Issues in Midstream Restructurings

PART II: FERC AND THE BANKRUPTCY PROCESS

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January 7, 2021

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Issues in Midstream Restructurings: Series Overview

Part I: Covenants Running with the Land

Topics discussed:

- Overview of covenants running with the land
- Summary and analysis of recent decisions
- Paths for getting relieved from covenants running with the land
- Analysis of key factors in predicting the outcome

Part II: FERC and the Bankruptcy Process

Topics to be discussed:

- Jurisdiction over rejection of a FERC-filed contract
- Legal standard applicable to rejection
- Procedural considerations
- Options for addressing FERC-related concerns

Part III: The 1-2-3s of MLPs (Jan. 21, 2021 (Thur.), at 11:00 a.m. ET)

Topics to be discussed:

- Fundamentals of MLP structure
- Benefits of MLP structure
- MLP structure in the oil and gas industry
- Bankruptcy considerations for an MLP

Background: The Filed Rate Doctrine

- Under the Federal Power Act, Natural Gas Act and Interstate Commerce Act, certain contracts involving the sale of power and the transportation of oil and gas must be filed with FERC, which then determines whether the rates specified in those contracts are "just and reasonable"
- In a non-bankruptcy context, once a contract is filed with and approved by FERC, it has plenary and exclusive jurisdiction over the rates, terms and conditions of service under such a contract (the so-called "**filed rate doctrine**")

> "[T]he right to a reasonable rate is the right to the rate which [FERC] files or fixes, and . . . , ***except for review of [FERC]'s orders, the courts can assume no right to a different one*** on the ground that, in its opinion, it is the only or the more reasonable one."
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> *Montana-Dakota Utilities Co. v. Nw. Pub. Serv. Co., 341 U.S. 246, 251-52 (1951)*

Background: Rejection and the Filed Rate Doctrine

- Historically, FERC has opposed motions to reject FERC-filed contracts pursuant to section 365 of the Bankruptcy Code, claiming that the "filed rate doctrine" equally applies to the rejection context and divests the bankruptcy court *entirely* of subject matter jurisdiction over such a motion
- More recently, FERC has pressed the argument that it has "concurrent jurisdiction" with the bankruptcy court over power purchase agreements and pipeline agreements. In essence, FERC maintains that where a party to a filed rate contract seeks to reject the agreement in bankruptcy, it requires approval from **both the Commission and the bankruptcy court**
- FERC's position is articulated clearly in its recent decisions, as follows:

  "Where a party to a Commission-jurisdictional agreement under the NGA seeks to reject the agreement in bankruptcy, that party must obtain approval from both the Commission and the bankruptcy court to modify the filed rate and reject the contract, respectively . . . .

  [T]he Bankruptcy Code does not displace the Commission's jurisdiction over filed rate contracts under the NGA. As filed rates, such contracts are not typical commercial contracts but rather establish public obligations that carry the force of law. As the Supreme Court explained with specific regard to Commission-jurisdictional contracts, filed rate obligations exist independently of private contractual duties and continue to bind the counterparties, regardless of one party's breach of contract, or even a determination that a contract may not be enforced at all."

  ETC Tiger Pipeline, LLC, 171 FERC ¶ 61,248 (2020)

Background: Rejection and the Filed Rate Doctrine (cont.)

- FERC's position regarding exclusive jurisdiction prevailed in the 2006 *Calpine* decision, in which the SDNY district court held that authorizing rejection would constitute an impermissible "collateral attack" on the filed rate
  - The court held that "it lacks jurisdiction to authorize the rejection of the Power Agreements because doing so would directly interfere with FERC's jurisdiction over the rates, terms, conditions, and duration of wholesale energy contracts"
  - It reasoned that "just as regulatory action was required to transform the terms and conditions of the Power Agreements from mere contracts into regulated duties, so also is regulatory action from FERC required to eliminate those duties"
- However, similar arguments were rejected by the Fifth Circuit's 2004 *Mirant* decision and the Sixth Circuit's 2019 *FirstEnergy* decision
  - *Mirant* and *FirstEnergy* did not accept FERC's contention that filed rate contracts have the status of a federal regulation for all purposes
  - Instead, they reasoned that, while the Bankruptcy Code has certain exceptions to and limitations on the rejection power (e.g., for collective bargaining agreements), no such limitations exist for filed rate agreements. Rather, upon rejection, the filed rate would be honored in the calculation of rejection damages
- It is possible to distinguish *Calpine*, on the one hand, from *Mirant and FirstEnergy*. In *Calpine*, the debtors were transparently rejecting agreements due to their pricing and other terms, which lent credence to the view that rejection was a collateral attack on the rate. By contrast, in *Mirant* and *FirstEnergy*, the debtors were careful to make clear that they had no need for the purchased power, regardless of rate. This distinction is specifically addressed in the *Calpine* and *FirstEnergy* opinions

Rejection of FERC-Filed Contracts: A Heightened Standard?

