

Bankruptcy Court Rejects FERC's Claims of Current Jurisdiction Over PPAs in PG&E Bankruptcy

June 13, 2019

In a strongly worded decision issued on June 7, 2019, the United States Bankruptcy Court for the Northern District of California (the “Bankruptcy Court”) told the Federal Energy Regulatory Commission (“FERC”) to stay in its own lane and declared that the Bankruptcy Court has exclusive jurisdiction over the rejection of power purchase agreements by a debtor in bankruptcy under section 365 of the Bankruptcy Code.^[1] Addressing FERC’s assertion that the Federal Power Act (“FPA”) clothed it with concurrent jurisdiction, the Bankruptcy Court further ruled that three prior decisions of FERC claiming such jurisdiction are of no force and effect and are not binding. The Bankruptcy Court held that with respect to the rejection of federally regulated power related executory contracts “[t]he Bankruptcy Code is the proper and only authority to apply and not any aspect of the FPA.”^[2] The Bankruptcy Court rejected FERC’s attempt to “expand its jurisdiction to those matters not covered by the FPA.”^[3]

The Bankruptcy Court dismissed the Debtors’ counts seeking enforcement of the automatic stay and issuance of an injunction holding that in light of its decision granting declaratory relief, the remaining requests were not necessary.

I. Background

PG&E Corporation and Pacific Gas and Electric Company (jointly, the “Debtors” or “PG&E”) filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”) and their bankruptcy case is pending before the Bankruptcy Court.

a. The Power Purchase Agreements

PG&E is a counterparty as a buyer under at least three hundred eighty-seven (387) executory power purchase agreements or other similar agreements (collectively, the “PPAs”). Most of PG&E’s energy portfolio requires PG&E to purchase energy pursuant to PPAs PG&E has entered into to satisfy renewable energy requirements mandated by the State of California. PG&E alleges that it is reviewing its PPAs and may seek to amend, restructure and terminate contracts where appropriate because there has been a significant decrease in demand for PG&E’s electricity supply and many of PG&E’s power supply contracts are at above-market rates. As of December 2017, PG&E’s PPAs represent contractual commitments aggregating approximately \$42 billion. Due to the economic significance of PG&E’s PPAs and the evolving competitive regulatory factors affecting these agreements, PG&E’s

ability to reject or assume the PPA agreements will play a critical role in its restructuring and post-bankruptcy operations.

b. FERC Orders

In the months preceding PG&E's bankruptcy filing, several counterparties to wholesale PPAs initiated proceedings before FERC to prevent PG&E from abrogating, amending or rejecting any of the rates, terms and conditions of its wholesale PPAs without obtaining FERC approval. On January 25, 2019 and January 28, 2019, FERC issued decisions concluding that FERC and the Bankruptcy Court have concurrent jurisdiction to review and address the disposition of PG&E's wholesale power contracts upon rejection (the "FERC Orders"). The FERC Orders held that FERC approval is necessary for PG&E to reject any of its PPAs because rejection of a PPA in bankruptcy would alter the essential terms and conditions of the contract. Thus, FERC reasoned, rejection of a PPA is within FERC's mandate as an independent agency empowered by Congress to regulate the interstate transmission of electricity and natural gas and ensure that all rates, and charges made, demanded or received by power wholesalers are just and reasonable. PG&E sought rehearing of the FERC Orders, but FERC denied this request in its order dated May 1, 2019 (the "FERC Denial").

c. The Adversary Proceeding

In response to the FERC Orders, PG&E filed an adversary proceeding against FERC asking the Bankruptcy Court to issue an order (i) granting PG&E a declaratory judgment (a) confirming the Bankruptcy Court's exclusive jurisdiction over PG&E's right to reject PPAs, (b) declaring that FERC does not have concurrent jurisdiction, or any jurisdiction, over the determination of whether PG&E's rejection of any of the PPAs should be authorized, and (c) confirming that PG&E does not need to obtain approval from FERC to reject any of the PPAs and (ii) enforcing the bankruptcy automatic stay, or to the extent the automatic stay does not apply, exercising its powers under section 105(a) of title 11 of the United States Code (the "Bankruptcy Code"), to enjoin any entity's attempt to enforce the FERC Orders.

PG&E asserts that the Bankruptcy Court should enforce Section 365(d)(2) of the Bankruptcy Code, which empowers a debtor with the right to assume or reject executory contracts prior to the confirmation of a plan within its reasonable business judgment. PG&E argues that granting FERC concurrent jurisdiction over rejection of its PPAs would impose a higher burden and negatively impact PG&E's ability to facilitate a successful reorganization. Moreover, any attempt by FERC to force PG&E to perform under specific PPAs, could have the effect of converting certain PPA counterparties' prepetition, unsecured rejection damage claims into first priority administrative expense claims, which would threaten PG&E's reorganization to the detriment of its creditors and stakeholders.

