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Natural Gas & Electricity

April 2020

Volume 36
Number 9

THE MONTHLY JOURNAL FOR PRODUCERS, MARKETERS, PIPELINES, DISTRIBUTORS, AND END-USERS

Clash of the Titans: Bankruptcy Court and FERC Collide Over Jurisdiction Yet Again

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"Bankruptcy court" and "the Federal Energy Regulatory Commission" (FERC) are typically not words one hears together in the realm of the natural gas and electricity industry. After all, the energy sector for the most part offers boundless opportunities for profit and avoidance of bankruptcies. Nevertheless, the vast fluctuations and the vagaries of markets, technological change, and economic conditions at times force industry participants to seek refuge in the bankruptcy courts, which presents an immediate problem.

Normally participants in the interstate markets for natural gas and electricity are answerable, first and foremost, to FERC. As far back as 1935 and the New Deal, Congress assigned FERC (and its predecessors) the responsibility to maintain fair and orderly markets in both those vital commodities. Among other things, the agency is tasked with protecting the "public good" when approving rates charged for natural gas and electricity.

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DOI: 10.1002/gas.22XXX

Yet in matters of insolvency, it is the bankruptcy court that is master. Its judicial authority encompasses all aspects of overseeing the reorganization of a troubled company, adjudicating the claims of creditors, and pursuing the laudable goal of returning the entity to financial health.

This brings us to the salient point: When an energy business files for bankruptcy, particularly when it seeks to reorganize its finances pursuant to Chapter 11 of the Bankruptcy Code, who has the last word—the bankruptcy judge or FERC? In previous articles, I have inferred upon the various conflicts between the provisions of the Bankruptcy Code and federal energy law. However, the controversy surrounding this topic is of an entirely different order of magnitude; it goes to the very heart of which adjudicator has jurisdiction and how much authority over the issue it has, and if the other's authority is simply nonexistent.

Most recently, the United States Court of Appeals for the Sixth Circuit confronted precisely such a situation in *FERC v. FirstEnergy Solutions Corp. (In re FirstEnergy Solutions Corp.)*.[1] The appellate court's resolution of this jurisdictional clash of titans is equal parts fair and revealing. Significant was the tribunal's finding that the "filed-rate" doctrine was inapplicable in this Chapter 11, and that the bankruptcy court and FERC must share jurisdiction, which nullified the sweeping injunction issued against the agency by the bankruptcy judge.

Nevertheless, its conclusions of law sowed the seeds for continuing conflict between bankruptcy judges and energy regulators and opened opportunities for markedly different results in the next such controversy. As such, this new case is worthy of attention. But first, it is important to understand the background of legal authority essential to understanding the Sixth Circuit's reasoning, which preserved a role for FERC, yet gave primacy to the authority of the bankruptcy court in such matters.

THE "FILED-RATE" DOCTRINE

The first legal fundamental essential to a better understanding of *FirstEnergy* is a principle of law peculiar to the energy sector. As previously mentioned, a primary regulatory function of FERC is to assure fair and reasonable prices in the interstate markets for wholesale natural gas and electricity. The agency works toward that goal by, among other things, reviewing and approving power supply contracts between private parties. If the regulators determine that the rates set forth in such documents are fair, and serve the public interest, then FERC allows the contracting parties to enter into these agreements.

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The agency's approval of this transaction has a transformative effect. Pursuant to what is informally referred to as the "filed-rate" doctrine, these once-routine contracts become *de jure* regulations; in other words, they take on the force of law. Thereafter, such filed rates become exceedingly difficult to modify or retract. Only through agency action in the form of investigation, hearings, and a conclusion based on a public record that the public interest is not at risk can FERC relieve the contracting parties of their financial burden.[2]

In sum, once an ostensibly private agreement to purchase or supply natural gas or electricity is vetted by FERC, the now not so ordinary contract is akin to a federal regulation and cannot be changed without enduring an arduous process before the regulators.

BANKRUPTCY LAW'S AUTOMATIC STAY, AND ITS POLICE POWER EXCEPTION

The next legal component vital to our consideration of *FirstEnergy* is a maxim of the Bankruptcy Code. Since its inception, the national insolvency law has provided for

[1] 945 F.3d 431 (6th Cir. 2019).

[2] Sabino, A. M., & Sabino, M. A. (2010). Supreme Court defines broad role of *Mobile-Sierra*—Protecting all parties. *Natural Gas & Electricity, 26*(8), 1–3.

