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Sixth Circuit Rules in Chapter 11 Reorganizations

A divided Sixth Circuit Court of Appeals panel ruled in the case of *In re FirstEnergy Solutions Corp.* on Dec. 12, 2019. The panel decided that the U.S. Bankruptcy Court and the Federal Energy Regulatory Commission (FERC) share jurisdiction when a Chapter 11 debtor moves to reject a power purchase and sale contract over which the FERC has jurisdiction (Power Contract). However, the Sixth Circuit noted that such jurisdiction is not equal; declaring the bankruptcy court's authority as primary and superior to that of the FERC. In doing so, however, the Sixth Circuit was critical of the Bankruptcy Court's attempts in the case to completely circumvent the involvement of the FERC, stressing that the FERC is to play a participatory role; just not the final, decisive role. Therefore, for the time being in the Sixth Circuit, with some participation of the FERC, the U.S. bankruptcy courts will have ultimate authority over such contract rejections. The holding is likely to have significant ramifications for the energy-consuming public.

Importantly, the Sixth Circuit also held that when a Chapter 11 debtor moves the bankruptcy court for permission to reject a Power Contract, the court must "consider the public interest and ensure that the equities balance in favor of rejecting the contract..." Thus, the bankruptcy court is arguably being charged with "public interest" considerations comparable to those of the FERC in its own consideration of a Power Contract, at least in the Sixth Circuit. In making that consideration, the court "must invite the FERC to participate and provide an opinion ... within a reasonable time."

The Sixth Circuit affirmed in part and reversed in part the decision of the bankruptcy court. The court had entered a temporary restraining order, followed by a preliminary injunction, barring the FERC from commencing or continuing any proceedings addressing the debtor's rejection of certain Power Contracts. The bankruptcy court's order also enjoined the FERC from interfering with the bankruptcy court's "exclusive jurisdiction" with respect to any rejection motions involving those Power Contracts.

The FERC, joined by the power producers who were parties to the contracts at issue, asserted an argument from case law in other contexts that once Power Contracts are filed with and approved by the FERC, they should no longer be considered ordinary contracts in the bankruptcy context. This is known as the “Filed Rate Doctrine.” It has been applied in situations involving disputes over rates set forth in contracts that have been approved by the FERC. Arguing that the doctrine should be applied in the bankruptcy context, as well, the FERC advocated that once it approves such contracts, they take on the characteristics of a regulation or statute, which a bankruptcy court lacks the authority to overturn. The Sixth Circuit rejected that argument, finding that such Power Contracts are in fact ordinary contracts, not the equivalent of statutes or regulations. As such, they may be rejected in a bankruptcy proceeding if approved by the bankruptcy court. The Sixth Circuit noted the public necessity of having available and functional bankruptcy relief, and further noted that such public necessity is superior to the public need for the FERC to have complete and exclusive jurisdiction over the regulation of Power Contracts.

Additionally, the Sixth Circuit determined that the bankruptcy court cannot prevent the FERC from taking actions in the matter which are not inconsistent with the final determination of the bankruptcy court. In this case, the Sixth Circuit determined that the bankruptcy court had gone too far by enjoining the FERC from initiating or continuing any proceedings, issuing any orders regarding the Power Contracts, or interfering with the bankruptcy court’s “exclusive jurisdiction.” The Sixth Circuit concluded that the bankruptcy court has only the limited authority to enjoin the FERC from issuing an order or compelling an action which would directly conflict with the bankruptcy court’s orders, and does not have exclusive jurisdiction over such contracts.

Finally, the Sixth Circuit addressed the standard which is to be applied by the bankruptcy court in the rejection of a Power Contract. Typically, the standard to be applied to a debtor’s request to reject a contract is the “business judgment test.” That is, the rejection of a contract is normally granted if it is determined to be burdensome to the debtor in the informed reasonable business judgment of the debtor (or its receiver or trustee). In this case, the

Sixth Circuit determined that a heightened standard is appropriate, given the potentially significant public interest in such Power Contracts. Specifically, the bankruptcy court must consider the impact of a rejection of the contract on that public interest, “including the consequential impact on consumers, and any tangential contract provisions concerning such things as decommissioning, environmental management, and future pension obligations.”

While this important question of jurisdiction has now been addressed by the Sixth Circuit, it remains the subject of a split among the circuit courts and is currently the subject of an appeal in the Ninth Circuit.

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