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Fifth Circuit doubles down on right to reject filed-rate contracts, but with an exception

The Fifth Circuit recently issued an opinion, *Federal Energy Regulatory Commission v. Ultra Resources, Inc.*, in which it relied on and affirmed its prior 2004 decision — *In re Mirant* — and held that bankruptcy courts have the authority — at least in many common contexts — to reject filed-rate contracts without the approval of the Federal Energy Regulatory Commission (FERC), and a bankruptcy plan that rejects such contracts is not in violation of 11 U.S.C. § 1129(a)(6) because rejection does not effectuate a modification of the filed-rate. This opinion further empowers debtors to reject filed-rate contracts in bankruptcy cases, *so long as rejection does not amount to a rate change*.

However, the Fifth Circuit also pronounced that where the purpose of rejection is to avoid paying an above market rate pursuant to a contract in circumstances where the capacity provided by the contract is actually needed, such rejection *would constitute a prohibited collateral attack on a filed-rate*.[1] The Fifth Circuit suggested, in reference to the Mirant decision, that where the purpose for rejection is both to avoid a high contract rate and to shed unneeded capacity, such rejection could be permissible.[2] What may remain to be determined in the future is where the line that separates permissible capacity reduction from impermissible rate reduction will fall.

Ultra Resources, Inc. (Ultra), an energy company whose primary business was oil and gas production, filed for bankruptcy protection in the Bankruptcy Court for the Southern District of Texas in 2020. Before its bankruptcy, Ultra had contracted with Rockies Express Pipeline LLC (REX) to reserve space on REX's pipeline for transportation of its natural gas. Such contracts are subject to regulation by FERC, and FERC must approve the rate charged including the rate charged for the use of capacity on the pipeline. Once approved by FERC, the rate becomes a "filed-rate" that, in effect, is akin to a federal statute that cannot be modified absent approval by FERC. During its bankruptcy, Ultra sought permission from the bankruptcy court to reject the filed-rate contract, to which REX objected. REX requested the bankruptcy court refrain from rejecting the contract until FERC could hear the issue and decide whether rejection of the contract was in the public's interest. REX argued that since the contract was a filed-rate contract, FERC had the exclusive authority to decide whether Ultra could reject its contract with REX, as only FERC has jurisdiction to approve modifications to filed-rate contracts.

The bankruptcy court held an evidentiary hearing on the issue and ruled that it had the authority to approve rejection of the contract under the precedent previously established by the Fifth Circuit in *In re Mirant Corp.*, 378 F.3d 511 (5th Cir. 2004). The bankruptcy court considered the contract under heightened scrutiny and weighed the effect of the rejection against the public's interest, and held that rejection was appropriate because it would not harm the public's supply of natural gas and would significantly benefit Ultra's bankruptcy estate (and by extension Ultra's creditors). Additionally, rejection "neither modified nor abrogated the contract," and therefore it did not amount to a rate change requiring approval under 11 U.S.C. § 1129. The Fifth Circuit considered these issues on appeal and affirmed the bankruptcy court's decision.

First, the Court here established that *In re Mirant* was binding precedent. In *In re Mirant*, the Fifth Circuit

[1] *FERC v. Ultra Resources Inc.* at 15.
[2] *Id.* at 7.

held that "the power of the [bankruptcy court] to authorize rejection of a [filed-rate contract] does not conflict with the authority given to FERC to regulate rates," and rejection "is not a collateral attack upon [the] contract's filed rate because that rate is given full effect when determining the breach of contract damages resulting from rejection." Additionally, *Mirant* requires the bankruptcy court to consider the harm to the public interest caused by rejection and weigh these effects against the contract's burden on the bankruptcy estate.[3]

The Court also specified that it agreed with the determination in *Mirant* that rejection – in certain circumstances – only has an indirect effect on the filed-rate, and therefore is not a collateral attack on the filed-rate. However, FERC would have had the authority to enforce continued performance of the filed-rate contract if Ultra's rejection of REX's contract was an attempt to change the filed rate itself. The court determined that was not the case in *Ultra*, as the filed-rate was used to set the damage amount that REX was entitled to after rejection. Further, Ultra did not seek rejection in an effort to change the filed-rate, but was instead looking to terminate the contract and cease continued use of the pipeline capacity. According to the Court, this type of rejection was valid under *Mirant* and did not undermine FERC's exclusive authority to set rates.

Further, the Court noted that the bankruptcy court properly considered the rejection under the heightened standard required by *Mirant*, which requires the court consider the effect of rejection on the public interest. Through this approach, the bankruptcy court determined that Ultra's rejection of REX's contract would not cause disruption to the supply of natural gas or harm the public, so its rejection decision was proper.

The Court also dismissed FERC's argument that *Mirant* requires that FERC must be permitted to conduct a hearing on the issue of rejection before the bankruptcy court can make a decision on rejection. While the court conceded that FERC is a party in interest to the rejection decision, and it must be allowed to participate in the bankruptcy court proceedings on the issue, it did not believe FERC was entitled to hold its own hearing. The Court noted that in Chapter 11 proceedings, time is of the essence, and halting proceedings to allow FERC to hold a hearing would be an unnecessary and costly delay.

Finally, the Court held that the plan of reorganization did not violate 11 U.S.C. § 1129(a)(6), which prohibits a plan from making a rate change without the express approval of the governmental regulatory commission that has jurisdiction over the rate change. According to the Court, rejection is not a rate change because the filed rate itself is separate from full payment of that rate. Since the bankruptcy court did not change the actual rate and used it to calculate the damages claim that would result from rejection of the contract, the confirmation of the plan did not violate 11 U.S.C. § 1129(a)(6).

Through this decision, the Fifth Circuit reiterated its position that the bankruptcy court has the power to determine rejection of filed-rate contracts, as long as rejection does not modify or abrogate the actual filed-rate. The *Ultra* decision leaves unanswered what facts and circumstances may give rise to a determination that rejection is a modification or abrogation of the filed-rate. For example, if a debtor could be shown to need continued use of pipeline capacity — which Ultra did not need — rejection may simply be the debtor's attempt to shed itself of the burdensome filed-rate and renegotiate for capacity post-rejection at a lower rate. In such a scenario, rejection may well be impermissible absent FERC assent.

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[3] *Mirant*, 378 F.3d at 518, 522, 525.

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