

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

California Electricity Oversight Board,

Docket No. EL06-30-000

People of the State of California, ex rel.
Bill Lockyer, Attorney General of the
State of California, and

California Department of Water Resources

v.

Calpine Energy Services, L.P.,
Calpine Corporation. Power Contract Financing,
and Gilroy Energy Center, L.L.C.

ORDER PROVIDING INTERIM GUIDANCE

(Issued January 3, 2006)

1. On December 19, 2005, the California Electricity Oversight Board, the California Attorney General, and the California Department of Water Resources (California State Parties) filed a Petition for Emergency Declaratory Order Requiring Continuing Performance of Jurisdictional Power Purchase Agreement and Complaint Requesting Fast Track Processing (Petition). The Petition seeks a Commission order requiring Calpine Energy Services, LP, and Calpine Corporation (Calpine) to continue to supply power, and otherwise perform, under a Master Power Purchase and Sale Agreement (Calpine 2 Contract). As explained in more detail below, because of a recently issued Ex Parte Temporary Restraining Order (TRO) against the Commission, we cannot grant the relief requested. However, in the event the Commission participates in the bankruptcy proceedings, we hereby provide interim guidance to the parties regarding the standard to be applied in this case, and require certain additional filings.

Background

2. The California State Parties state in their Petition that they expect Calpine to file for reorganization under Chapter 11 of the United States Bankruptcy Code and, when it does, to request that the Bankruptcy Court reject the Calpine 2 Contract. The California State Parties state that, if the Commission does not act to require performance of the Calpine 2 Contract, the Bankruptcy Court may enjoin the Commission from so acting. The Petition states that a similar result occurred when Mirant Corporation filed for bankruptcy and the Bankruptcy Court enjoined the Commission from taking certain actions with respect to Mirant.

3. The California State Parties argue that the Commission should grant the relief requested because "rejection of the Calpine 2 Contract would: (1) force California consumers to bear significantly higher costs; (2) undermine the parties' 2002 global settlement entered in order to resolve the State's claims arising in its 2000-01 energy crises; (3) jeopardize the State's efforts to put in place protections to ensure that the health, safety and welfare of California ratepayers are not adversely affected by a similar crisis in the future; and (4) threaten the stability of California electricity markets and potentially undermine the reliability of the California electricity grid, particularly during summer 2006." Petition at 6. The California State Parties state that an order granting this relief would be consistent with the Commission's action in *Blumenthal v. NRG Power Marketing, Inc.*, 103 FERC ¶ 61,188 (2003), *reh'g denied*, 104 FERC ¶ 61,211 (2003) (orders requiring performance), and *Blumenthal v. NRG Power Marketing, Inc.*, 104 FERC ¶ 61,210 (2003) (order upholding contract) (*NRG*).

4. On December 21, 2005, Calpine filed for bankruptcy in the United States Bankruptcy Court in the Southern District of New York. The Bankruptcy Court immediately issued an *Ex Parte* Temporary Restraining Order Against Federal Energy Regulatory Commission (TRO) that prohibits the Commission from taking any action "to require or coerce the Debtors to continue performing under the executory contracts identified in Schedule 1." One of the contracts identified in Schedule 1 of the TRO is the Calpine 2 Contract.

Authority to Act

5. Although the Bankruptcy Code provides that the filing of a bankruptcy petition automatically stays certain actions against the debtor,¹ the Code also provides an exception from this automatic stay for:

¹ 11 U.S.C. § 362(a)(1).

An action or proceeding by a governmental unit . . . to enforce such governmental unit's or organization's police and regulatory powers, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power.[²]

6. As noted earlier, the TRO entered on December 21, 2005 by the Bankruptcy Court in the Southern District of New York precludes the Commission from granting the relief requested. However the TRO does not preclude the Commission from issuing this Interim Guidance Order. Accordingly, this order provides guidance to the parties regarding the standards that will be applied in this case. It does not "require or coerce" Calpine to continue performing its executory contracts.