- As a general matter, a deferential standard of "business judgment" applies to a debtor's motion to reject an executory contract under section 365 of the Bankruptcy Code
- However, in an effort to "harmonize" the Federal Power Act and the Bankruptcy Code, *Mirant* and *FirstEnergy* held that a heightened standard applies to the rejection of FERC-filed contracts
  - A bankruptcy court should permit a rejection of a FERC-filed contract "only if the debtor can show that **[the contract] burdens the estate**, [and] that **after careful scrutiny, the equities balance in favor of rejecting**" (*Mirant*)
  - In conducting this inquiry, a bankruptcy court should consider the rejection's impact on the ***public interest***, "including the consequential impact on consumers and any tangential contract provisions concerning such things as decommissioning, environmental management, and future pension obligations" (*FirstEnergy*)
- However, the heightened standards are still vastly more favorable to the debtors than having to seek a modification from FERC
- *FirstEnergy* and *Mirant* were decided in the context of the Federal Power Act, which governs power supply contracts, and there is no circuit level authority on the standard for rejecting in the context of the Natural Gas Act or Interstate Commerce Act
  - In *Ultra Petroleum* (S.D. Tex. 2020), the court extended the *Mirant* decision to a natural gas transportation agreement
  - However, in *Extraction* (D. Del. 2020), the court suggested that the heightened standard **does not** apply to the rejection of an oil transportation service agreement, the rates of which were approved by FERC. The *Extraction* court stated that *Ultra Petroleum* was distinguishable on two grounds: (1) FERC has a more limited jurisdiction over oil pipelines than over gas and power contracts, and (2) the Interstate Commerce Act, which governs the oil pipelines, contemplates different "public interest" considerations than the Natural Gas Act, which governs the gas pipelines

Defensive Strategies: A Race to the Courthouse

- Recently, pipeline companies have anticipated their E&P counterparties' chapter 11 proceedings by commencing administrative proceedings before FERC seeking a declaratory judgment from the agency that rejection requires FERC approval
  - ***Gulfport*:** Rockies Express Pipeline, Midship Pipeline, TC Energy Pipelines and Rover Pipeline obtained (a) a ruling from FERC that it has concurrent jurisdiction over rejection; and (b) as to Rockies Express Pipeline, Midship Pipeline and Rover Pipeline, a determination that public interest does not require abrogation or modification of the Gulfport TSAs
  - ***Chesapeake*:** In advance of Chesapeake's chapter 11 filing, FERC issued an opinion in favor of ETC Tiger, holding that FERC had concurrent jurisdiction over the rejection of TSA. FERC's ruling with respect to ETC Tiger is on appeal to the Fifth Circuit
  - ***Ultra Petroleum*:** Rockies Express filed a FERC petition seeking a declaratory judgment, but the proceeding was stayed by the bankruptcy filing before FERC issued a ruling
  - ***PG&E*:** California law mandated that PG&E provide a 15-day notice period before filing for bankruptcy. When the notice was filed, certain power purchase agreement counterparties sought and obtained a declaratory judgment from FERC that it has concurrent jurisdiction over the rejection of FERC-filed wholesale power contracts

Defensive Strategies: A Race to the Courthouse (cont.)