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an "automatic stay" against any and all attempts to act against a debtor's property once the bankruptcy is filed. Found at Section 362 of the modern codification, it stops dead in its tracks any and all attempts to continue or commence actions to seize or interfere with property of the insolvent. Creditors are relegated to the bankruptcy court for justice, and any attempt to act outside that forum is subject to severe penalties.[3] Nevertheless, even as stern a measure as Section 362 has its exceptions. The statute particularizes certain actions that can continue to move forward without incurring the wrath of the bankruptcy court.

One exemption highly germane to the matter at hand is the so-called "police or regulatory power" exception.[4] As the title suggests, the subsection carves out an exception for any action by governmental authorities that is in the nature of enforcing the law or exercising a regulatory function. Put another way, even the mighty automatic stay does not prevent the wheels of justice, and regulation, from intervening.

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However, as sometimes happens within the law, even the exception has an exception. It is well-established in the realm of bankruptcy jurisprudence that if the governmental action in question is more attuned to serving a pecuniary interest or leans more toward administering private interests, then it is not a true exercise of the police or regulatory power. Hence, it is not exempt, and the government (or, in the matter at hand, the regulatory agency) remains barred from taking further action. Thus, it must be beyond question that the government is exercising a police or regulatory function, the principal aim of which must be upholding the public good.

[3] 11 U.S.C. § 362.

[4] 11 U.S.C. § 362(b)(4).

BANKRUPTCY CODE SECTION 365—REJECTING, ASSUMING, OR ASSIGNING CONTRACTS

Third and last among our vital legal principles, and the second found in the insolvency law, is Bankruptcy Code Section 365. This proviso gives the debtor significant power to reject, assume, or assign extant contracts (debtors enjoy an identical power with respect to unexpired leases of real property, but that is unnecessary to this discussion).[5]

Distilled to its essence, the statute authorizes a debtor to discard burdensome contracts, retain beneficial accords, and likewise transfer worthwhile arrangements it no longer needs but can profit from, by assigning these to another willing party. In the context of a Chapter 11 reorganization case, such as *FirstEnergy* presents, Section 365 bestows upon the reorganizing debtor significant power to reshape its finances.

To be certain, the debtor does not enjoy unrestrained freedom of action in this regard. The insolvent must still obtain court approval, which can only follow after a notice and hearing, and affording counterparties and other stakeholders an opportunity to object or otherwise be heard with respect to the proposed rejection or assumption. Moreover, a Section 365 motion is subject to judicial review undertaken pursuant to the traditional business judgment rule. Admittedly, this metric affords the debtor a great deal of latitude, as its business discretion should not be overturned by the bankruptcy court unless it is deemed demonstrably irrational.

The admixture of these legal principles proved to be the catalyst for the *FirstEnergy* appeal. And on that note, we may now turn to describe the actions of the bankruptcy judge that FERC appealed to the higher court.

BANKRUPTCY COURT ENJOINS FERC

The proceedings in the lower court were straightforward, and easily explained. Among the various financial difficulties that drove the

[5] 11 U.S.C. § 365.

  / DOI 10.1002/gas

debtor into Chapter 11 were burdensome electricity purchase contracts, at higher than prevailing market prices, rendered uneconomic by changed market conditions. FirstEnergy contended that it could not successfully reorganize unless it was relieved of these obligations pursuant to Section 365.

The counterparties and FERC objected, with the agency asserting authority over the insolvent. The regulators unequivocally contended that the subject agreements were not ordinary contracts, but rather *de jure* regulations. As such, the debtor could not abrogate them without FERC's consent, which could only follow after investigation and hearings.

The bankruptcy judge strenuously disagreed, and, at the debtor's insistence, issued a sweeping injunction, pursuant to Section 362, barring FERC from further interference. Above all else, the lower court declared that it held the entirety of jurisdiction over this matter, while FERC had none.

Thereafter, characterizing these power supply agreements as garden variety contracts (and not filed rates), a standard that examines only the process of making a business decision and never the result, and almost universally defers to the debtor's chosen course of action. All that said, it comes as no surprise that FirstEnergy was authorized to abandon the power supply contracts at issue. Considering the gravity and risk of the precedent being established, a direct appeal to the federal circuit court was permitted.

