No. 05-10033

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

IN THE MATTER OF: MIRANT CORPORATION,
DEBTOR.

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF MIRANT CORPORATION; MIRANT CORPORATION; MLW DEVELOPMENT LLC; MIRANT AMERICAS ENERGY MARKETING LP; MIRANT AMERICAS GENERATION LLC, MIRANT MID-ATLANTIC LLC; OFFICIAL COMMITTEE OF EQUITY SECURITY HOLDERS; *ET AL.*,
Appellants,

v.

POTOMAC ELECTRIC POWER COMPANY; FEDERAL ENERGY REGULATORY COMMISSION,
Appellees.

On Appeal From the United States District Court for the Northern District of Texas, Fort Worth Division

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BRIEF OF APPELLEE FEDERAL ENERGY REGULATORY COMMISSION

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MAY 19, 2005

CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that the Certificate of Interested Persons contained in the Brief of Appellants Mirant Corporation, *et al.* lists the persons and entities as described in the fourth sentence of Fifth Circuit Rule 28.2.1 that have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

_____

Dennis Lane
Attorney of Record for Appellee Federal Energy Regulatory Commission

May 19, 2005

STATEMENT REGARDING ORAL ARGUMENT

In accordance with Fifth Circuit Rule 28.2.4 and Federal Rule of Appellate Procedure 34(a)(1), the Federal Energy Regulatory Commission submits that oral argument would be helpful to the Court's disposition. Oral argument would provide an opportunity for the Court to question counsel about the important matters raised by this appeal.

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STATEMENT REGARDING JURISDICTION

Appellee Federal Energy Regulatory Commission ("Commission" or "FERC") states that the District Court had jurisdiction over the rejection motion pursuant to 28 U.S.C. § 1334(a), (b), and (e) and this Court's ruling in *Mirant Corp. v. Potomac Electric Power Co. (In re Mirant Corp.)*, 378 F.3d 511 (5th Cir. 2004) ("*Mirant I*"). The Commission further states that this Court has jurisdiction pursuant to 28 U.S.C. § 1291, only to the extent that this appeal presents issues that are justiciable.

STATEMENT OF THE ISSUES[1]

Is the more rigorous standard suggested by the District Court, if its ruling on severability were reversed, appropriate for considering a motion to reject the Back-to-Back Agreement?

Should this Court decline to rule at this time on Appellants' challenges to the District Court's stated views on the applicable rejection standard, as that issue is moot given the dispositive ruling on severability, and was only offered as provisional guidance to the parties?

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[1] The Commission takes no position in this appeal on the separateness of the Back-to-Back Agreement from the Asset Purchase and Sale Agreement ("APSA") between Mirant and Pepco.

STATEMENT OF THE CASE

I. NATURE OF THE CASE, COURSE OF PROCEEDINGS, AND DISPOSITION BELOW

This is the second appeal regarding the motion of Appellants Mirant Corporation, *et al.* (collectively, "Mirant") to reject, pursuant to 11 U.S.C. § 365, the so-called Back-to-Back Agreement ("BTB") between Mirant and Appellee Potomac Electric Power Company ("Pepco").

The first appeal centered on the jurisdiction of the federal courts to rule on the rejection motion. This Court determined that the Federal Power Act ("FPA") did not necessarily preempt a district court's jurisdiction to authorize the rejection in bankruptcy of an executory power contract, so long as a rejection motion was not a collateral attack on the contract's filed rate. *Mirant I*, 378 F.3d at 522.[2]

This Court's decision on the jurisdictional issue did not, however, resolve the merits of the instant rejection question. Quite the opposite: this Court expressly declined Mirant's request that this Court render judgment on the rejection motion, and made clear that substantial questions remained to be resolved prior to any ruling whether rejection would be authorized:

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[2] This Court also addressed the Bankruptcy Court's broad injunctions that prevented FERC from taking any action with respect to Mirant's FERC-jurisdictional contracts, concluding that the injunctions were broader than necessary to further the purposes of 11 U.S.C. § 365, and were "inconsistent with the Bankruptcy Code's assumption that a debtor is subject to ongoing agency regulation while in bankruptcy." *Id.* at 524 (citing *Louisiana PSC v. Mabey (In re Cajun Elec. Power Coop., Inc.)*, 185 F.3d 446, 453 (5th Cir. 1999)).

> [I]mportant issues [such as separateness of the BTB] must still be resolved before a decision on the merits would be appropriate. . . . We, of course, express no opinion regarding this issue, and merely note its existence to indicate the significant work that remains. Developing the factual record necessary to answer these questions is the work of the trial courts.

Mirant I, 378 F.3d at 524.

This second appeal concerns the same rejection motion; on remand, the District Court issued an order denying the motion on the merits. *In re Mirant Corp.*, 318 B.R. 100 (N.D. Tex. Dec. 9, 2004) ("December 9 Order"), JRE 4.[3] The December 9 Order was based on the District Court's finding that the BTB was not a separate agreement from the APSA for purposes of rejection. Applying District of Columbia law to the facts before it, the Court found that the parties had not agreed to the rights and obligations under the BTB as contractual commitments separate and independent from sale under the APSA, and that there would not have been a contract if the rights and obligations in the BTB had constituted the entire bargain. JRE 4:8-9.

Having denied the motion on those grounds, the District Court did not need to set out its view on the applicable standard for deciding whether to authorize rejection; nevertheless, the Court chose to do so as an aid to the parties:

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[3] Citations to the Joint Record Excerpts, submitted by Appellants Mirant and The Official Committee of Equity Security Holders will be designated "JRE."

> Even though, considering the court's ruling on the first issue, the second issue is moot, the court is making known its views on that issue. In the event of a reversal of the court's ruling on the first issue, the parties will know the standard to be applied.

