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PG&E Highlights Circuit Split On Power Purchase Agreements

By **J. Paul Forrester and Andrew Young** (January 31, 2019, 4:55 PM EST)

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As was the stated intention (and ending months of speculation), Pacific Gas and Electric Corp. and its primary utility subsidiary, Pacific Gas and Electric Co. filed for reorganization under Chapter 11 in the U.S. Bankruptcy Court for the Northern District of California on Jan. 29, 2019.

Listing assets of $71.4 billion and debts of $51.7 billion in the related petitions for relief, this is the largest U.S. utility bankruptcy to date, PG&E's second bankruptcy in as many decades and the sixth-largest U.S. corporate bankruptcy ever (larger than either Enron Corp. or Energy Future Holdings Corp.).

Earlier, in a related Jan. 14, 2019, Form 8-K filing, PG&E stated that this filing is "appropriate, necessary and in the best interests of all stakeholders, including wildfire claimants, PG&E's other creditors and shareholders, and is ultimately the only viable option to restore PG&E's financial stability to fund ongoing operations and provide safe service to customers."

PG&E's recent 8-K filing also provides details of the claims that may result from these fires (which are reported to possibly exceed $30 billion — more than PG&E's current market capitalization — and significantly exceeding available insurance) and the related regulatory proceeding before the California Public Utility Commission, or CPUC, as well as the proceedings before Judge William Alsup, who currently oversees the utility subsidiary's probation following the Jan. 26, 2017, guilty finding on six felony counts for the San Bruno explosion.

In the 8-K filing, PG&E stated that, having considered "all possible solutions that improve safety and service, while providing equitable treatment for wildfire claimants, employees, customers, other creditors and other constituencies," it determined that "the Chapter 11 reorganization cases will allow it to work with these many constituencies in one court-supervised forum to comprehensively address its potential liabilities and to implement necessary changes."

PG&E noted that "the decision to seek relief under Chapter 11 will raise concerns among its constituencies, including customers, vendors, suppliers and employees, and may lead to a contraction in trade credit and the departure of key employees." PG&E stated that it has taken steps to mitigate the impact of these potential developments — although without specifically identifying those steps.

Implications for Power Purchase Agreements

Stakeholders with significant concerns include the counterparties to a substantial number and value (estimated by PG&E to be about $43 billion as of Dec. 31, 2017) of mandated renewable energy power purchase agreements, or PPAs, that PG&E has solicited and signed under specific statutory and CPUC requirements. Debtors have often sought to reject PPAs in bankruptcy to the extent that the PPAs require the purchase of electricity at rates higher than prevailing market rates.

In addition to the customary day-one motions (and potentially signaling the importance of this issue), PG&E filed an adversary proceeding in the bankruptcy case seeking a declaratory judgment confirming the bankruptcy court's exclusive jurisdiction over PG&E's rights to reject any of its PPAs under Bankruptcy Code Section 365 and a further declaration that the Federal Energy Regulatory Commission does not have "concurrent" or any other jurisdiction over the determination of whether PG&E's rejection of any PPAs should be authorized and that PG&E does not need the approval from FERC to reject any PPA. The adversary proceeding also seeks a temporary and permanent injunction against any related action by FERC.

FERC Position

This adversary proceeding follows FERC's related Jan. 25, 2019, order,[1] issued following a petition by NextEra Energy Inc., in which FERC "clarified" its related position. While acknowledging that the law in this area is "unsettled," FERC held that that it has concurrent jurisdiction with the bankruptcy court to review and address the disposition of wholesale power contracts sought to be rejected through bankruptcy. FERC ruled that, to give effect to both its jurisdiction under the Federal Power Act, or FPA, and the bankruptcy court's jurisdiction under the Bankruptcy Code, a party to a FERC-jurisdictional wholesale power purchase agreement must obtain approval from both FERC and the bankruptcy court to reject the contract.

In its order, FERC noted that In the Matter of Mirant Corp.[2] the U.S. Court of Appeals for the Fifth Circuit found that the FPA does not preempt the Bankruptcy Code because the rejection of a wholesale power purchase agreement would only have an indirect on the "filed rate" approved by FERC. In contrast, In re Calpine Corp.,[3] the U.S. District Court for the Southern District of New York found that it lacked subject matter jurisdiction to authorize the rejection of the energy contracts at issue and concluded that FERC has exclusive jurisdiction over their disposition. The same jurisdictional issues are currently before the U.S. Court of Appeals for the Sixth Circuit on appeal from the U.S. District Court for the Northern District of Ohio's decision in FirstEnergy Solution Corp. v. FERC,[4] which included a preliminary injunction enjoining FERC from requiring FirstEnergy Solutions Corp. to continue performing under certain wholesale power contracts that FirstEnergy sought to reject through bankruptcy.