THE SIXTH CIRCUIT RESTORES FERC'S AUTHORITY

The Sixth Circuit posited the essential legal question before it as twofold: "the nature and extent of jurisdiction as between the bankruptcy court and [FERC]" and determining the proper legal standard for granting or denying a debtor's proposed rejection of a contract typically subject to the agency's oversight. Writing for the panel, Circuit Judge Alice M. Batchelder described the underlying facts with almost a hint of astonishment, first noting that the bankruptcy court deemed it necessary to "seize complete authority and enjoin FERC from any actions whatsoever." In a seeming rebuke, the tribunal observed that the bankruptcy court appeared to entirely disregard the fact that FERC holds a congressional mandate to oversee the energy sector.

The tribunal commenced by cataloging several significant flaws in the lower court's rationale. First, the panel chided the bankruptcy judge for analogizing the case at bar to a Chapter 7 liquidation where the defunct entity is compelled to abandon all its pending contracts. This is a Chapter 11 reorganization, noted the appellate court, where it is implicit that the debtor will need to continue at least some of its contracts as it continues to operate.

Second, the appellate court was dismayed at the insolvency judge's classification of these power supply contracts as ordinary agreements. Well before analyzing these agreements pursuant to the filed-rate doctrine, Circuit Judge Batchelder emphasized that the parties had bargained for more than purchasing wholesale electricity. These contracts encompassed several related obligations, such as defraying the costs of power plant decommissioning, environmental remediation, and retiree benefits, all components over which FERC has at least nominal jurisdiction.

Lastly, the Sixth Circuit took exception to the bankruptcy court minimizing the significance of FERC's legislative mandate to protect the public interest. To be sure, opined Circuit Judge Batchelder, the record indicated that the contracts FirstEnergy was seeking to reject implicated but a *de minimis* component of its purchase commitments, let alone the larger market. Yet, the panel commented, the bankruptcy judge's ruling was untethered from this fact. The Sixth Circuit expressed alarm that the lower court's ruling could become a precedent for universally denying a role for FERC in all future Chapter 11 cases in which the agency had a legitimate role to play.

BANKRUPTCY COURT JURISDICTION NOT EXCLUSIVE, BUT CONCURRENT WITH FERC

Turning to its legal holding, the Sixth Circuit assigned paramountcy to declaring that the bankruptcy court's unlimited enjoining of FERC upended the normal functioning of

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the energy regulation scheme Congress had so carefully crafted some 90 years ago. The Federal Power Act obligates a party seeking to abrogate its wholesale energy contracts to justify its proposal to the regulators that bestowed the stature of *de jure* regulation upon the tariff in the first place. The petitioner is required to assure the agency that counterparties, competitors, overall market capacity, and, most importantly, the public, shall not suffer should the purportedly burdensome agreement be discarded. "This is the approach Congress intended," declared the tribunal, and the circuit judges were openly skeptical of the bankruptcy court's decision to "circumvent all of that" solely for reason of the happenstance of a Chapter 11.

Despite its obvious displeasure at the bankruptcy court aggrandizing its own power at the expense of the regulators, the Sixth Circuit was nevertheless unwilling to restore parity to FERC in this matter. Quite to the contrary, Circuit Judge Batchelder opined that the "public necessity of available and functional bankruptcy relief is generally superior to the necessity of FERC's [sic] having complete or exclusive authority to regulate energy contracts" to which a debtor is a party. For these reasons, the appellate court decreed that the lower court must play a role here "primary or superior" to that of the agency.

Concurrent to that ruling, the Sixth Circuit declined to view the agreements FirstEnergy wished to abrogate as *de jure* FERC regulations. This tribunal, while certainly expositing a detailed discussion of the need and efficacy of the filed-rate doctrine, decided to disallow its application to this controversy. Circuit Judge Batchelder notably opined that, in the context of a Chapter 11, electricity agreements that would otherwise be deemed filed rates reverted to the status of "ordinary contracts susceptible to rejection in bankruptcy."

To be sure, the Sixth Circuit simultaneously rejected any notion that the bankruptcy court's jurisdiction was exclusive when the reorganizing debtor operates in a domain where FERC is the paramount regulator. The tribunal rationalized that the bankruptcy court and the regulators enjoyed concurrent jurisdiction, albeit, as explained above, with the insolvency judge possessing a slight advantage over FERC. Yet, noted Circuit Judge Batchelder, "[t]his rather simple decision" clarifying jurisdiction "does not end this appeal."

FERC WITHIN THE POLICE POWER EXCEPTION—BUT BARELY SO

Having adjudicated *FirstEnergy*'s thorny jurisdictional controversy, the Sixth Circuit moved on to scrutinize the bankruptcy court's unquestionably expansive injunction against FERC action.

