

PG&E BANKRUPTCY COURT REJECTS FERC'S "CONCURRENT" JURISDICTION OVER PPA REJECTION

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In response to the Federal Energy Regulatory Commission ("FERC"), the U.S. Bankruptcy Court for the Northern District of California held that the rejection of wholesale power purchase agreements "is solely within the power of the bankruptcy court, a core matter exclusively this court's responsibility." [1]

The decision arises from the complex chapter 11 proceedings of Pacific Gas and Electric Company ("PG&E"), where the utility is attempting to reorganize its business in the face of billions of dollars of liabilities. FERC had previously asserted concurrent jurisdiction with the bankruptcy court over any decision to reject a "filed-rate" contract and would require PG&E to continue buying power under rejected agreements unless and until FERC determined that cessation was appropriate under the Federal Power Act. [2] Bankruptcy Judge Dennis Montali sharply criticized FERC's decision, noting that he found FERC's ruling "guts and renders meaningless the bankruptcy court's responsibilities in this area of the law." [3]

This is K&L Gates' second alert addressing the rejection of FERC-regulated agreements in bankruptcy. For a comprehensive analysis of the intersection between the Federal Power Act and the Bankruptcy Code, please [click here](#) for our coverage of the FirstEnergy Solutions bankruptcy. Last summer, the United States Bankruptcy Court for the Northern District of Ohio authorized FirstEnergy to reject several filed-rate contracts. That decision is now before the U.S. Court of Appeals for the Sixth Circuit, which heard oral argument on June 26th.

A. BACKGROUND

On January 14, 2019, PG&E announced its intention to file for protection under chapter 11 of the Bankruptcy Code to address multibillion-dollar claims stemming from the deadly California wildfires of 2017 and 2018. Within days, counterparties to several of PG&E's power purchase agreements ("PPAs") initiated proceedings before FERC, seeking a ruling that any rejection of a PPA while PG&E was in bankruptcy would be subject to FERC approval. On January 25 and 28, FERC issued an order stating that its jurisdiction over PPAs was "concurrent" with the bankruptcy court, meaning that PG&E would have to obtain sign-off from FERC (applying the *Mobile-Sierra* Doctrine) before it could amend any PPAs and stop performance. [4] FERC denied PG&E's request to rehear the matter.

In the meantime, PG&E filed for bankruptcy on January 29th in the Northern District of California. Immediately after the chapter 11 filing, PG&E commenced an adversary proceeding in the bankruptcy court against FERC. PG&E sought a declaratory judgment that the bankruptcy court has exclusive jurisdiction to approve a request to reject a PPA under section 365 of the Bankruptcy Code. [5]

B. BANKRUPTCY COURT FINDS IT HAS EXCLUSIVE JURISDICTION OVER THE REJECTION OF PPAS

Section 365(a) of the Bankruptcy Code allows a debtor to reject "any executory contract," subject to bankruptcy court approval. Rejection is treated as a breach of the contract, and the Code gives the counterparty a claim for damages. [6] Judge Montali began his opinion by citing to the Supreme Court's recent decision in *Mission Product Holdings, Inc. v. Tempnology, LLC*, [7] for the proposition that a debtor's ability to assume or reject contracts under section 365 applies broadly, subject to express exceptions. [8] Finding no exception for FERC or the FPA in section 365, he concluded that FERC has no jurisdiction, "concurrent" or otherwise, to consider PG&E's requests to reject its PPAs. [9]

Judge Montali acknowledged FERC's statutory jurisdiction over the terms and conditions of wholesale electricity sales and power contracts, including requested modifications to the filed rates for said contracts. [10] Judge Montali found that once PG&E filed for bankruptcy, however, FERC's jurisdiction over its PPAs presented an immediate conflict with the Bankruptcy Code. According to Judge Montali, rejection under section 365 was "the only issue before this court," and the bankruptcy court alone could decide the issue without reference to the FPA or case law expounding on the "filed rate doctrine." [11] FERC's assertion that a debtor must continue performing under a rejected PPA until FERC has approved cessation "is wrong as a matter of law," Judge Montali concluded. [12]

C. STANDARD FOR APPROVING REJECTION OF A PPA

Having established its exclusive jurisdiction to hear and decide the matter, the bankruptcy court addressed the standard for approving the rejection of a PPA under section 365. Although rejection of an executory contract is a question of the debtor's "business judgment," bankruptcy courts presume that the debtor is acting prudently, on an informed basis, in good faith, and with the honest belief that rejection is in the best interests of the estate. [13] If and when PG&E elects to reject a PPA, the counterparties will be free to contest whether these elements are present.