JRE 4:10. Following an extensive excerpt from *Mirant I* addressing the application of a more rigorous test than the business judgment standard for rejection of the BTB, the District Court set forth its views on the standard it would apply, if it ever reached the issue:

> To be entitled to an order authorizing rejection of the Back-to-Back Agreement, Debtors must prove that it burdens the bankrupt estates, that, after careful scrutiny and giving significant weight to comments and findings of the FERC relative to the effect such a rejection would have on the public interest inherent in the transmission and sale of electricity in interstate commerce, the equities balance in favor of rejecting the Back-to-Back Agreement, and that rejection of the Back-to-Back Agreement would further the Chapter 11 goal of permitting the successful rehabilitation of Debtors.

JRE 4:11. The District Court further noted that it "would carefully scrutinize the impact of rejection upon the public interest" (*id.*), and, "[i]f rejection would compromise the public interest in any respect," would not authorize such rejection unless the Debtors showed that they could not reorganize without the rejection. JRE 4:12. Before authorizing a rejection, the Court "would afford FERC an opportunity to engage in appropriate inquiry to enable it to evaluate the effect that such a rejection would have on the public interest." *Id.*

Mirant and two committees appointed in its bankruptcy case, the Official Committee of Unsecured Creditors ("Creditors Committee") and the Official Committee of Equity Security Holders, each appealed the District Court's December 9 Order denying Mirant's rejection motion. *See* JRE 2, 3; Cred. RE 4.[4] The appeals were consolidated on this Court's docket.

Meanwhile, a third round of related litigation has commenced. On January 21, 2005, Mirant filed a second rejection motion in the Bankruptcy Court, seeking to reject the APSA, including the BTB.[5] On March 1, 2005, the District Court issued an Order withdrawing the reference of that second rejection motion to the Bankruptcy Court. That order, together with subsequent orders denying reconsideration and modifying the briefing schedule on the second rejection motion, were the subject of a petition for a writ of mandamus, filed in this Court by Mirant on March 16, 2005. *See In re Mirant Corp.*, No. 05-10348. This Court denied the petition by order dated April 11, 2005. The District Court has not yet issued a decision on the second rejection motion.

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[4] Citations to Appellant Mirant's Brief will be designated "Mir. Br." Citations to the Brief of Appellant The Official Committee of Unsecured Creditors will be designated "Cred. Br."

[5] That motion has engendered considerable dispute between Mirant, who seeks to define the APSA narrowly, to exclude certain agreements that Mirant characterizes as ancillary, and Pepco, who seeks to define the APSA more broadly.

II. STATEMENT OF FACTS

This Court is well-acquainted with the basic factual dispute regarding the BTB and the related litigation, both from the previous appeal and from recent briefing on Mirant's unsuccessful motion to expedite briefing in this appeal and on Mirant's denied mandamus petition in No. 05-10348. Moreover, because Appellants' challenge to the District Court's remarks about the standard for rejection turns on a theoretical issue of law, a detailed review of the facts concerning the BTB dispute is not necessary.

To the extent that a review of the facts is required, the Commission hereby adopts and incorporates by reference the Statement of Facts contained in the brief of Appellee Pepco.

SUMMARY OF ARGUMENT

The views set forth by the District Court's December 9 Order on the applicable standard to govern rejection of the BTB, if justiciable in this appeal, are appropriate and consistent with this Court's guidance in *Mirant I*, with the FPA, and with Supreme Court precedent.

First, the proposed standard is consistent with this Court's views set forth in *Mirant I*. The December 9 Order incorporates much of *Mirant I*'s guidance on a more rigorous legal standard to apply in rejecting the BTB, including wholesale adoption of many of the same phrases and terms. The District Court's rejection standard conforms with *Mirant I* by requiring that Mirant prove that the BTB burdens the bankrupt estate, that the equities balance in favor of rejection, and that rejection would further the Chapter 11 goal of successful rehabilitation. Likewise, in fashioning its rejection standard, the District Court properly interpreted *Mirant I*'s advisement to use a standard more rigorous than the business judgment standard for the BTB rejection motion. Although the Creditors Committee maintains otherwise, the clear language of *Mirant I* and the context of the business judgment standard discussion reflect this Court's charge that a standard other than the business judgment standard be utilized in evaluating whether to reject the BTB.

Second, contrary to Appellant's claims, the proposed standard does not conflict with the FPA. Appellants wrongly assume that the relevant "public

interest" would necessarily be determined under the *Mobile-Sierra* doctrine, and speculate as to how the proposed standard would be applied to specific facts. Their speculation, however, incorrectly reads the District Court's proposal as directing how FERC should evaluate specific facts. In stating that it would involve FERC in assessing the public interest impact, however and contrary to Appellants' claims, the District Court did not encourage FERC to follow a particular course, but, consistent with the doctrine of primary jurisdiction, left such matters to FERC.

Third, the District Court's proposed standard is consistent with Supreme Court precedent, which, as explained in *Mirant I*, supports applying a more rigorous standard for rejection where the Bankruptcy Code intersects with another federal statute. Because the FPA protects fundamental public interest considerations, a more rigorous standard than the business judgment rule is appropriate to reconcile the intersection of FPA and Bankruptcy Code concerns.

Moreover, the cases cited to support the Creditors Committee's contention that the business judgment standard must apply to all executory contracts, including the BTB, are inapposite because they either (1) did not address, in the context of a regulated industry, the applicability of the business judgment standard, (2) involved executory contracts in non-FERC regulated industries, (3) concerned a rejection provision unlike Section 365 of the Code, or (4) acknowledged FERC involvement in whether rejection should be granted.

In any event, the District Court's statement of its views outlined an abstract standard that has yet to be applied in this bankruptcy proceeding. The District Court ruled on Mirant's rejection motion on the ground that the BTB is not separate from the APSA, thus making "moot" the issue of the applicable standard. Without any facts or record within which that standard has been applied, it is questionable whether Appellants minimally satisfy the requirements of Article III; at the least, prudential considerations weigh against resolving their claims on this appeal.

ARGUMENT

I. STANDARD OF REVIEW

The District Court's findings of fact are reviewed for clear error; its conclusions of law and mixed questions of fact and law are reviewed *de novo*. *E.g., Century Indem. Co. v. NGC Settlement Trust (In re Nat'l Gypsum Co.)*, 208 F.3d 498, 504 (5th Cir. 2000); *Traina v. Whitney Nat'l Bank*, 109 F.3d 244, 246 (5th Cir. 1997).

