



FERC Jurisdiction in Bankruptcy Cases

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For several months, PJM has been working through the stakeholder process on a solution package intended to protect and enhance PJM's rights in the event of a Member bankruptcy, and thus mitigate the risk of potential losses to PJM members and markets, which may result from the delay and uncertainty common to bankruptcy cases. In the course of discussions at the Risk Management Committee about the proposed bankruptcy package, good questions were raised about how the package deals with the sometimes competing jurisdictions of the Federal Energy Regulatory Commission and the bankruptcy courts.

The purpose of this white paper is to provide information on this jurisdictional issue. As discussed below, the proposed bankruptcy package does not assume or require an expansion or limitation of either FERC or bankruptcy court jurisdiction over a member's FERC-regulated contracts. The package instead reflects an accurate assessment of these respective jurisdictions.

A. FERC and Bankruptcy Court Jurisdiction

As part of its charge to ensure compliance with the Federal Power Act (FPA), FERC has authority over the interstate transmission system and sale of electric energy and exclusive jurisdiction over the reasonableness and fairness of electricity rates. The rates regulated by FERC cannot be collaterally attacked in state or federal court. Only FERC or a federal court reviewing an order issued by FERC has exclusive authority to determine challenges to rates.

Federal courts (which include all bankruptcy courts), on the other hand, have exclusive jurisdiction over all matters arising under the Bankruptcy Code. When a bankruptcy debtor seeks to reject a contract that is regulated by FERC, there can be a jurisdictional dispute as to whether the bankruptcy court or FERC can hear and determine the issue. FERC has argued that it has exclusive jurisdiction over matters concerning FERC-regulated contracts, consistent with the filed rate doctrine.

While the case law concerning this FERC/bankruptcy court jurisdictional dispute has been mixed, a consensus appears to be developing in the most recent cases addressing the issue. These cases hold that the bankruptcy courts have exclusive jurisdiction over a debtor's rejection of FERC-regulated contracts, as contract rejection is a core debtor power under the United States Bankruptcy Code. FERC, meanwhile, continues to hold exclusive jurisdiction over the cancellation and terms of a FERC-regulated contract.

1. What Contract "Rejection" in Bankruptcy Means

The Bankruptcy Code authorizes a debtor to assume or reject any executory contract. See 11 U.S.C. § 365. As the Supreme Court has explained:

- Section 365(a) enables the debtor (or its trustee), upon entering bankruptcy, to decide whether the contract is a good deal for the estate going forward. If so, the debtor will want to assume the contract, fulfilling its obligations while benefiting from the counterparty's performance. But if not, the debtor will want to reject the contract, repudiating any further performance of its duties. The bankruptcy court will generally approve that choice, under the deferential "business judgment" rule. *Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 139 S. Ct. 1652, 1658 (2019).

A debtor may, in its business judgment, choose to reject a contract, which then constitutes a breach of the contract that is deemed to occur immediately before the date of the filing of the bankruptcy petition. The counterparty to the

rejected contract will have a claim for damages arising from the breach. The value of rejection to a debtor and its bankruptcy estate is that this claim will be treated as a pre-petition claim, and unless the counterparty holds collateral, the claim will have the same priority as claims of the debtor's other unsecured creditors.

Just as important as what rejection is – a contract breach – is what it is *not*. Rejection of a contract does not rewrite the terms of a contract, and it does not cancel or void a contract (although rejection does often result in the counterparty terminating the contract due to the debtor's breach).

2. Current State of the Law on FERC/Bankruptcy Court Jurisdiction over Rejection

A debtor's decision to reject an executory contract is considered a "core" bankruptcy proceeding, because it invokes a substantive right provided by the Bankruptcy Code and is a matter that can only arise in a bankruptcy case. As a result, there generally is no dispute that the bankruptcy court has exclusive jurisdiction over contract rejection. FERC, however, has asserted jurisdiction over contract rejection in bankruptcy cases, and while FERC has been successful in several cases, the recent trend is that the bankruptcy courts' exclusive jurisdiction over contract rejection has been upheld.

