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"A Clash of Two Congressionally Constructed Titans": Fifth Circuit Declares Bankruptcy Court Victorious Over FERC in In re Ultra Petroleum Corporation

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On March 14, 2022, the United States Court of Appeals for the Fifth Circuit (the "Fifth Circuit") revisited the issue of the rejection of filed-rate contracts in bankruptcy where such contracts are governed by the Federal Energy Regulatory Commission ("FERC"). The ruling marks the first time the Fifth Circuit has addressed this issue since its 2004 decision in *In re Mirant Corp*.[1] In *Federal Energy Regulatory Commission v. Ultra Resources, Incorporated (In re: Ultra Petroleum Corporation)*, the Fifth Circuit panel affirmed findings issued by the United States Bankruptcy Court for the Southern District of Texas (the "Bankruptcy Court") that, "under the particular circumstances presented [therein]," (i) FERC cannot require debtor Ultra Resources, Inc. ("Ultra") to continue performance of a rejected filed-rate contract and (ii) FERC's approval was not required pursuant to section 1129(a)(6) of the Bankruptcy Code prior to the Bankruptcy Court confirming Ultra's Chapter 11 plan of reorganization.

The dispute in *FERC v. Ultra Resources* centered around a filed-rate contract between Ultra and Rockies Express Pipeline LLC ("REX") pursuant to which Ultra was required to pay REX a total of $169 million from December 2019 until December 2026 for reserved capacity on a REX pipeline, whether or not Ultra utilized the capacity. Due to the vast decline in commodity prices for oil and gas, Ultra had suspended its drilling program in September 2019 and, as a result, Ultra never used any of its reserved space on the REX pipeline. In anticipation of Ultra's bankruptcy filing, REX petitioned FERC for a declaration that Ultra could not reject the filed-rate contract without FERC's approval, but Ultra filed for bankruptcy and moved to reject the contract before FERC could issue a decision.

On the first day of the *Ultra* bankruptcy, Ultra sought to reject the filed-rate contract. Relying on *Mirant*, the Bankruptcy Court determined that it had authority to approve rejection of the contract. The Bankruptcy Court also ruled that rejection of the contract was not tantamount to a rate change that would conflict with FERC's undivided authority over such rate changes under the Natural Gas Act. Finally, the Bankruptcy Court found that rejection of the contract was not a rate change that would require FERC approval under section 1129(a)(6) of the Bankruptcy Code before confirmation of a Chapter 11 plan.

On appeal, the Fifth Circuit characterized the dispute as a "clash of two congressionally constructed titans" – FERC and the bankruptcy courts. However, the panel noted, "today's battlefield lies in the shadow of our precedent in [*Mirant*]" and, in light of the holding in *Mirant*, "what FERC casts as a pitched battle is actually a settled truce."

In reaching its decision in *Ultra*, the Fifth Circuit spent significant time clarifying the holding in *Mirant* in order to "avoid the risk that [the] statements in *Mirant* are read as mere recommendations, rather than commands." Rejecting FERC's arguments challenging the language in *Mirant*, the Court found that *Mirant* stood for the following propositions:

- The power of the bankruptcy court to authorize rejection of a filed-rate contract does not conflict with FERC's authority to regulate rates, because rejection is not a rate change;

- As long as rejection is based on reasons beyond the fact that the debtor would prefer a lower rate, rejection is not a collateral attack on the contract's filed rate (and FERC's jurisdiction thereover) because the rate is given full effect when determining damages resulting from the rejection; and

- In ruling on rejection motions, bankruptcy courts must consider whether rejection harms the public interest or disrupts the supply of energy and weigh those effects against the burden on the bankruptcy estate. *See Mirant*, 378 F.3d at 518-525.

Based on this interpretation of *Mirant*, the Court determined that the result of FERC's appeal was "straightforward" as "each element [of *Mirant*] is satisfied here." In particular, the Court focused on the fact that Ultra "is not just seeking to secure a lower rate, but instead wants out of the contract altogether, given the suspension of its drilling program and its nonuse of the volume reservation."

The Fifth Circuit rejected FERC's argument that *Mirant* required a bankruptcy court to wait until FERC issues an opinion on the public-interest ramifications of rejecting a filed-rate contract through full proceedings before FERC, instead determining that *Mirant* merely requires bankruptcy courts to invite FERC to participate in the bankruptcy proceedings as a party-in-interest to assist the court in its consideration of the impact of rejection upon the public interest. The Fifth Circuit explicitly declined to expand *Mirant* to require a bankruptcy court to wait for FERC to issue a decision, citing the need for speedy proceedings in Chapter 11.