II. IF JUSTICIABLE, THE REJECTION STANDARD PROPOSED BY THE DISTRICT COURT IS APPROPRIATE

A. The Proposed Standard Is Consistent With This Court's Guidance In *Mirant I*

Although Mirant and the Creditors Committee argue that the District Court's rejection standard conflicts with *Mirant I* (*see* Mir. Br. 37-41; Cred. Br. 33-36), their alleged inconsistency withers under a closer review, which reveals no

inherent conflict. The District Court was well aware of this Court's position on the standard to apply in rejection, as the District Court recited, virtually word for word, a substantial portion of *Mirant I*'s exposition of that standard. *See* December 9 Order, JRE 4:10-11 (quoting *Mirant I*, 378 F.3d at 525-26). That portion of *Mirant I* expressly stated "[u]se of the business judgment standard would be inappropriate in this case," 378 F.3d at 525, and recommended "the district court should consider applying a more rigorous standard to the rejection of the Back-to-Back Agreement," *see id.* This Court further advised that the District Court "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 id.* (quoting *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 526 (1984)).

Fully cognizant of this Court's remarks, the December 9 Order laid out the District Court's view of a test consistent with *Mirant I*'s language. The District Court specifically observed that "the standard should be as follows:"

> To be entitled to an order authorizing rejection of the Back-to-Back Agreement, Debtors must prove that it burdens the bankrupt estates, that, after careful scrutiny and giving significant weight to comments and findings of the FERC relative to the effect such a rejection would have on the public interest inherent in the transmission

> and sale of electricity in interstate commerce, the equities balance in favor of rejecting the Back-to-Back Agreement, and that rejection of the Back-to-Back Agreement would further the Chapter 11 goal of permitting the successful rehabilitation of Debtors.

JRE 4:11.

A comparison of this standard to *Mirant I* reveals that the District Court did not stray from this Court's guidance. As *Mirant I* suggested, the District Court adopted a standard that requires Mirant to prove that the BTB burdens the bankrupt estate; the equities balance in favor of rejection; and rejection would further the Chapter 11 goal of successful rehabilitation. *Compare id. with* 378 F.3d at 525. It also incorporated this Court's concern over the impact of rejection upon the public interest governed by FERC, particularly to assure no disruption of electricity. *Id.* at 525. The District Court's order copies much from *Mirant I* and nearly mirrors it. While the District Court would give "significant weight to comments and findings of the FERC relative to the effect such rejection would have on the public interest inherent in the transmission and sale of electricity in interstate commerce," JRE

4:11, this statement does not contravene any dictate in *Mirant I*.[6] Indeed, it confirms this Court's observation and tacit suggestion in *Mirant I* that FERC would be "a party in interest" and "w[ould] be able to assist the court in balancing these equities." 378 F.3 at 525-26. *Mirant I* does not preclude FERC's comments and finding from being given weight.

The Creditors Committee uses its selective reading of the *Mirant I* opinion to allege that the District Court misunderstood this Court's instruction that "[u]se of the business judgment standard would be inappropriate in this case." *See* Cred. Br. 36 n.85. According to the Creditors Committee, the phrase "in this case" modifies the preceding sentence's phrase "FERC proceedings to alter the terms of a contract within its jurisdiction," and has nothing to do with the Mirant bankruptcy. *Id.* Thus, the Creditors Committee sees *Mirant I* as addressing "a hypothetical FERC proceeding in which a party to a contract subject to FERC regulation seeks to change the terms of that contract." *See id.* On that premise, the Creditors Committee contends that the issue of whether the business judgment

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[6] Mirant and the Creditors Committee seek to extend the actual holding of *Mirant I*, which concluded that the district court had jurisdiction to authorize the rejection of an executory power contract in bankruptcy, beyond its meaning. 378 F.3d at 514. In effect, Mirant and the Creditors Committee would expand the District Court's original jurisdiction to be synonymous with exclusive jurisdiction and to deny any FERC involvement. But *Mirant I* did not preclude FERC from participating in the lower court proceeding or bar the district court from addressing FERC's concerns in the rejection calculus. 378 F.3d at 526 ("Therefore, FERC will be able to assist the court in balancing these equities.").

standard would apply in the rejection of the BTB was left open. *See id.*

This contention is devoid of any merit. In context, the *Mirant I* decision clearly reflects this Court's view that a more rigorous test than the business judgment standard should apply in the Mirant bankruptcy. *See, e.g.*, 378 F.3d at 524 (noting Bankruptcy Court's "opinion indicated that it may choose to apply a more rigorous standard to Mirant's motion to reject"). That sentence was immediately followed by the statement "Supreme Court precedent supports applying a more rigorous standard *in this case*." *Id.* (emphasis added). Thus, the clear antecedent of "in this case" is "Mirant's motion to reject" the BTB, not some hypothetical FERC proceeding, as the Creditors Committee posits.

Furthermore, the Creditors Committee conveniently overlooks the sentence immediately following the one on which it relies; that immediately following sentence ties the test to the instant rejection: "Therefore, upon remand, the district court should consider applying a more rigorous standard to the rejection of the Back-to-Back Agreement." 378 F.3d at 525. That statement reaffirmed this Court's consistent understanding that "this case" meant Mirant's motion to reject the BTB. To argue otherwise, as the Creditors Committee does, essentially ignores substantial language in the *Mirant I* decision discussing application of a more rigorous standard to the only matter before this Court: the proposed rejection of the BTB.