Notable cases include:

- *In re Mirant Corp.*, 378 F.3d 511 (5th Cir. 2004), in which the court found that it is clear that FERC has the exclusive authority to determine wholesale rates. However, the court concluded that those rates were not implicated because rejection is a breach of the contract containing those rates, which allowed the federal court to authorize rejection so long as that rejection does not constitute a challenge to that agreement's filed rate. The court also found that section 365 of the Bankruptcy Code, which governs rejection, does not include any exceptions for FERC despite having exceptions for other individuals or entities, illustrating that Congress did not intend to exclude FERC-regulated contracts from the general power to reject.
- *In re Calpine Corp.*, 337 B.R. 27 (S.D.N.Y. 2006), in which the court disagreed with *Mirant* and found that it lacked jurisdiction to authorize the rejection of power purchase agreements because doing so would directly interfere with FERC's jurisdiction over the rates, terms, conditions and duration of wholesale energy contracts.
- *In re FirstEnergy Sols. Corp.*, 945 F.3d 431, 446 (6th Cir. 2019), in which the court found that a debtor "can reject the contracts subject to proper bankruptcy court approval and FERC cannot independently prevent it" and "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, and accordingly, the bankruptcy court's jurisdiction over rejection was "primary or superior to FERC's position."
- *In re PG&E Corp.*, 603 B.R. 471 (Bankr. N.D. Cal. 2019), in which the court found that nothing in the FPA or the Bankruptcy Code grants FERC concurrent jurisdiction with a bankruptcy court over motions to reject executory contracts covering federal power matters; the rejection of an executory contract is solely within the power of the bankruptcy court; and the Bankruptcy Code is the proper and only authority to apply to a contract rejection and not any aspect of the FPA.

- *In re Extraction Oil & Gas*, 622 B.R. 608, 625–28 (Bankr. D. Del. 2020), in which court found that an order authorizing rejection does not abrogate or modify a filed rate and does not implicate FERC jurisdiction, and finding that heightened scrutiny, including consideration of the public interest, was not appropriate.
- *FERC v. Ultra Resources Inc. (In re Ultra Petroleum Corp.)*, 28 F.4th 629 (5th Cir. 2022), in which the court stated that challenges to bankruptcy court’s jurisdiction over FERC-related contracts fundamentally misunderstand the nature of rejection and held that only the bankruptcy court can decide a debtor’s rejection motions.
- *Gulfport Energy Corp. v. FERC*, 41 F.4th 667, 672 (5th Cir. 2022), in which the court recognized FERC’s power to change or cancel filed-rate contracts, and observed that rejection – which allows a debtor to breach a contract and excuses the debtor from future performance – is something completely different (“Rejection does not change or cancel a contract; it breaches that contract, giving the debtor’s counterparty a damages claim for the value of the debtor’s continued performance. The contract itself does not change; nor does the filed rate. No change is wrought where the counterparty’s claim for damages is ‘calculated using the filed rate’, even if the debtor cannot pay that claim in full.”)

B. The Bankruptcy Solution Package

The proposed bankruptcy solution package works within the limits of FERC and bankruptcy court jurisdiction. The package does not presume FERC’s ability to interfere with bankruptcy court jurisdiction over a debtor’s possible decision to reject a contract. By the same token, even when asserting bankruptcy court jurisdiction over contract rejection, the courts have recognized FERC’s jurisdiction over the terms and cancellation of a FERC-regulated contract. Incorporating PJM’s proposed enhanced bankruptcy protections into a FERC-regulated tariff will support the position that critical FERC regulatory purposes will be served through protection of PJM’s interests in a bankruptcy case, while at the same time maintaining an appropriate level of understanding and acknowledgment of the bankruptcy process and bankruptcy court jurisdiction.