- Certain E&P debtors have responded to the midstream entities' preemptive moves by seeking relief from the Bankruptcy Court:

  - ***Ultra Petroleum*:** Shortly after the filing of a chapter 11 petition, the debtor commenced an adversary proceeding against FERC, seeking, among other things, an injunction enjoining FERC from issuing any order that would interfere with the rejection
    - Shortly thereafter, the debtors filed a motion for a temporary restraining order. During the oral argument on that motion, Rockies Express agreed to withdraw or revise its FERC petition to reflect that the bankruptcy court has primary jurisdiction over the rejection issue, and on that basis, the bankruptcy court denied the motion for TRO as unnecessary
    - Eventually, the debtors voluntarily dismissed the adversary proceeding against FERC

  - ***Gulfport*:** FERC issued orders prepetition, proclaiming that it has concurrent jurisdiction with the bankruptcy court over the rejection of FERC-filed TSAs. The debtor commenced an adversary proceeding seeking, among other things, an injunction enjoining FERC from issuing or enforcing any order that would interfere with the rejection
    - Like in *Ultra Petroleum*, the debtors filed a motion for a temporary restraining order. However, the bankruptcy court denied the motion as "premature and unnecessary"
    - In the end, the debtors voluntarily dismissed the adversary proceeding against FERC

Defensive Strategies: A Race to the Courthouse (cont.)

- ***PG&E*:** The debtors commenced an adversary proceeding against FERC on the first day of bankruptcy seeking, among other things, a declaration of the bankruptcy court's exclusive jurisdiction over the rejection
  - The bankruptcy court granted the requested declaration, but the jurisdiction issue was eventually mooted by the confirmation of a reorganization plan, under which the debtors would assume the power purchase agreements at issue

- ***Chesapeake*:** FERC issued an order prepetition, finding that, where a party to a contract filed with FERC under the Natural Gas Act seeks to reject it in bankruptcy, that party must obtain approval from both FERC and the bankruptcy court. The debtors commenced on the first day of bankruptcy an adversary proceeding against FERC, seeking, among other things, an injunction enjoining FERC from issuing or enforcing any order that would interfere with the rejection
  - To resolve the adversary proceeding, FERC stipulated that it would not issue any order requiring the debtors to obtain FERC's approval in rejecting the FERC-filed midstream TSAs and would not rule on any FERC petitions filed by the midstream entities prepetition without obtaining from the bankruptcy court a relief from the automatic stay
  - Subsequent to the stipulation, the debtors filed with FERC a request for rehearing of FERC's order finding concurrent jurisdiction, but FERC denied the request
  - The debtors then filed with the bankruptcy court an emergency motion for, among other things, an order that would direct FERC to withdraw its order denying the rehearing request, arguing that FERC's issuance of that order constituted a violation of the stipulation
  - After a hearing, the bankruptcy court denied the debtors' emergency motion without prejudice
  - The debtors subsequently filed with the Fifth Circuit a petition for review of FERC's concurrent jurisdiction order

Defensive Strategies: A Race to the Courthouse (cont.)

- The automatic stay is a significant factor in how rejection of filed rate agreements is adjudicated because it may preclude FERC from issuing orders or pipeline companies from commencing or continuing litigation before FERC
- In addition, bankruptcy courts are often willing to enjoin FERC proceedings, relying on their section 105(a) authority
- As a result, counterparties that do not seek relief from FERC prepetition will be hard-pressed to seek such relief afterward
  - *In Extraction*, Grand Mesa (a midstream entity) moved the bankruptcy court to declare that filing a FERC petition for a public interest determination on the rejection of TSAs at issue would not violate the automatic stay or, in the alternative, relieve it from the automatic stay to file such a petition
  - The court denied this motion. Grand Mesa appealed but eventually settled with the debtors
- However, the applicability of the automatic stay to an anticipated action by FERC is less straightforward, given that the exercise of police and regulatory power is excepted from the automatic stay
  - In *FirstEnergy*, the Sixth Circuit rejected the bankruptcy court's sweeping determination that any action FERC might take would be subject to the stay because FERC was merely adjudicating private rights rather than pursuing public policy. However, the court did state that, in the particular case at hand, FERC might be subject to the automatic stay because the FERC-filed contract at issue only involved a small portion of electricity supply within the applicable region
- Both *Mirant* and *FirstEnergy* made clear that any injunction to be issued under section 105(a) has to be appropriately tailored

Procedural Considerations: Withdrawal of Reference

- Title 28, section 157(d) of the United States Code provides:

  "The district court may withdraw, in whole or in part, any case or proceeding referred [to the bankruptcy court], on its motion or on timely motion of any party, for cause shown. The district court shall, on timely motion of a party, so withdraw a proceeding if the court determines that resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce"

- Counterparties to power purchase agreements and gas transportation agreements have sought withdrawal of the reference in rejection disputes, perceiving the bankruptcy court to be an unfavorable forum

