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Fifth Circuit Rules Just Energy Bankruptcy Court Erred in Exercising Jurisdiction to Redetermine ERCOT Pricing During Winter Storm Uri

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In a January 5, 2023 opinion from the United States Court of Appeals for the Fifth Circuit, the panel held the *Just Energy* bankruptcy court erred in exercising jurisdiction over the debtor's suit to recover Winter Storm Uri payments made to ERCOT. The Fifth Circuit found the underlying issue—*i.e.*, the propriety of ERCOT and PUCT's pricing—to be precisely the type of controversy that should be decided in the manner carefully prescribed by the Texas legislature, and not be second-guessed by the bankruptcy court. Therefore, the Fifth Circuit held that the Travis County, Texas district court is the appropriate forum to consider the merits of the debtor's clawback claims. Following the opinion, federal courts must carefully consider whether to abstain from deciding controversies that would unduly interfere with the complex utility regulatory scheme established by the Texas legislature.

Some background on Texas' utility regulatory scheme is necessary to understand the Fifth Circuit's opinion. Texas' Public Utility Regulatory Act (PURA) was created to establish a "comprehensive and adequate regulatory system for electric utilities to assure rates, operations, and services that are just and reasonable to the consumers and to the electric utilities."[1] To that end, PURA created the Public Utility Commission of Texas (PUCT) as the agency charged with overseeing and implementing PURA and as the entity with ultimate authority over Texas' electric grid.[2] As required by statute, PUCT has certified Electric Reliability Council of Texas, Inc. (ERCOT) as the independent organization to manage the wholesale electricity market, including determining market-clearing prices.[3]

This framework was put to the test during Winter Storm Uri, which resulted in unprecedented sub-freezing temperatures, power outages and energy shortages from February 13, 2021 through February 20, 2021. During the storm, ERCOT was forced to order load sheds—*i.e.*, consumption cuts via forced power outages—to reduce the strain on the power grid. PUCT further issued orders directing ERCOT to ensure that load shed was accounted for in ERCOT's scarcity pricing signals, leading ERCOT to price energy at the maximum of $9,000 per megawatt hour for over eighty consecutive hours.

As a result of the surge in energy pricing, Just Energy, a Canada-based retail energy provider, incurred ERCOT invoices of approximately $335 million. After commencing bankruptcy proceedings in Canada and filing for Chapter 15 in the Southern District of Texas, Just Energy

paid ERCOT the full $335 million under protest and filed an adversary complaint, disputing $274 million of the invoiced amounts on the grounds that (a) "among things, the Invoices are based on the PUCT Orders, which themselves are unlawful under the [Administrative Procedure Act] and the [Public Utility Regulatory Act], and otherwise are inconsistent with the ERCOT Protocols and the [Standard Form Market Participant Agreement]" and (b) "even if the PUCT Orders are valid, [it] still has valid claims because ERCOT had no basis to apply the $9,000/MWh price after 11:55 p.m. on February 17, 2021." The bankruptcy court dismissed all counts of Just Energy's complaint except for three preference arguments under Canadian law and a turnover argument under section 542 of the Bankruptcy Code, additionally holding that certain selective deletions from the complaint regarding energy pricing resolved any abstention issues.

On appeal, the Fifth Circuit disagreed that any abstention issues had been resolved or mooted and instead considered whether abstention was appropriate under a *Burford* analysis,[4] which provides federal courts with discretion to abstain from deciding unclear questions of state law arising in complex state administrative schemes when federal court intervention would undermine uniform treatment of local issues. The Fifth Circuit further disagreed with Just Energy's argument that section 1334(c)(1) of the Bankruptcy Code—which provides that, except with respect to a chapter 15 case, nothing in section 1334 of the Bankruptcy Code prevents a district court in the interest of justice from abstaining from hearing a proceeding arising under the Bankruptcy Code—"subsumed" any abstention consideration under *Burford*.

In determining whether to abstain under the *Burford* analysis, the Fifth Circuit considered: (1) whether Just Energy raised state or federal claims, (2) whether the case involved unsettled state law or detailed local facts, (3) the importance of the state's interest in the litigation, (4) the state's need for a coherent policy in the area, and (5) whether there is a special state forum for judicial review.

While Just Energy's complaint raised issues of Canadian and federal law, the Fifth Circuit panel found the remaining four *Burford* factors overwhelmingly supported abstention, specifically:

- With respect to the second factor, the merits of the case significantly implicate its review of PUCT and ERCOT's decisions in an area in which those agencies were arguably experts, putting federal courts in the position of second guessing ERCOT's decision making and authority during the emergency circumstances of Winter Storm Uri.

- With respect to the third factor, Texas' interest in utility regulation and litigation is clear from the face of PURA and cited Texas Supreme Court case law consistently evidencing Texas' interest in utility regulation and litigation and its protection of the electricity-related public interest.

- With respect to the fourth factor, a complex regulatory scheme already existed and was precisely the type of scheme *Burford* aims to protect from federal interference.

- With respect to the fifth factor, the Fifth Circuit noted that "behind the guise of Just Energy's bankruptcy action is its challenge to ERCOT's pricing decision and invoices," which is the type of challenge that must be filed with ERCOT, with a right of appeal to the PUCT, and then to Travis County district court.

Accordingly, where "the scoreboard is this lopsided in favor of abstention," the Fifth Circuit vacated the bankruptcy court's order and remanded with appropriate instructions to determine the appropriate trajectory of the case after abstention. While the ice from Winter Storm Uri has long since thawed, the Fifth Circuit's deference to Texas' regulatory scheme serves as a reminder to future litigants looking to challenge ERCOT in federal court. Indeed, the decision reaffirms Texas' regulatory authority and came just prior to arguments in front of the Texas Supreme Court over whether ERCOT should enjoy the same sovereign immunity that shields government agencies from civil suits. While the Texas Supreme Court has not yet determined whether ERCOT is "too big to fail," other federal courts may follow the Fifth Circuit's example and abstain from deciding issues that might otherwise complicate the already complex regulatory framework designed to keep power flowing across Texas.

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1. Tex. Util. Code § 31.001(a).

2. *Id.* § 39.151(d).

3. *Id.* § 39.151(b); 16 Tex. Admin. Code § 25.501(a).

4. *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943); the Fifth Circuit further disagreed with