Appellants contend (Mir. Br. 39, 41-42; Cred. Br. 49) that the District Court's standard improperly gives too much weight to public interest considerations under the FPA and subverts Section 365 by precluding rejection absent risk of liquidation. In particular, they focus on the District Court's statement that "[i]f rejection would compromise the public interest in any respect, it would not be authorized unless Debtors show that they cannot reorganize without the rejection." JRE 4:12. While Appellants seem to believe the use of "in any respect" means a single detrimental factor would sabotage a rejection motion, the public interest calculus involves determining whether beneficial factors outweigh the detrimental factors. Thus, a single detrimental factor need not compromise the public interest if it is outweighed by beneficial factors. Of course, it is virtually impossible to discern, from a single sentence of dicta, divorced from any facts, precisely what would "compromise the public interest." Further, even if the FPA public interest is compromised, the Debtors could still prevail if they showed an inability to reorganize. Thus, contrary to Appellants' claims, the District Court's formulation properly balances the relevant considerations under the FPA and the Bankruptcy Code.

The District Court's approach follows from *Bildisco*, which rejected a more rigorous standard adopted by the Second Circuit that "subordinate[d] the multiple, competing considerations underlying a Chapter 11 reorganization to one issue:

whether rejection of the collective-bargaining agreement is necessary to prevent the debtor from going into liquidation." 465 U.S. at 525 (referring to *Brotherhood of Railway, Airline and Steamship Clerks, Freight Handlers, Express and Station Employees v. REA Express, Inc.*, 523 F.2d 164, 169 (2d Cir. 1975)). But *REA Express* was flawed in that it effectively held all collective-bargaining agreements, by virtue of their special nature, were *per se* unrejectable unless a reorganization would fail. *See* 523 F.2d at 172 (rejection "should be authorized only where it clearly appears to be the lesser of two evils and that, unless the agreement is rejected, the carrier will collapse and the employees will no longer have their jobs"); *see also Bildisco*, 465 U.S. at 524 (describing *REA Express* standard as precluding rejection "unless [the debtor] can demonstrate that its reorganization will fail unless rejection is permitted").

Here, by contrast, the District Court did not suggest the special nature of the BTB, or of FPA-jurisdictional contracts in general, would by itself automatically preclude rejection absent Mirant's collapse. Rather, the Court indicated if the facts of the instant (or a future) case demonstrated the actual detriment of rejection outweighed any benefits, and thus compromised the public interest, rejection could be allowed if the risk to Mirant's reorganization made it necessary to approve rejection. Thus, the District Court did not suggest subordinating bankruptcy considerations to a single issue. Rather, the Court proposed a means to evaluate

two sets of possibly competing public interests — one under the Code and one under the FPA — in a concrete factual setting. That approach is fully consistent with the "more rigorous" standard contemplated in *Bildisco* and *Mirant I*.

B. The Proposed Standard Does Not Violate The FPA

Appellants assert that the District Court's proposed standard conflicts with *Mirant I* and with the FPA. *See generally* Mir. Br. 37 *et seq*. and Cred. Br. 44 *et seq*. Those assertions rest largely on how Appellants *think* the standard would be applied. *E.g.*, Cred. Br. 45 ("the District Court's proposed rejection standard would adopt FERC's *Mobile-Sierra* doctrine for contract modification permitting, if not encouraging, the Commission to commence a *Mobile-Sierra* hearing").

The District Court's discussion, JRE 4:10-12, does not, however, refer to the *Mobile-Sierra* doctrine[7] or otherwise encourage FERC to follow a particular approach. Rather, the District Court noted that should the occasion arise, it would simply "afford the FERC an opportunity to engage in appropriate inquiry to enable it to evaluate the effect that such a rejection would have on the public interest." *Id*. at 12. That approach reasonably carries out this Court's suggestion of the usefulness of having FERC "'assist the court in balancing these equities.'" *Id*. at 11 (quoting *Mirant I*, 378 F.3d at 526).

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[7] *See FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 353 (1956); *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956).

Contrary to Appellants' claim (Cred. Br. 45), nothing in the District Court's approach encourages FERC to employ the *Mobile-Sierra* "public interest" standard in FERC's inquiry.[8] Rather, the District Court referred to "the public interest inherent in the transmission and sale of electricity in interstate commerce," JRE 4:11, which mirrors this Court's reference to "the public interest in the transmission and sale of electricity. 16 U.S.C. § 824(a)." *Mirant I*, 378 F.3d at 525. That reference encompasses a broadly-defined "public interest." *See* 16 U.S.C. § 824(a) ("the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation . . . of such business . . . is necessary in the public interest").

As Appellants point out (Mir. Br. 45; Cred. Br. 43-44), what is the public interest under the FPA "take[s] meaning from the purposes of the regulatory legislation," *NAACP v. FPC*, 425 U.S. 662, 669 (1972), which in the case of the FPA means "'assur[ing] an abundant supply of electric energy throughout the United States with the greatest possible economy.'" *Id.* at 670 n.5 (alteration added; citation omitted). From this, Appellants assert (Mir. Br. 44; Cred. Br. 45) that the *Mobile-Sierra* standard would be applied should FERC ever address issues related to a BTB rejection application. Not all FERC public interest evaluations

[8] Of course, FERC may decide, after evaluation of the relevant facts, that the *Mobile-Sierra* standard should be used here.

related to contractual matters are done, however, under a *Mobile-Sierra* standard. *E.g.*, *Union Pac. Fuels, Inc. v. FERC*, 129 F.3d 157, 162-63 (D.C Cir. 1997) (notwithstanding the inapplicability of *Mobile-Sierra* to contracts at issue, court upholds FERC public interest determination). If presented with the question, FERC would determine whether *Mobile-Sierra* or a different standard should apply. It should be noted that a proposed rejection related to the BTB may also implicate public interest concerns under the Public Utilities Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3, and may require an inquiry as to how a proposed rejection application would affect the public interest under that statute. *See American Paper Inst. v. American Elec. Power Serv. Corp*, 461 U.S. 402, 414-15 (1983) (referring to public interest factors).[9]

Should the occasion arise, FERC would, in the first instance, have to determine (1) whether the *Mobile-Sierra* standard applies, and (2) whether or not it applies, how the public interest under the FPA (and possibly PURPA) would be affected. Deferral to FERC on those questions, as the District Court proposed, JRE 4:12, follows not only *Mirant I*, but also the doctrine of primary jurisdiction. The

[9] Appellants' attempt to restrict the scope of a FERC public interest inquiry should be rejected. For example, the Creditors Committee notes that "FERC declared that it lacked jurisdiction over the proposed transfer of power purchase rights from one utility to another" under FPA § 203, 16 U.S.C. § 824b. Cred. Br. 50. No one has suggested that rejection of the BTB should be treated as an assignment of rights, and thus reliance on a FERC case involving an assignment of rights is inapposite.

doctrine "applies where a claim is originally cognizable in the courts, and comes into play whenever enforcement of the claim requires the resolution of issues which, under a regulatory scheme, have been placed within the special competence of an administrative body; in such a case, the judicial process is suspended pending referral of such issues to the administrative body for its views." *Aircraft & Diesel Equip. Corp. v. Hirsch*, 331 U.S. 52, 64 (1947) (citation omitted).