II. Analysis of the Bankruptcy Court's Decision

The Bankruptcy Court examined the existing precedent,^[4] but noted that none of those cases involved FERC issuing orders before the bankruptcy cases were filed, as it did with respect to PG&E. This distinction is important because it leads to the Bankruptcy Court's criticism that FERC is attempting to settle a disputed issue of law regarding FERC's jurisdiction and the Bankruptcy Court's jurisdiction "by fiat or decree" of a Federal agency rather

than through judicial analysis and decision.^[5]

The Bankruptcy Court also rejected defendants' assertion that the adversary proceeding was an improper attack on the FERC Orders and the FERC Denial. The Bankruptcy Court held that FERC had acted outside of its statutory authority in issuing those orders and that once the bankruptcy was filed those orders were in direct conflict with the Bankruptcy Code. The Bankruptcy Court held that it is empowered to address this conflict without deference to FERC. The Bankruptcy Court found that nothing in the FPA or the Bankruptcy Code grants FERC concurrent jurisdiction with it over motions to reject contracts involving federal power matters pursuant to Section 365 of the Bankruptcy Code. Moreover, it is exclusively Section 365 of the Bankruptcy Code that is implicated, and not the filed-rate doctrine, the FPA or any decisions of FERC. Accordingly, rejection of an executory contract is a core matter solely within the Bankruptcy Court's exclusive jurisdiction.

The Bankruptcy Court went on to disagree with FERC's analysis of Section 365 of the Bankruptcy Code and to declare its attempt to interpret and apply the Bankruptcy Code in the FERC Denial void. The Bankruptcy Court analyzed recent Supreme Court precedent^[6] and clarified that rejection of an executory contract under Section 365 of the Bankruptcy Code operates as a breach of the contract and entitles the counter party to a claim for damages. It would not, as FERC characterized it, be "a license to cease or modify performance in whatever matter [Debtors] wish[es]."^[7] Nor, would performance under the rejected contract remain subject to FERC's review. The Bankruptcy Court opined that it need not give any deference to FERC because the Bankruptcy Code gives an unmistakable direction regarding rejection of contracts. Moreover, Congress clearly knew how to grant exceptions for special circumstances in Section 365 but did not include any such exception for FERC review or the FPA.^[8] Thus, there is no distinction in Section 365 of the Bankruptcy Code between rejection of PPAs and rejection of "run-of-the-mill contracts." The Bankruptcy Court held that this lack of a statutory exception means that FERC has no jurisdiction over the rejection of contracts in bankruptcy. Thus, because the Bankruptcy Court found that FERC's interpretation of Section 365 was in error, it could declare its orders void.^[9] The Bankruptcy Court went further to hold that because it has exclusive jurisdiction and FERC was acting beyond its statutory authority in entering the orders, FERC's orders are prospectively void because they conflict with a core proceeding delegated solely to the Bankruptcy Court.

The Bankruptcy Court then set out the Bankruptcy Code standard for analysis of rejection of an executory contract, including the potential need to consider the public interest, but appropriately noted that this was a decision for a later date when a motion to reject comes before it. A more detailed analysis of the Bankruptcy Court's discussion of the business judgment standard will be addressed in a separate client alert.

The Bankruptcy Court overruled the defendants' arguments regarding lack of standing, sovereign immunity, non-consent to a final judgment and judicial estoppel.

FERC has until June 21, 2019 to appeal the Bankruptcy Court's decision.

[1] PG&E Corporation and Pacific Gas and Electric Company v. Federal Energy Regulatory Commission, Adv. Pro. No. 19-3003 (N.D.Ca. June 7, 2019), Memorandum Decision on Action for Declaratory and Injunctive Relief [Dkt. No. 153] (the "Bankruptcy Court Decision").

[2] Bankruptcy Court Decision, p. 31.

[3] Bankruptcy Court Decision, p. 25.

[4] Bankruptcy Court Decision, pp. 9-11, citing *In the matter of Mirant Corp.*, 378 F.3d 511 (5th Cir. 2004); *In re Calpine Corp.*, 337 B.R. 27 (S.D.N.Y. 2006); *In re FirstEnergy Solutions Corp.*, v. FERC, 2018 WL 2315916 (Bankr. N.D. Ohio May 18, 2018).

[5] Bankruptcy Court Decision, p. 11.

[6] Bankruptcy Court Decision, pp. 6-8 and 22, citing *Mission Product Holdings, Inc. v. Tempnology, LLC*, 587 U.S.

(2019).

[7] Bankruptcy Court Decision, p. 22.

[8] Bankruptcy Court Decision, p. 25, citing 11 U.S.C. §§365(h), (i), (n) and (o).

[9] Bankruptcy Court Decision, p. 23-25, citing *In re Gruntz*, 202 F.3d 1074, 1082 (9th Cir. 2000).

Please note that this advisory is a general overview and is not intended as formal legal advice. If you have any questions please feel free to contact:

Michelle McMahon at (212) 510 - 2296 or via email at mmcmahon@CullenandDykman.com

Bruce Miller at (516) 296 - 9133 or via email at bmiller@CullenandDykman.com

Practices

- Bankruptcy and Creditors' Rights

Attorneys

- Michelle McMahon
- Bruce V. Miller