES may reject certain power purchase agreements.[1] However, the appellate court found that the bankruptcy court's jurisdiction is not exclusive, holding that while the bankruptcy court had some limited authority to enjoin the Federal Energy Regulatory Commission (FERC) from issuing any order requiring FES to continue performing under the contracts, the bankruptcy court had acted improperly in enjoining FERC from conducting any proceedings related to the contracts. The Sixth Circuit also concluded that the bankruptcy court must consider the impact of the rejection of these contracts on the public interest and may only authorize rejection if the "equities balance in favor of rejecting the contracts."

Background

The Bankruptcy Code authorizes a Chapter 11 debtor to assume, assign, or reject executory contracts, subject to court approval.[2] An executory contract is generally defined as a contract in which continued material performance is due on both sides. When a debtor rejects an executory contract, the debtor is relieved from future performance obligations. Outside of bankruptcy, FERC has broad jurisdiction to regulate the rates, terms, and conditions of power purchase agreements. However, in the bankruptcy context, disputes have arisen as to whether a bankruptcy court may authorize the rejection of this type of contract, or whether FERC approval is required before a debtor may stop performing its obligations.[3]

When FES filed its Chapter 11 bankruptcy petition, it initiated an adversary proceeding to enjoin FERC from interfering with its plan to reject certain power purchase agreements that FERC had previously approved under the authority of the Federal Power Act (FPA)[4] and/or the Public Utilities Regulatory Policies Act (PURPA).[5] FERC opposed the action. Several other parties intervened to oppose the action as well, including three counterparties to those contracts and the Ohio Consumers' Counsel.

The bankruptcy court decided that it had exclusive and unlimited jurisdiction, while FERC had no jurisdiction, and enjoined FERC from taking any action relating to the contracts. The bankruptcy court then applied the business judgment standard—the standard typically used for the rejection of contracts in bankruptcy—and found that the contracts were financially burdensome to FES. Accordingly, it permitted FES to reject them. Upon rejection, the contracts would be treated as "breached" and the counterparties left with unsecured claims arising out of the so-called "breach." Each of the opposing parties appealed the bankruptcy court's decision.

The Court's Decision

On appeal, the Sixth Circuit found that the bankruptcy court "presupposed three contested things: that it has exclusive jurisdiction, that these are ordinary contracts (not de jure regulations via the FPA and the filed-rate doctrine), and that the public interest—which is otherwise paramount in the world of electricity contracts—is irrelevant or insignificant in a bankruptcy reorganization."

The majority opinion began by evaluating the second of these three issues. After acknowledging the filed-rate doctrine, which provides that a contract effectively becomes a de jure federal regulation once it is filed with FERC, the majority concluded that "the public necessity of available and functional bankruptcy relief is generally superior to the necessity of FERC's having complete or exclusive authority to regulate energy contracts and markets." Therefore, for present purposes, the contracts at issue are not de jure regulations but, rather, ordinary contracts susceptible to rejection in bankruptcy without FERC approval.

On the issue of jurisdiction, the appeals court attempted to "harmonize" the apparently conflicting Bankruptcy Code and FPA. The majority found that the bankruptcy court "went much farther than necessary and enjoined FERC from doing *anything at all*." Although the bankruptcy court could enjoin FERC from issuing an order that would directly interfere with FERC's request to reject the contracts, it may not enjoin FERC from conducting other related proceedings. In fact, the majority pointed out, "through this rash and unnecessary overreach, the bankruptcy court has prevented FERC from timely completing an investigation into or holding a hearing about the public interest in the proposed rejection of these contracts, which ... *would* have been appropriate and might have been valuable or beneficial to the ultimate determination."

Finally, the majority held that in deciding whether to approve rejection of a power purchase agreement, the bankruptcy court must consider the impact of the rejection on the public interest, "including the consequential impact on consumers and any tangential contract provisions concerning such things as decommissioning, environmental management, and future pension obligations."

In a dissenting opinion, U.S. Circuit Judge Richard Allen Griffin pointed out that once filed with FERC, a "filed rate" becomes an independent legal obligation separate from a contract for the sale of power. Because FERC alone has the authority to determine whether a filed rate may by modified or abrogated, a debtor seeking to reject a power purchase agreement must seek approval from the bankruptcy court and must *also* petition FERC for relief from its filed-rate obligations. "Chapter 11 provides a shield against an insolvent company's creditors, not its regulators," Judge Griffin concluded.

Takeaways and Anticipated Developments

This decision, which attempts to balance facilitating successful bankruptcy reorganization with protecting the public interest, adds to a growing body of case law addressing the authority to approve rejection of power purchase agreements in bankruptcy. The Sixth Circuit is now the second court of appeals to rule on the issue, in addition to the U.S. Court of Appeals for the Fifth Circuit, which held in *Mirant* that the FPA does not preempt a bankruptcy court's jurisdiction to authorize the rejection of a PPA.[6] A similar case is currently pending before the U.S. Court of Appeals for the Ninth Circuit, which is deciding whether Pacific Gas & Electric needs FERC's approval in order to reject any of its power purchase agreements. The emerging case law appears to indicate that bankruptcy courts have significant jurisdiction over the rejection of power purchase agreements in bankruptcy. However, additional courts will need to rule on the issue before the emergence of a more definitive rule as to whether the full extent of that jurisdiction is exclusive, and even if it is, what the applicable legal standard should be for approving rejection.

For more information about the Sixth Circuit opinion or related matters, please contact any member of the restructuring practice at Wilson Sonsini.

---

[1] *In re FirstEnergy Solutions Corp.*, No. 18-3787 (6th Cir. Dec. 12, 2019).

[2] 11 U. S. C. §365(a).

[3] Wilson Sonsini Client Alert, June 14, 2019: https://www.wsgr.com/en/insights/bankruptcy-court-denies-ferc-jurisdiction-over-power-purchase-agreements-in-pgande-bankruptcy.html.

[4] 16 U.S.C. § 791a, *et seq.*

[5] 16 U.S.C. § 2601, *et seq.*

[6] *In re Mirant*, 78 F.3d 511 (5th Cir. 2004).