Courts have invoked the doctrine in bankruptcy cases that involve a question within the statutory responsibility and expertise of a regulatory agency. *See In re Star Net, Inc.*, 355 F.3d 634, 639 (7th Cir. 2004) (noting doctrine "allows a federal court to refer a matter extending beyond the 'conventional experiences of judges' or 'falling within the realm of administrative discretion' to an administrative agency with more specialized experience, expertise, and insight").[10] There, as the

[10] Though it did not involve the issue of primary jurisdiction, *Bildisco*, 465 U.S. at 526-27, was careful, in requiring bankruptcy courts to effectuate the policies of the National Labor Relations Act ("NLRA"), not to require the courts to venture beyond their expertise:

> [T]he Bankruptcy Court should be persuaded that reasonable efforts to negotiate a voluntary modification have been made and are not likely to produce a prompt and satisfactory solution. . . . The Bankruptcy Court need step into this [NLRA-mandated negotiation] process only if the parties' inability to reach an agreement threatens to impede the success of the debtor's reorganization. . . . At such a point, action by the Bankruptcy Court is required, while the policies of the NLRA have been adequately served since reasonable

District Court proposes to do here, the Seventh Circuit did not cede jurisdiction, but sought a determination and statutory and regulatory issues that were in "the bailiwick of the FCC rather than a bankruptcy court." *Id.* *See also Niagara Mohawk Power Corp. v. Megan- Racine Assocs., Inc. (In re Megan-Racine Assocs., Inc.*), 180 B.R. 375 (Bankr. N.D.N.Y. 1995), *and* 203 B.R. 873, 877-78 (Bankr. N.D.N.Y. 1996) (referral to FERC of certain questions related to a purchase power agreement, like the BTB, and discussion of FERC resolution); *see also Gingold v. United States (In re Shelby County Healthcare Servs. of Al., Inc.)*, 80 B.R. 555, 562 (Bankr. N.D. Ga. 1987) (invoking doctrine in Medicare matter).

Mirant contends that "respect for the primacy of contracts" embodied in the FPA requires rejection be judged under a standard that "would apply if 'there were [sic] no regulation at all of the contract's subject matter.'" Mir. Br. 45 (citing *Pennzoil Co. v. FERC*, 645 F.2d 360, 387 (5th Cir. 1981)). Mirant apparently believes *Pennzoil* requires application of the business judgment rule by a court in the instant case. *Id.* *Pennzoil* does not support Mirant's view, but provides further support for the District Court's proposed standard. *Pennzoil* involved determining the parties' intent as to meaning of a price escalation clause, which this Court

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> efforts to reach agreement have been made. That court need not determine that the parties have bargained to impasse or *make any other determination outside the field of its expertise*. [Emphasis added.]

indicated could be resolved by courts. *See* 645 F.2d at 385-86. That did not, however, as Mirant implies, remove FERC's views from consideration. Rather, "[c]ourts can be easily informed of the language, purpose, and history of the [applicable FERC] regulation when presented with an area rate clause interpretation. This information is already available in the preambles to the [FERC] order here under review. Courts are not any less able to take this into account when construing contracts." *Id*. at 386. Here, there are no readily available FERC materials that would inform a court of how FERC views the instant issue, and thus the District Court properly proposed, should the occasion arise, to obtain equivalent information by affording FERC "an opportunity to engage in appropriate inquiry" to evaluate the facts presented. JRE 4:12.

Further, the holding that the contracts should be interpreted as if "there [were] no regulation at all of the contract's subject matter," 645 F.2d at 387, did not give the courts sole jurisdiction; rather, it left the question to FERC, only requiring that FERC "must take into account, in resolving a particular contractual authority dispute, the law of the state that would apply to its resolution under appropriate choice of law rules," and, even then, placed "the burden on the parties to inform FERC if the state law that should apply is any different from the general principles that FERC utilizes." *Id*. Nothing in that holding supports Appellants' view that a business judgment analysis can control whether to authorize rejection

of the BTB or precludes the District Court's proposal to give FERC an opportunity to make an appropriate inquiry as to the FPA public interest effects.

Mirant also makes a facial challenge to the proposed standard, asserting that it "would cause the district court to evaluate the reasonableness of rates," and thereby violate the filed rate doctrine. Mir. Br. 47; *see id*. at 46-47 (developing assertion). That challenge incorrectly reads the District Court's proposal and speculates as to application of the proposal to specific facts. Mirant reads the proposal to "require[the District Court] to consider whether rejection will result in '*unjust or excessive rates*' in order to authorize rejection." *Id*. at 47 (citing JRE 4:12 (emphasis added by Mirant)). But the structure of the District Court's proposal neither compels nor supports Mirant's reading.