Discussion

7. In *NRG*, the Commission addressed "an issue of first impression: whether a bankruptcy court's approval of a public utility seller's request to reject a contract between it and a buyer precludes the Commission from making an independent determination, pursuant to the Federal Power Act (FPA), as to whether that seller must continue [to] fulfill its contractual obligations to provide service to the buyer."³ In answering that question, "[t]he Commission found that, even if a public utility files for bankruptcy, the utility still must meet its obligations under the FPA."⁴ The Commission then proceeded to address in a paper hearing whether *NRG* could meet the *Mobile Sierra* standard applicable to a request to terminate the contract under section 205 of the FPA. The Commission held that *NRG* could not do so and therefore ordered it to perform under the contract.⁵

8. Subsequently to our decision in *NRG*, the United States Court of Appeals for the Fifth Circuit decided *Mirant Corp. v. Potomac Electric Power Co. (In re Mirant)*.⁶ In *Mirant*, the 5th Circuit addressed the same fundamental issue decided in *NRG*, namely

² 11 U.S.C. § 362(b)(4).

³ 104 FERC ¶ 61,210 at P1.

⁴ *Id.*

⁵ *NRG*, 104 FERC ¶ 61,210.

⁶ 378 F.3d 511 (5th Cir. 2004) (*Mirant*).

whether a Bankruptcy Court has the authority to reject a Commission-jurisdictional contract without the seller first obtaining approval from the Commission to terminate that contract under section 205. The court held, in pertinent part, as follows:

It is clear that FERC has the exclusive authority to determine wholesale rates, *see Mississippi Power & Light, 487 U.S. at 371*, and Mirant does not contest that it would need FERC approval to either modify the rates in the Back-to-Back Agreement or to completely abrogate that agreement. *Cf. 11 U.S.C. § 362(b)(4)* (creating exception from automatic stay for agencies acting to enforce their regulatory power). Under the Bankruptcy Code, however, Mirant's *rejection* of the Back-to-Back Agreement is a *breach* of that contract. *See 11 U.S.C. § 365(g)* ("The rejection of an executory contract . . . constitutes a breach of such contract. . . ."); *see also In re Continental Airlines, 981 F.2d 1450, 1459 (5th Cir. 1993)* ("[section] 365(g)(1) speaks only in terms of 'breach.' The statute does not invalidate the contract, or treat the contract as if it did not exist."). Thus, whether the FPA preempts a district court's jurisdiction over a bankruptcy rejection necessarily depends upon whether the FPA generally preempts a district court's jurisdiction over claims of breach related to executory power contracts.

Outside of the bankruptcy context, the FPA does not provide FERC with exclusive jurisdiction over the breach of a FERC approved contract. While the FPA does preempt breach of contract claims that challenge a filed rate, district courts are permitted to grant relief in situations where the breach of contract claim is based upon another rationale.

* * *

We conclude that the FPA does not preempt Mirant's rejection of the Back-to-Back Agreement because it would only have an indirect effect upon the filed rate. When an executory contract is rejected in bankruptcy, the non-breaching party receives an unsecured claim against the bankruptcy estate for an amount equal to its damages from the breach. *See 11 U.S.C. §§ 365(g)(1), 502(g)*. If Mirant's rejection of the Back-to-Back Agreement was approved, then PEPCO's unsecured claim against the bankruptcy estate would be based upon the amount of electricity it would have otherwise sold to Mirant under that agreement *at the filed rate*.

* * *

The FPA does not preempt a district court's jurisdiction to authorize the rejection of an executory contract subject to FERC regulation as part of a bankruptcy proceeding. A motion to reject an executory power contract is not a collateral attack upon that contract's filed rate because that rate is given full effect when determining the breach of contract damages resulting from the rejection. Further, there is nothing within the Bankruptcy Code itself that limits a public utility's ability to choose to reject an executory contract subject to FERC regulation as part of its reorganization process.

378 F.3d at 519-522 (emphasis in original).

9. Moreover, as the *Mirant* court recognized, the Commission has a number of regulatory responsibilities under the Federal Power Act that continue while a bankruptcy case is pending, that do not necessarily impact a debtor's ability to reject a contract.⁷

10. The 5th Circuit also provided guidance on the standard to be applied in determining whether rejection of an FPA-jurisdictional contract by a bankruptcy court is appropriate. The court noted that the standard ordinarily applicable is the "business judgment rule," but it found that the Supreme Court had given greater protection to certain contracts affected with the public interest, such as collective bargaining agreements. *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984). The 5th Circuit therefore held that a higher standard may be appropriate for FPA-jurisdictional contracts, reasoning as follows:

The nature of a contract for the interstate sale of electricity at wholesale is also unique. Additionally, Congress found when it passed the