Judge Montali further suggested that in cases of PPA rejection, a heightened business judgment standard may be appropriate to accommodate the impact that rejection would have on the public interest. The Fifth Circuit took a similar view in the *Mirant* case, which Judge Montali cited in his opinion. [14] He distinguished PPA rejection from "regular rejection," for which the business judgment standard is "more deferential than that given to contracts that are in the 'public interest.'" [15] However, he deferred consideration of public interest issues in PG&E's bankruptcy to the facts of specific motions to reject when they are filed later.

This raises the issue of which "public interest" issues the court will consider when PG&E moves to reject a PPA. Judge Montali previously stated during oral argument in the Adversary Proceeding that it is "fundamental" that PG&E's bankruptcy filing does not give it a right to ignore state law; [16] and his decision favorably cited a portion of the *Tempnology* decision stating that section 365 of the Bankruptcy Code does not exempt bankruptcy debtors "from all of the burdens that generally applicable law ... impose on property owners," citing 28 U.S.C. § 959(b). [17] It remains to be seen how he will apply these concepts in the context of the State of California's own interest in the outcome of the PG&E bankruptcy proceeding, which it has expressed through numerous statements from the Governor's office and ongoing proceedings of the California Public Utilities Commission. In other words, will

Judge Montali show more deference to state regulatory interests than to FERC's federal regulatory interests, or will he consider both as comprising the "public interest" for purposes of rejection under section 365?

The bankruptcy court has certified its decision for direct appeal to the U.S. Court of Appeals for the Ninth Circuit, citing the issues as "very much a matter of public importance" and subject to conflicting prior court decisions in three other federal Circuits. [18] The Ninth Circuit will thus become the next court to address the Bankruptcy Code-FERC conflict. Meanwhile, on June 26th, the Sixth Circuit heard oral argument in FERC's appeal of the United States Bankruptcy Court for the Northern District of Ohio's decision approving the reject of several PPAs in the FirstEnergy Solutions bankruptcy. If either the Sixth or Ninth Circuit reverses the bankruptcy court in their respective cases and sides with FERC, that would create a circuit split with the Fifth Circuit's *In re Mirant* decision, thereby increasing the likelihood that the Supreme Court may weigh in on the issue.

NOTES

[1] See *PG&E Corporation et al. v. Federal Energy Regulatory Comm'n*, Adv. No. 19-03003 (the "Adversary Proceeding"), Memorandum Decision on Action for Declaratory and Injunctive Relief, slip op. at 22 (Bankr. N.D. Cal. June 7, 2019) (the "Bankruptcy Opinion").

[2] *NextEra Energy, Inc. v. Pac. Gas and Elec. Co.*, Order Denying Rehearing, 167 FERC ¶ 61,096 (2019) at Para 21.

[3] Bankruptcy Opinion at pp. 3 and 26.

[4] *Id.* at p. 4.

[5] *Id.* at pp. 4-5.

[6] See 11 U.S.C. § 365(g).

[7] 139 S. Ct. 1652 (2019).

[8] Bankruptcy Opinion at p. 7 (noting that Congress knows how to "craft special rules for special circumstances").

[9] *Id.* at pp. 23-25.

[10] *Id.* at p. 19.

[11] *Id.* at p. 22.

[12] *Id.* at p. 23.

[13] *Id.* at p. 27.

[14] *Id.* at pp. 28-29, citing *In the matter of Mirant Corp.*, 378 F.3d 511, 525 (5th Cir. 2004) ("the courts should carefully scrutinize the impact of rejection upon the public interest and should, inter alia, ensure that rejection does not cause any disruption in the supply of electricity to other public utilities or to consumers").

[15] *Id.* at p. 29.

[16] See audio file of oral argument on April 10, 2019, Docket No. 144 in the Adversary Proceeding.

[17] Bankruptcy Opinion at p. 8.

[18] Memorandum Regarding Certification for Direct Appeal to Court of Appeals, Docket No. 156 (June 12, 2019), in the Adversary Proceeding.

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