Plainly stated, the court decreed that enjoining FERC was an appropriate application of Section 362 and was not contrary to the police or regulatory exception found within that same statute. To guide its reasoning, the tribunal posited the traditional norms of defining the scope of the police power exemption.

On the one hand, noted the Sixth Circuit, government action that protects the sovereign's pecuniary interest or otherwise mainly adjudicates private rights falls outside the ambit of the police power exception, and therefore the automatic stay remains in full force. The subsection only exempts activity that, in truth, represents an endeavor of law enforcement or necessary regulatory action. The linchpin, the tribunal indicated, was to what degree such action protected public, as opposed to private, interests.

Heartening news at last for FERC: The appellate panel first found that notably absent here was a pecuniary interest of the government in this controversy. Next, given that these agreements had devolved into but a tiny fraction of FirstEnergy's business, let alone the broader market, FERC's opposition could not be said to advance private interests. Yet by that same token, the tribunal was unconvinced that the regulators' interest was wholly based upon safeguarding the public good.

This led to a decidedly mixed result. On the one hand, the Sixth Circuit cryptically opined that the bankruptcy judge was "not entirely wrong" in enjoining the agency, since there was a distinct lack of a substantial public interest in need of protection here. However, and now apparently more concerned that the bankruptcy court had greatly exceeded its jurisdictional bounds, the tribunal refused to condone the complete ouster of FERC's customary jurisdiction.

Put another way, the lack of an overwhelmingly obvious public interest in these matters weakened, yet could not completely oust, FERC's right to assert at least some jurisdiction over this debtor. Circuit Judge Batchelder pithily summarized the panel's holding as follows: The court below "went much farther than necessary" when it prohibited the agency from carrying out its traditional regulatory function of speaking for the public good.

Next, the agency had to be allowed to pursue its normal procedures, including, among other things, investigating, holding hearings, and then opining on whether dissolving the debtor's power supply contracts was harmful to the markets and the public at large. Nonetheless, the Sixth Circuit declared the court of bankruptcy was to take primacy in finally deciding whether the debtor was entitled to reject these agreements pursuant to Section 365.

Lastly, the panel ruled that the bankruptcy court erred by reviewing the debtor's rejection motion pursuant to the routine business judgment rule. The Sixth Circuit declared that a heightened business judgment standard is more appropriate in Chapter 11 cases where the debtor seeks to reject a contract ostensibly subject to FERC jurisdiction. Moreover, the tribunal further declared that the bankruptcy judge must allow the regulators to appear and voice their concerns for the public good, and then the insolvency court must balance the same against the debtor's rationale for rejecting the accord.

LOOKING AHEAD—WITH CAUTION

In this brief take on *FirstEnergy*, one can applaud the Sixth Circuit for recognizing the concurrent jurisdiction of the bankruptcy court and FERC in cases where interstate energy firms enter Chapter 11. The panel's well-reasoned decision struck the balance between the necessity of bankruptcy judges remaining unimpaired when adjudicating a debtor's reorganization with the concurrent and equally imperative need for FERC to exercise its regulatory function. The more restrained ruling of the appellate court stands in sharp contradistinction to the bankruptcy judge's preference for a sweeping injunction denying any role whatsoever to the very agency Congress tasked with overseeing the interstate energy industry some nine decades ago.

The panel's well-reasoned decision struck the balance between the necessity of bankruptcy judges remaining unimpaired when adjudicating a debtor's reorganization with the concurrent and equally imperative need for FERC to exercise its regulatory function.

Yet in resolving this most recent question of how and where to cabin the jurisdiction of the bankruptcy court, there remains an air of uncertainty for the next Chapter 11 featuring a FERC-regulated entity. Certainly, the tribunal recognized that the agency's desire to exercise regulatory power here fell within the police power exception of Section 362. However, the Sixth Circuit declined to espouse a bright-line rule for determining when FERC's actions are truly protective of public, not private, interests, an outcome seemingly at odds with Circuit Judge Batchelder's notation that the tribunal's intent was to postulate "a broader rule that will govern or guide future cases with different facts." Only time will tell if this newest axiom shall prove to be workable in future conflicts between FERC and the nation's bankruptcy judges.

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In conclusion, *FirstEnergy* was well-decided, and for the right reasons. Nevertheless, the august tribunal's pronouncements may have opened the door to markedly different and unpredictable results when these two titans clash again, as they inevitably shall.

 DOI 10.1002/gas /