- The courts have interpreted section 157(d) as providing two bases for withdrawal: (1) permissive withdrawal "for cause shown," and (2) mandatory withdrawal when a consideration of federal law other than title 11 is required
  - Whether to grant a motion for permissive withdrawal of reference is within a district court's discretion
  - Application of mandatory withdrawal requires the *interpretation, as opposed to mere application*, of a non-bankruptcy federal law

- Recent decisions suggest that the FERC-filed status of a contract is **insufficient** as a basis to withdraw the reference of a motion to reject it from the bankruptcy court
  - The bankruptcy courts have reasoned that only section 365 of the Bankruptcy Code and no other federal law is relevant to the resolution of a motion to reject a FERC-filed contract (*see, e.g.*, *PG&E*, *Chesapeake*)
  - In *PG&E*, the district court agreed with the bankruptcy court that the resolution of whether the bankruptcy court may unilaterally allow a debtor to reject a FERC-filed contract does **not** require any substantial consideration of non-bankruptcy federal law, implicitly suggesting that the Federal Power Act is irrelevant to the rejection

Procedural Considerations: Withdrawal of Reference (cont.)

- However, older decisions in the Southern District of New York have concluded the opposite, holding that the FERC-filed status of a contract does warrant a mandatory withdrawal of the rejection motion to the district court
- In *In re Calpine* (S.D.N.Y. 2006), the district court concluded that the district court (as well as the bankruptcy court) lacked jurisdiction to authorize the rejection of a FERC-filed contract because it would "directly interfere with FERC's jurisdiction over the rates, terms, conditions, and duration of wholesale energy contracts" and thus the rejection would amount to a "collateral attack on the filed rate itself"
  - The court distinguished *Mirant* on the grounds that (1) *Mirant* heavily relied on Fifth Circuit cases that have no Second Circuit corollaries and (2) the debtor in *Mirant* provided a rationale that is unrelated to the rate for rejecting a FERC-filed contract
- In *In re Boston Generating, LLC* (S.D.N.Y. 2010), the district court concluded that the debtor utility company's motion to reject a FERC-filed gas TSA had to be withdrawn mandatorily, concluding that, "[i]n order to decide the Rejection Motion, a court will have to decide whether Congress has, through the Bankruptcy Code, given the district court power to authorize the Debtors to reject the [TSA], or if instead, doing so would run afoul of FERC's exclusive jurisdiction over filed rate contracts under the [Natural Gas Act]"

Procedural Considerations: Direct Appeal to Court of Appeals

- Generally, a final order of the bankruptcy court may be appealed to the district court or, in certain circuits, to the bankruptcy appellate panel. A decision on that appeal may be further appealed to a court of appeals
- However, 28 U.S.C. § 158(d) provides a mechanism for a party to appeal a bankruptcy court's decision directly to a court of appeals
  - Section 158(d)(2)(A) provides that the appropriate court of appeals shall have jurisdiction of appeals to a final decision by the bankruptcy court if the bankruptcy court, the district court, or the bankruptcy appellate panel involved, acting on its own motion or at the request of a party to the decision, or all the appellants and appellees (if any) acting jointly, certify that:
    i. the decision "involves a question of law as to which there is no controlling decision of the court of appeals for the circuit or of the Supreme Court of the United States, or involves a matter of public importance,"
    ii. the decision "involves a question of law requiring resolution of conflicting decisions," or
    iii. "an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken"

    and if the court of appeals **authorizes** the direct appeal of the decision

Procedural Considerations: Direct Appeal to Court of Appeals (cont.)

- In *Extraction*, Grand Mesa (a midstream entity) and FERC filed a joint motion asking the district court to certify for direct appeal to the Third Circuit the bankruptcy court's (1) order approving the debtors' rejection of Grand Mesa TSAs and (2) order denying the stay of rejection pending appeal
  - Grand Mesa and FERC argued that their appeals satisfy each of section 158(d)(2)(A)'s three subsections
- Most recently, in *Ultra Petroleum*, the district court granted the debtors' motion for certification of the bankruptcy court's approval of rejection for direct appeal to the Fifth Circuit
  - The district court concluded that the rejection dispute at issue is a matter of public importance, as required under 28 U.S.C. § 158(d)(2)(A)(i), because the issue presented "may indeed transcend the dispute between Ultra and [the midstream entity] currently before [it]"
  - In reaching this conclusion, the district court noted that the Fifth Circuit granted the joint petition for direct appeal with respect to FERC's appeal to the bankruptcy court's confirmation of reorganization plan