The District Court largely paraphrased this Court's suggestion concerning a more rigorous standard: "As the Fifth Circuit has suggested, when applying this standard, the court would carefully scrutinize the impact of rejection upon the public interest and would, *inter alia,* ensure that rejection will not cause any disruption in the supply of electricity to other public utilities or to consumers or lead to unjust or excessive rates." JRE 4:11-12; *compare Mirant I*, 378 F.3d at 525. Use of "*inter alia*" signals a list of some, but not all, the possible considerations under "the public interest." As the very same paragraph indicates FERC would be given an opportunity to evaluate the effect of a possible rejection

on "the public interest," it can be reasonably inferred that the proposal anticipates, should the occasion arise, FERC, not the Court, will evaluate possible rate effects of a proposed rejection along with any other factors that FERC finds have an effect on its public interest evaluation under the FPA.[11]

Thus, and contrary to Mirant's reading, the District Court's proposal contemplates FERC, not the Court, will "evaluate the reasonableness of rates." Mir. Br. 47. As FERC has exclusive jurisdiction under the FPA to make rate determinations, applying the proposal by referring rate questions to FERC in the context of a BTB rejection would not violate the filed rate doctrine. Further, when and if the standard set forth by the District Court is applied in a specific fact situation, that application would be subject to judicial review and remedy, if needed. It follows that Mirant's facial challenge to the proposal must fail as unsupported and unnecessary.

C. The Reasoning Of *Bildisco* Supports Applying A Stricter Standard To FPA-Governed Contracts

The less rigorous "business judgment" standard for assumption or rejection of executory contracts is not set forth in the Bankruptcy Code, but rather was developed by the courts. *See, e.g., In re Stable Mews Assocs., Inc.*, 41 B.R. 594, 595 (Bankr. S.D.N.Y. 1984) (noting that "the [Bankruptcy] Code, like the

[11] In any event, this Court could clarify that only FERC can address rate questions without rejecting the District Court's proposal in its entirety.

Bankruptcy Act of 1898 . . . before it, provides no guidance as to the standards to be applied by the court in evaluating the rejection of an unexpired lease" under Section 365; discussing "divergent standards" developed by courts, including more-prevalent business judgment test) (citation omitted); *In re Tama Beef Packing, Inc.*, 277 B.R. 407, 413 (Bankr. D. Iowa 2002) (discussing "judicially developed" rule for evaluating assumption of leases under Section 365); *see also* 3 *Collier on Bankruptcy* ¶ 365.03[2] at 365-22 (15th ed. rev. 2004).

Courts have also developed a more rigorous standard for application where the Bankruptcy Code intersects with another federal statute. The courts concluded that, to give effect to the Congressional policies underlying both laws, a higher rejection standard is appropriate. *See Bildisco*, 465 U.S. at 523 (recognizing consensus among Courts of Appeals that more rigorous standard should apply to rejection of collective-bargaining agreements, despite absence of Bankruptcy Code provision requiring different standard). In the collective-bargaining agreement cases, that consensus was grounded in the principle that the policies of the National Labor Relations Act ("NLRA") as well as those of the Bankruptcy Code must be given effect. *See id.* at 526; *see also Local Unions 20, et al. v. Brada Miller Freight Sys., Inc. (In re Brada Miller Freight Sys., Inc.)*, 702 F.2d 890, 896 (11th Cir. 1983) (citing use of more rigorous standard as an "attempt to reconcile the statutes in a manner which best effectuates the intent of Congress"); *Shopmen's*

Local Union No. 455 v. Kevin Steel Prods., Inc., 519 F.2d 698, 706-07 (2d Cir. 1975) ("We recognize, of course, that the policies animating the two statutes are different"; criticizing approach that would narrowly focus on improving debtor's financial status, as that would "totally ignore[] the policies of the [NLRA] and make[] no attempt to accommodate to them").

The Creditors Committee argues that the *Bildisco* line of cases is inapposite here because collective-bargaining agreements are unique and involve fundamental rights (of laborers to self-organize), whereas wholesale power contracts do not warrant any special status. Cred. Br. 41-44. But this Court rightly followed the underlying principle in *Bildisco* as requiring a more rigorous standard here. The instant case similarly requires reconciliation of another federal statute that protects certain fundamental interests with the Bankruptcy Code, and thus requires something more than use of the business judgment rule to evaluate Mirant's rejection motion.

The policies of the NLRA and the FPA, of course, differ: the NLRA embodies the policies of "avoiding labor strife and encouraging collective bargaining," *Bildisco*, 465 U.S. at 526; the FPA recognizes the "public interest inherent in the transmission and sale of electricity," *Mirant I*, 378 F.3d at 525. But each statute shows Congressional intent to afford protection and special consideration over the area covered by the specific Act. Indeed, the need for

deferral to FERC on FPA matters is strong. The principles to be vindicated under the NLRA — requiring efforts to attempt to negotiate a voluntary modification of the agreement (*see Bildisco*, 465 U.S. at 526) — contrast with the complex (and technical) public interest considerations under the FPA, including, among other things, "an interest in the continuity of electrical service to the customers of public utilities" as well as the interests protected by the filed rate doctrine. *Mirant I*, 378 F.3d at 525. Thus, considerations under the FPA would likely require a court to go beyond its field of expertise, unlike the situation in *Bildisco*, which warrants the approach proposed by the District Court.

The Creditors Committee also emphasizes the enactment of 11 U.S.C. § 1113, which imposed a specific test for rejection of a collective bargaining agreement, and points to the absence of a similar provision regarding utility contracts as meaning business judgment could apply here. Cred. Br. 42. That is a false comparison because the *Bildisco* Court did not need a statutory provision to set out a more rigorous test. Acknowledging "there is no indication in § 365 of the Bankruptcy Code that rejection of collective-bargaining agreements should be governed by a standard different from that governing other executory contracts," the *Bildisco* Court nevertheless determined that a more rigorous standard for rejecting labor agreements was appropriate. *See* 465 U.S. at 523.

Congress's disagreement with the *Bildisco* decision was not that the courts

set a more rigorous standard, but that the heightened standard was not rigorous *enough*. Passage of § 1113 does not create a negative inference that, absent such an explicit provision, every rejection motion *must* default to the deferential, court-made "business judgment" standard. Rather, that legislation reinforces Congressional acceptance of court-developed standards for contract rejection, unless Congress explicitly states otherwise.

In short, this Court reasonably concluded that greater scrutiny would likewise be appropriate for the BTB, as a contract for interstate sale of electricity at wholesale, which, like collective bargaining agreements, is "also unique" and imbued by the FPA with special considerations. *Mirant I*, 378 F.3d at 525.