⁷ See also *Louisiana Pub. Serv. Comm'n v. Mabey (In re Cajun Elec. Power Coop., Inc.)*, 185 F.3d 446, 453 (5th Cir. 1999) (noting that Bankruptcy Code "'indirectly suggests continued governmental regulatory jurisdiction' during the pendency of the bankruptcy proceeding") (citation omitted), cited in *Mirant*, 378 F.3d at 523; *FCC v. Nextwave Personal Communications Inc.*, 537 U.S. 293, 307 n.5 (2003) (on review of FCC's regulatory decisionmaking, in case involving both Bankruptcy Code and Communications Act, Court noted that Second Circuit had, on appeal from bankruptcy court, denied subject matter jurisdiction to decide whether FCC's regulatory decision was proper exercise of its discretion, and that D.C. Circuit, on petition for review of FCC decision, had "recognized and seemingly approved that distinction [between regulatory and bankruptcy matters]").

FPA that the public has an interest in the transmission and sale of electricity. *16 U.S.C. § 824(a)*. This includes an interest in the continuity of electrical service to the customers of public utilities. *16 U.S.C. § 824a(g)*. . . . Clearly the business judgment standard normally applicable to rejection motions is more deferential than the public interest standard applicable in FERC proceedings to alter the terms of a contract within its jurisdiction. Use of the business judgment standard would be inappropriate in this case because it would not account for the public interest inherent in the transmission and sale of electricity.

Therefore, upon remand, the district court should consider applying a more rigorous standard to the rejection of the Back-to-Back Agreement. If the district court decides that a more rigorous standard is required, then it might adopt a standard by which it would authorize rejection of an executory power contract only if the debtor can show that it "burdens the estate, [] that, after careful scrutiny, the equities balance in favor of rejecting" that power contract, and that rejection of the contract would further the Chapter 11 goal of permitting the successful rehabilitation of debtors. *See Bildisco, 465 U.S. at 526-27*. When considering these issues, the courts should carefully scrutinize the impact of rejection upon the public interest and should, *inter alia*, ensure that rejection does not cause any disruption in the supply of electricity to other public utilities or to consumers. *Cf. Id. at 527* (requiring the bankruptcy court to balance the interests of the debtor, the creditors and the employees when determining what constitutes a successful rehabilitation). The bankruptcy court has already indicated that it would include FERC as a party in interest for all purposes in this case under *11 U.S.C. § 1109(b)* and *Fed. R. Bankr. P. 2018*. We presume that the district court would also welcome FERC's participation, if this case is not referred back to the bankruptcy court. Therefore, FERC will be able to assist the court in balancing these equities.

378 F.3d at 525 (footnote omitted).⁸

⁸ On remand, the district court denied the rejection motion on other grounds, and responded to the 5th Circuit by articulating a heightened standard for rejection, under which the court would have to determine whether rejection would compromise the public interest (with input from the Commission, after affording it "an opportunity to engage in appropriate inquiry to enable it to evaluate the effect ... on the public interest"). *In re Mirant Corp.*, 318 B.R. 100, 108 (N.D. Tex. 2004). An appeal from that order is pending (continued)

11. Although the Commission reached a different result in *NRG*, a federal court of appeals has now spoken to the issue addressed in *NRG* and we intend to follow that authority. Under that authority, the Commission is precluded from taking action under the FPA that impacts a debtor's ability to reject an executory contract. A Bankruptcy Court cannot reject a FERC-jurisdictional contract under the business judgment rule "because it would not account for the public interest inherent in the transmission and sale of electricity." *Id.* Rather, such a court must "carefully scrutinize the impact of rejection upon the public interest and . . . ensure that rejection does not cause any disruption in the supply of electricity to other public utilities or to consumers." *Id.*

12. The Commission seeks comment on whether rejection of the Calpine 2 Contract would impact the public interest,⁹ including whether rejection of the Calpine 2 Contract would cause "any disruption in the supply of electricity to other public utilities or to consumers." *Id.*¹⁰ By seeking comment on this issue, the Commission does not intend to supplant the role of the Bankruptcy Court in considering whether to reject the Calpine 2 Contract. Rather, the purpose of our inquiry is to develop a record on which the

before the 5th Circuit. *See Official Comm. of Unsecured Creditors v. Potomac Elec. Power Co., et al. (In re Mirant Corp.)*, Case No. 05-10033 (5th Cir).