Finally, reiterating its earlier determination that rejection did not constitute a rate change subject to FERC approval, the Court rejected FERC's argument that the Chapter 11 plan in *Ultra* violated section 1129(a)(6) of the Bankruptcy Code, which requires any rate change in Chapter 11 plans to be either (i) expressly approved by government regulatory commissions with jurisdiction over rates, or (ii) conditioned on such approval.

While the Fifth Circuit's decision appears at first blush to further cement its decision from nearly 20 years prior and prioritize the power of rejection over FERC's authority, the facts in *Ultra* differ in several important respects from other recent cases involving rejection of filed-rate contracts. Importantly, Ultra had suspended its drilling program and had never shipped on the REX pipeline. Accordingly, Ultra would not follow the rejection of the contract with any attempt to renegotiate a filed-rate contract at a more favorable rate. This is in stark contrast to the facts in *Gulfport Energy*, in which the debtor seeking to reject the filed-rate contract had used its reserved capacity and had no intention of shuttering this integral part of its business.[2] In further contrast, one contract counterparty in *Gulfport* obtained a FERC ruling prepetition that determined that the public interest did not require the modification or abrogation of the contract rate.[3]

While the parties in *Gulfport* settled prior to litigating the rejection issue, the Fifth Circuit's opinion in *Ultra* can be read as providing some leeway for a different outcome under circumstances similar to those in *Gulfport*. Specifically, in addressing whether the rejection in *Ultra* was a collateral attack on the filed rate, the Fifth Circuit noted that, on account of its suspension of its drilling program, "Ultra [was] not just seeking to secure a lower rate, but instead [wanted] out of the contract altogether, given the suspension of its drilling program and its nonuse of the volume reservation." Accordingly, it is possible that the Fifth Circuit might reach a different conclusion where the debtor intends to try to re-engage the pipeline immediately after rejection at more favorable pricing.

Finally, the Fifth Circuit's opinion in *Ultra* could set the stage for a disagreement among circuit courts over the extent of FERC's involvement in the rejection process. In *Mirant*, the Fifth Circuit counseled the bankruptcy court to consider the public-interest ramifications of the rejection of a filed-rate contract. Likewise, in *Ultra*, the Court recognizes the "expertise that FERC has to offer and the importance that expertise is considered" during rejection proceedings, and continues on to instruct that "a bankruptcy court must invite FERC to participate in bankruptcy proceedings as a party in interest."

Courts in other circuits have been more deferential to FERC's determination of what serves the public interest. Specifically, in *Calpine Corp.*, 337 B.R. 27 (S.D.N.Y. 2006), Judge Richard Casey in the Southern District of New York opined that if a court must consider the public interest when determining the fate of FERC-regulated contracts, then "the executive agency FERC should determine that interest." Judge Casey's formulation could leave FERC as the arbiter of whether rejection serves the public interest, while the Fifth Circuit's recent Ultra opinion finds that a bankruptcy court merely needs to "extend the invitation" to FERC to participate as a party-in-interest.

In light of the Fifth Circuit's *Ultra* decision, contract parties anticipating the bankruptcy of their counterparties should consider engaging FERC in an effort to receive a favorable decision prior to the commencement of the bankruptcy. While the Fifth Circuit has made clear that it invites FERC to take part in the bankruptcy as a party-in-interest, a favorable ruling from FERC prepetition, while likely not producing any *res judicata* effect, may play a part in establishing early that the public interest will not be served by rejection. Bracewell attorneys have been actively involved in litigating matters arising in the context of overlapping FERC and bankruptcy court jurisdiction. Bracewell represented REX in the subsequent *Gulfport* bankruptcy and received a positive FERC order before Gulfport filed for bankruptcy. This was beneficial to REX as the bankruptcy proceeding advanced. Bracewell attorneys have also litigated similar issues arising under the Federal Power Act for various clients in the bankruptcies of *NRG Energy*, *Calpine Corp*., and *PG&E Corporation*.

Given the diversity of opinions on this issue, FERC may appeal the *Ultra* decision to the United States Supreme Court. Bracewell will continue to monitor for updates related to the *Ultra* decision.

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1. *In re Mirant Corp.*, 378 F.3d 511 (5th Cir. 2004) (“*Mirant*”).

2. *In re Gulfport Energy Corp.*, Case No. 20-35562 (DRJ) (Bankr. S.D. Tex. 2020) (“*Gulfport*”).

3. Order on Paper Hearing Rockies Express Pipeline LLC, 173 FERC ¶ 61,099 (2020).

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