In finding that it has concurrent jurisdiction with the bankruptcy court, FERC noted the broad scope of FERC's statutory jurisdiction under the FPA over rates, terms and conditions of wholesale electricity sales. Contrary to the Fifth Circuit's holding in Mirant, FERC found that a rejection of a FERC-jurisdictional contract by a bankruptcy court would alter the essential terms and conditions of the contract, and, thus, FERC's approval was required. FERC also indicated that it was not reviewing the specific contracts at issue between NextEra and PG&E, but rather explaining FERC's concurrent jurisdiction with respect to wholesale power agreements generally.

Other Issues

Bankruptcy law allows for a debtor's rejection of executory contracts[5] subject to court approval. Typically, courts will defer to the debtor's decision to reject an executory contract as long as the debtor has exercised sound business judgment, which may take into account, among other things, the debtor's increased ability to reorganize as a result of the contract rejection and disaffirmance of continuing performance obligations. The Supreme Court has held that "the authority to reject an executory contract is vital to the basic purpose [of] a Chapter 11 reorganization."[6]

However, rejection of PPAs raises other issues because the FPA grants FERC exclusive jurisdiction over the prices, terms and conditions for the transmission or sale at wholesale of electric energy, including PPAs. The Supreme Court, in a series of cases, established what is now known as the "Mobile-Sierra doctrine," which prohibits FERC from setting aside rates previously agreed to by the parties and filed with FERC unless the rate "seriously harm[s] the public interest."[7]

Furthermore, under the "filed rate" doctrine, federal courts have regularly found that once filed with FERC a wholesale power contract becomes the equivalent of a federal regulation, and the duty to perform under those contracts not only comes from the agreement itself but also from FERC.[8]

Open Questions

While rejecting PPAs that are no longer necessary or economic may be beneficial to PG&E and the bankruptcy estate, this rejection raises at least two critical legal issues. First, does the bankruptcy court have jurisdiction to order rejection of these contracts, or is FERC's approval required to abrogate? Second, what standard of review should be used in deciding whether the utility must continue to perform under these contracts? These questions have at least tangentially been addressed in the Second,[9] Fifth[10] and Sixth[11] circuits and, in the Sixth Circuit, are the subject of a pending appeal and, of course, have been raised to the forefront by PG&E's adversary proceeding. Given the unsettled nature of the law in this area and the potential importance of this issue to PG&E's reorganization, interested parties should monitor these proceedings closely.

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[1] NextEra Energy Inc. and NextEra Energy Partners LP v. Pacific Gas and Electric Co., 166 FERC ¶ 61,049 (2019).

[2] In the Matter of Mirant Corp., 378 F.3d 511 (5th Cir. 2004).

[3] In re Calpine Corp., 337 B.R. 27 (S.D.N.Y. 2006).

[4] FirstEnergy Solution Corp. v. FERC, 2018 WL 2315916 (Bankr. N.D. Ohio May 18, 2018).

[5] 11 U.S.C. Sec. 365. Although the Bankruptcy Code does not define what makes a contract "executory," the weight of precedent defines such contracts as ones where each party has material

unperformed obligations, such that the failure of either to complete its performance would constitute a material breach excusing the performance of the other.

[6] N.L.R.B v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984).

[7] United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956) and Federal Power Commission v. Sierra Pacific Power Co., 350 U.S. 348 (1956). In negotiating a PPA, the parties can decide whether to apply the higher "public interest" standard or the more common "just and reasonable" standard of review. In negotiating a PPA, contracting parties can elect to include the higher "public interest" standard of review by adding a Mobile-Sierra clause instead of the normal "just and reasonable" standard of review under the FPA.

[8] See In re Calpine Corporation; California ex rel. Lockyer v. Dynegy Inc., 375 F.3d 831, (9th Cir. 2004); Pennsylvania Water & Power Comm'n, 343 U.S. 414 (1952).

[9] See In re Calpine Corporation, 337 B.R. 27 (S.D.N.Y. 2006).

[10] See In re Mirant Corporation, 378 F.3d 511 (5th Cir. 2004).

[11] See FirstEnergy Solutions Corp. v. Federal Energy Regulatory Commission, No. 18-05021, 2018 WL 2315916 (Bankr. N.D. Ohio May 18, 2018).