⁹ To the extent any party believes it should seek leave of the Bankruptcy Court to submit further pleadings in this case, it should do so.

¹⁰ In Calpine's Memorandum of Law in Support of Debtors' Motion for Declaratory Judgment, *Ex Parte* Temporary Restraining Order, and Preliminary Injunction Against the Federal Energy Regulatory Commission, at p. 5, Calpine asserts:

If the Court permits the rejection of the energy contracts, there will be no disruption in the supply of power. For its part, Calpine will continue to produce all the energy that it may profitably do so, and CDWR and the other counter-parties to the contracts could readily obtain power from the national grid or from Calpine, albeit at the market rates.

See also Complaint for Declaratory Judgment, *Ex Parte* Temporary Restraining Order, and Preliminary and Permanent Injunction Against the Federal Energy Regulatory Commission, at P 15 ("If the Court permits the rejection of the energy contracts, there will be no disruption in the supply of power. Calpine will continue to supply electricity to CDWR and the other counter-parties to the contracts, albeit at the market rates.").

Commission can, as necessary, make a determination, and then inform the Bankruptcy Court, of its views regarding potential rejection of the Calpine 2 Contract by the Bankruptcy Court. In the *Mirant* case, the 5th Circuit “presume[d] that the district court would . . . welcome FERC’s participation” and that “FERC will be able to assist the court in balancing the equities.”¹¹ In order to provide such assistance, we need to develop an appropriate record to render a decision.

13. In addressing the effect of rejection on the public interest, the parties should not confine their arguments to the factors normally considered in a *Mobile-Sierra* context. As the court in *Mirant* held, rejection of an executory contract constitutes a *breach* of contract, not approval to terminate it under section 205 of the FPA. See 378 F.3d at 519 (“*rejection* of the Back-to-Back Agreement is a *breach* of that contract” for which damages lie) (emphasis in original). In a section 205 proceeding, the issue is whether a party can terminate its obligations and *thereafter have no liability to its counterparty*. To obtain such approval, a party with a *Mobile Sierra* clause must meet a very high burden under the public interest test. In this case, however, there is no request by Calpine to terminate its obligations and thereafter be free of liability to the California State Parties. Rather, the issue is how the public interest bears on the Bankruptcy Court's determination of whether to permit Calpine to breach its obligations and, if so, to pay damages for such breach as determined by the Bankruptcy Court.

14. We therefore direct the California State Parties to amend their filing within fifteen (15) days to address the standard adopted in *Mirant*. Intervenors shall have fifteen (15) days from the date of that filing to file responses. Because we are also concerned whether rejection of the Calpine 2 Contract may pose reliability concerns, we also direct the California Independent System Operator Corporation (California ISO) to address this issue in response to the California State Parties’ amended filing within 15 days of their amended filing. The Commission will then be in a position to inform the Bankruptcy Court, as necessary, of the impact on the public interest of a potential rejection of the Calpine 2 Contract, or take such other action as may be appropriate under the circumstances.¹²

¹¹ *In re Mirant Corp.*, *supra* note6.

¹² In the *Mirant* case, the 5th Circuit “presume[d] that the district court would . . . welcome FERC's participation” and that “FERC will be able to assist the court in balancing the equities.” *Id.*

15. Finally, consistent with the due date established above for intervenors to submit responses to the California State Parties' amended filing, interventions shall be due on or before 15 days after the California State Parties submit their amended filing.¹³

The Commission orders:

(A) The California State Parties are hereby directed to amend their December 19, 2005 filing within 15 days of the date of this order, as discussed in the body of this order.

(B) Interventions and responses to the California State Parties' amended filing will be due within 15 days after the California State Parties submit their amended filing, as discussed in the body of this order.

(C) The California ISO is hereby directed to file a response to the California State Parties' amended filing within 15 days after the California State Parties submit their amended filing, as discussed in the body of this order.

(D) The December 22, 2005 notice of filing in Docket No. EL06-30-000 is hereby superseded by the comment procedures established in Ordering Paragraphs (A) - (C).

(E) The Secretary shall promptly publish this order in the *Federal Register*.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

¹³ On December 22, 2005, the Commission issued a notice of the California State Parties' filing, with interventions and protests due on or before January 19, 2006. However, the January 19 comment date established by that notice is superseded by the comment procedures established in this order.