D. Case Law Does Not Require Application Of The Business Judgment Standard To Rejection Of The Back-to-Back Agreement

The Creditors Committee contends that the business judgment standard must be applied to the rejection of the BTB. *See* Cred. Br. 35-40. But contrary to its assertions, the Bankruptcy Code does not mandate the use of the business judgment standard in the rejection of all executory contracts and unexpired leases. The Code itself is silent on what test to apply for rejection purposes. *See Stable Mews Assocs.*, 41 B.R. at 585-96. Nor do the cases the Creditors Committee cites for support, *see* Cred. Br. 37, mandate use of the business judgment standard here.

For example, *In re Health Plan of the Redwoods*, 286 B.R. 779 (Bankr. N.D.

Cal. 2002), never addressed whether the business judgment standard must apply or whether it should be discarded due to regulation in the medical industry. Furthermore, the federal government, which would have had oversight and was the counterparty to the executory contract, did not object to the rejection. *Id.* at 780. As the issue presented in the instant matter was not addressed in *Redwoods*, the Creditors Committee's citation to it for the proposition that the business judgment standard must apply in a regulated industry is baseless.

Similarly, *Sharon Steel Corp. v. National Fuel Gas Distribution Corp.*, 872 F.2d 36 (3d Cir. 1989), did not address whether the business judgment standard was the appropriate standard. There, the primary issue was whether the service agreement in question was an executory contract. *Id.* at 39. In addition, the issue as to whether FERC should be involved in the rejection analysis did not arise, as the power contract in question involved a state, not federal, regulated utility. *Id.* at 37.

Likewise, FERC played no role in *In re Hurricane Elkhorn Coal Corp. II*, 15 B.R. 987 (Bankr. W.D. Ky. 1981), nor did that case directly concern the effect of regulation on the rejection analysis. In *Hurricane*, both the debtor and the counterparty to a coal supply agreement (a matter not regulated by FERC) agreed that there were two potential standards for rejection: the business judgment rule and the "onerous and burdensome" test. *Id.* at 988. At issue was which of the two

should apply under the circumstances, not whether the business judgment standard must always apply in a regulatory context. *Id.* at 988-89.

In *Stable Mews Associates*, the district court addressed the applicability of Section 365 to unexpired leases, not executory power contracts. Moreover, that case involved an ostensible conflict between local landlord-tenant laws and the Code. 41 B.R. at 597. As such, the local laws were preempted pursuant to the Supremacy Clause. *Id.* at 597-98. In the instant case, whether a more rigorous standard should apply in rejecting the BTB does not concern the Supremacy Clause because any ostensible conflict would not be between local and federal law. Rather, this Court's role would be to interpret two federal laws so as to give effect to each. *Mirant I*, 378 F.3d at 517.

Wheeling-Pittsburgh Steel Corp. v. West Penn Power Co. (In re Wheeling-Pittsburgh Steel Corp.), 72 B.R. 845 (Bankr. W.D. Pa. 1987), is similarly unavailing because the rejection analysis was conducted in the context of a potential conflict with state public utility laws, not federal energy law. *Id.* at 848. Hence, those laws had to "give way to the federal bankruptcy laws by virtue of the Supremacy Clause." *Id.* As previously noted, the Supremacy Clause is inapplicable in the instant context. Furthermore, application of the business judgment standard was not specifically contested in *Wheeling-Pittsburgh*. *See id.* at 846 ("[B]oth parties concede the general applicability of the business judgment

test."). Instead, the counterparty asserted that certain facts should be considered under the business judgment standard. *See id.* at 847. Here, on the other hand, application of the business judgment standard itself is at dispute, not just what facts should be considered under it. This Court has already indicated that the business judgment standard should be replaced with a more rigorous standard. *Mirant I*, 378 F.3d at 524-25.

Although the Creditors Committee spends a couple of pages (Cred. Br. 38-39) discussing *In re Tilco, Inc.*, 408 F. Supp. 389 (D. Kan. 1976), *rev'd on other grounds, Carey v. Mobil Oil Corp. (In re Tilco, Inc.)*, 558 F.2d 1369 (10th Cir. 1977), neither the district court decision nor the appellate court's reversal there supports the Committee's contention that the business judgment standard must apply in the rejection context for all executory contracts. Cred. Br. 34. *Tilco* concerned a case under Chapter X of the prior Bankruptcy Act, *see* 408 F. Supp. at 391, and pertained to a statutory provision — Section 116 — that is not the exact equivalent of Section 365 of the Code, *compare id.* at 392 (quoting Section 116 of the Bankruptcy Act) *with* 11 U.S.C. § 365. Specifically, Section 116 of the Bankruptcy Act barred rejection of executory contracts "in the public authority," *see* 408 F. Supp. at 397, a bar that is not found in Section 365 of the Code.

On appeal, the appellate court did not address whether the fact that the natural gas contracts were subject to regulation by the Federal Power Commission

affected the rejection analysis. *Tilco*, 558 F.2d at 1371 ("The court held that the gas contracts were executory contracts and were not contracts 'in the public authority.' The court also held that it could act without infringing on the jurisdiction of the Federal Power Commission. None of these rulings are attacked on this appeal.") (citations omitted). The *Tilco* courts never addressed Section 365, which has been interpreted by the Supreme Court to require a more rigorous standard than the business judgment standard in certain contexts. *See Bildisco*, 465 U.S. at 526; *see also Mirant I*, 378 F.3d at 524-25 ("Supreme Court precedent supports applying a more rigorous standard to this case . . . . 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."). Thus, the Creditors Committee's reliance on *Tilco* as controlling here is misplaced.