FERC-Filed Contracts Post-Rejection

- FERC has viewed plan confirmation as yet another opportunity to assert its jurisdiction over filed rate contracts. In its chapter 11 confirmation objections, it has argued that the plan runs afoul of section 1129(a)(6) of the Bankruptcy Code, which requires that "[a]ny governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval"
- FERC has also objected to the broad scope of injunctions in the plan, and to provisions that provide for the bankruptcy court's retention of exclusive jurisdiction over a broad range of issues related to the chapter 11 plan
- In these objections, FERC appears to be laying the groundwork to seek to continue to enforce the filed rate, potentially on the basis of the Supreme Court's decision in *Mission Product Holdings, Inc. v. Tempnology,* which provides that rejection does not excuse a debtor from "all the burdens that generally applicable law . . . imposes"
- According to FERC, "*Mission Product* supports the principle that a debtor does not extinguish its filed rate obligations . . . by rejecting a contract in bankruptcy." ETC Tiger Pipeline, LLC, 171 FERC ¶ 61,248 (2020)

FERC-Filed Contracts Post-Rejection (cont.)

- By contrast, debtors take the position that once the bankruptcy court approves rejection of a FERC-filed contract, they are relieved from continuously performing under the contract, and the counterparty would be left with a damages claim against a debtor
- This position finds substantial support in *Mirant*, where the Fifth Circuit announced that "a bankruptcy court can clearly grant injunctive relief to prohibit FERC from negating [a debtor's] rejection by requiring continued performance at the pre-rejection filed rate"
  - As the court held in *Mirant*, paying rejection damages in "bankruptcy dollars" would not violate the filed rate doctrine because the damages are *calculated* based on the filed rate
  - In *FirstEnergy*, the Sixth Circuit relied on *Mirant* without expressing any disagreement as to the bankruptcy court's authority to issue such an injunction
- FERC's confirmation objections were overruled in *Ultra Petroleum, FirstEnergy* and *Extraction,* and a similar objection is currently pending in *Chesapeake*
  - In *Extraction,* the bankruptcy court overruled FERC's objection on 1129(a)(6) (which concerns rate changes) on the grounds that (1) as it previously held, neither the rejection nor the plan effected any change in rate going forward and (2) 1129(a)(6) applies only to rates charged by a debtor, not rates paid by a debtor
  - The bankruptcy court also overruled FERC's objection based on the potential conflict of the discharge injunction in the plan with future FERC proceedings as being "vague and conjectural in nature"
- FERC's appeals of the *Ultra Petroleum* and *Extraction* confirmation orders are currently pending

Current Legal Landscape: Pending Disputes

The following FERC rejection disputes are currently pending in front of the bankruptcy court and on appeal:

- *Chesapeake*
  - Chesapeake's appeal of the FERC ruling on concurrent jurisdiction is currently pending before the Fifth Circuit
  - Debtors' motion for rejection is currently pending and is the subject of a motion to withdraw the reference
  - FERC's confirmation objection is currently pending
- *Ultra Petroleum*
  - Rockies Pipeline and FERC have appealed the bankruptcy court's rejection decision
    - Pending appeal, Rockies Pipeline has settled with the debtors as to the amount of Rockies Pipeline's allowed claim without any prejudice to any party in the appeal
    - Both of the appeals by Rockies Pipeline and FERC are currently pending before the Fifth Circuit
    - In addition, FERC's appeal of the confirmation order is pending before the Fifth Circuit
- *Extraction*
  - FERC appealed the bankruptcy court's confirmation order to the district court, although such appeal may become moot due to settlements between Extraction and the midstream counterparties

Issues in Midstream Restructurings

PANELIST BIOS

Part II: FERC and the Bankruptcy Process

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Davis Polk | Energy and Natural Resources Restructurings
Davis Polk has held leading roles in some of the largest energy and natural resource-related restructurings in recent years, including Chesapeake Energy Corporation, California Resources Corporation, PG&E, Sable Permian Resources, Cloud Peak Energy, Hornbeck Offshore Services, Ultra Petroleum, Key Energy Services, Chaparral Energy, Philadelphia Energy, EdgeMarc Energy, FirstEnergy Solutions, San Juan Offshore, Cloud Peak Energy, Murray Energy, Southcross, Odebrecht Engenharia e Construção S.A., Arena Energy, Fieldwood and FTS International.