Contrary to the Creditors Committee's citation, *NRG Power Marketing, Inc. v. Blumenthal (In re NRG Energy, Inc.)*, 2003 U.S. Dist. LEXIS 11111 (S.D.N.Y. June 30, 2003), does not support the argument that the business judgment standard must apply and that the BTB must be rejected. Cred. Br. 37 n.88. While the bankruptcy court approved rejection of the power contract, it declined to vacate a FERC order requiring the debtor's compliance with that contract and declined to enjoin FERC, a ruling upheld by the district court on appeal for lack of jurisdiction. 2003 U.S. Dist. LEXIS 11111, at *2. The district court expressly

noted "the unique regulatory framework for the business of selling electric energy," and was not swayed by the debtor's argument that the rejection issue was merely a dispute over a financial arrangement. *Id.* at *8-9. The district court observed that "FERC acted within its legal authority, delegated to it under the FPA, when it ordered Plaintiff to continue to comply with its obligations." *Id.* at *11. In short, the district court ruled the matter squarely fell within "FERC's regulatory responsibility," which necessarily would not be limited to the business judgment standard, but must address "a range of public interest concerns." *Id.*

The Creditors Committee's citation (Cred. Br. 37 n.87) to *Lifemark Hospitals, Inc. v. Liljeberg Enterprises, Inc. (In re Liljeberg Enterprises, Inc.)*, 304 F.3d 410 (5th Cir. 2002), is equally meritless. The Creditors Committee asserts the executory contract issue in that case involved regulatory matters subject to state health and pharmacy boards. But the actual issue was whether certain contractual defaults occurred to prohibit assumption of the executory pharmacy agreement. *Id.* at 439-46. Whether regulatory concerns affected application of the business judgment standard was never at issue.

III. THIS COURT SHOULD NOT RULE ON APPELLANTS' CHALLENGE TO AN ABSTRACT STANDARD THAT HAS NOT YET BEEN APPLIED BELOW

Appellants ask this Court to rule on the District Court's statement of its "views" (JRE 4:10) concerning an abstract standard of how a rejection motion

related to the BTB would be evaluated (Mir. Br. 48; Cred. Br. 56) without any facts or record within which that standard has been applied. It is not clear that the Court's view in *that* context is justiciable. *See, e.g.*, *Monk v. Huston*, 340 F.3d 279, 282 (5th Cir. 2003) ("abstract or hypothetical" case is not justiciable; "a case is not ripe if further factual development is required."). It is questionable whether Appellants minimally satisfy the requirements of Article III, and, in any event, prudential considerations weigh against resolving their claim on this appeal. No court in the bankruptcy proceeding has yet applied *any* rejection standard to Mirant's efforts to reject the BTB or the APSA. To date, the only issues actually resolved have concerned jurisdiction, determined by this Court, and contract interpretation, decided by the District Court on remand.

Both this Court and the District Court have, of course, set forth their views on what the standard should be, if it ever need be reached, applied to rejection of a wholesale power sale contract. On the previous appeal, having resolved the jurisdictional issue before it, this Court offered its views that a "more rigorous standard" would be appropriate given the special nature of a contract for the interstate sale of electricity under the FPA, but did not prejudge the outcome or specify how to take the FPA's public interest into account, instead leaving the determination and application of the standard to the District Court in the first instance. *See Mirant I*, 378 F.3d at 524-25 (suggesting standards that the District

Court "should consider applying" and "might adopt").

On remand, the District Court, prior to ruling, invited the parties to submit memoranda regarding the applicable standard for rejection. After reviewing the comments, the Court ultimately ruled that the BTB could not be rejected separately from the APSA and denied the rejection motion on that basis. JRE 4:8-9. Therefore, it did not need to reach the definition of a standard. *See id.* at 10. ("[C]onsidering the court's ruling on the first issue [regarding severability], the second issue [regarding the standard] is moot . . . ."). Nevertheless, the District Court chose to "mak[e] known its views on that issue," with the stated purpose of providing guidance to the parties in preparing their presentations on the merits of rejection, in the event this Court were to reverse the ruling on the severability issue. *See id.*

Whether the District Court's views on the appropriate standard constitute a reviewable holding, however, is questionable, given that no court has yet reached the merits of either of Mirant's rejection motions. The District Court's views as to the standard addressed a legal question that was "moot." *Id.* Advisory holdings on issues unnecessary to orders on appeal are generally disfavored. *See, e.g., McCord v. Agard (In re Bean),* 252 F.3d 113, 117-18 (2d Cir. 2001) (where district court, on appeal from bankruptcy court, had not only reversed judgment but also made *sua sponte* finding of abuse of discretion by trustee, appeals court held the abuse

finding was "pure dicta," as it was "not necessary to decide the issue before the district court"; therefore, the finding "fail[ed] to generate any real controversy" and was "not ripe for review at this time"); *Karsten v. Kaiser Found. Health Plan of the Mid-Atl. States, Inc.*, 36 F.3d 8, 11 (4th Cir. 1994) (where procedural default was dispositive, "[a]ny treatment of the matter on its merits would be nothing more than pure dicta, unnecessary for the determination of this case, and it is a path we decline to tread"; though it was understandable for district court to want to explain to losing party that it would have lost on merits in any event, "that explanation . . . creates new law in a strictly advisory fashion"); *Preferred Communications, Inc. v. City of Los Angeles*, 13 F.3d 1327, 1333 (9th Cir. 1994) (having resolved dispositive issue, court declined to decide remaining legal questions "'without a more thoroughly developed record'" because doing so would be "rendering advisory opinions") (citation omitted). Therefore, this Court should decline to rule on the District Court's statement as it has not yet been fully developed below.

CONCLUSION

For the reasons stated, the appeals from the District Court's December 9 Order regarding the applicable standard for rejection should not be considered by this Court. In the alternative, the December 9 Order should be affirmed with respect to the proposed standard.

Respectfully submitted,

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May 19, 2005

CERTIFICATE OF SERVICE

I hereby certify that I have, this 19th day of May, 2005, served the foregoing by causing two copies of the Brief of Appellee Federal Energy Regulatory Commission, and one copy in PDF format on a computer diskette, to be sent by mail to the counsel listed below.

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CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C)(i) and 5th Cir. R. 32.3, I certify that the Brief of Appellee Federal Energy Regulatory Commission is proportionately spaced, has a typeface of 14 points, and contains 8,391 words, not including the tables of contents and authorities and the certificates of counsel.

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