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CLIENT ALERT

Fifth Circuit Clarifies When Bankruptcy Courts Must Abstain from Complex State Law Issues in Chapter 15 Proceedings

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Two years ago, winter storm Uri raged across the southern United States, devastating the energy grid in Texas. In the aftermath, several energy companies filed for bankruptcy. A recent Fifth Circuit opinion from one case highlights a tension that can arise when bankruptcy courts confront complex issues of state law as part of a restructuring—especially in the context of chapter 15 proceedings, which allow a company pursuing insolvency proceedings in a foreign jurisdiction to file bankruptcy in the United States as well.[1]

Chapter 15 proceedings provide significant protection to debtors, such as imposing an automatic stay on all U.S. litigation and requiring any disputes to instead go through the bankruptcy court. What's more, in chapter 15 cases, federal law generally prohibits courts from abstaining from legal issues under 28 U.S.C. § 1334(c) ("section 1334(c)").[2] This further streamlines chapter 15 proceedings by helping to ensure that the bankruptcy court serves as the single forum for disputes. At the same time, when complex state issues arise in connection with a chapter 15 bankruptcy case, federal courts may question whether those disputes belong in state court, rather than federal court.

Recently, the Fifth Circuit confronted this exact scenario in the context of a post-Uri chapter 15 case and held that abstention should have prevailed. Just Energy Group Inc. ("Just Energy") filed insolvency proceedings in Canada under the Companies' Creditors Arrangement Act and then filed ancillary chapter 15 proceedings in the Southern District of Texas. In connection with its chapter 15 cases, Just Energy sought to challenge amounts it had paid to ERCOT (the Electric Reliability Council of Texas) in the wake of Uri.

The backdrop of the *Just Energy* opinion is the state of Texas's uniquely insular energy system. Texas's Public Utility Regulatory Act established ERCOT as an independent operator of Texas's state-specific electrical grid. ERCOT's role is to manage the wholesale electricity market and set market-clearing prices for energy in Texas. Just Energy and others like it buy their power from ERCOT at the price ERCOT sets. During Uri, the interrupted supply and immense demand for energy strained the entire Texas energy system, leading ERCOT to set the price at $9000 per megawatt hour for more than 80 hours. This price caused Just Energy to face a $335 million bill from ERCOT, which Just Energy was unable to pay and ultimately led to the bankruptcy filing.

Just Energy eventually paid ERCOT the monies owed but filed a complaint against ERCOT in its chapter 15 proceedings,[3] alleging that at least $274 million of the $335 million was invalid and constituted a preferential

payment under Canadian law.[4] In response, ERCOT argued (among other things) that, notwithstanding section 1334(c), mandatory abstention under the *Burford* doctrine required the bankruptcy court to dismiss Just Energy's complaint because of the state-law issues that Just Energy had invoked. The *Burford* doctrine outlines five factors that apply to determine when a federal court should abstain from hearing a state law dispute:

- whether the plaintiff raises a state or federal claim;
- whether the case involves unsettled state law or detailed local facts;
- the importance of the state's interest in the litigation;
- the state's need for coherent policy; and
- whether there is a special state forum for judicial review.[5]

ERCOT argued that the *Burford* doctrine applied because Just Energy was raising complex challenges whether the Public Utility Commission of Texas had complied with Texas law.

The bankruptcy court disagreed with ERCOT—although, before doing so, it took the unusual step of striking certain allegations from the complaint.[6] The bankruptcy court held that mandatory abstention did not apply, but it certified ERCOT's direct appeal to the Fifth Circuit for further review.[7]

Before the Fifth Circuit, Just Energy argued that section 1334(c) barred the bankruptcy court from applying any abstention doctrine—including *Burford* abstention. The Fifth Circuit quickly discarded that argument, noting that ERCOT did not argue abstention under section 1334(c), and rather argued abstention under *Burford*. The court also confirmed that the *Burford* doctrine and section 1334(c) are "distinct" abstention doctrines and that they "stand alone."[8]

Having concluded that section 1334(c) did not prohibit *Burford* abstention, the Fifth Circuit analyzed the five *Burford* factors and ultimately agreed with ERCOT that the bankruptcy court should have abstained from Just Energy's complaint:

1. **Whether the plaintiff raises state or federal claims**: The Fifth Circuit concluded that this factor weighed against abstention, as Just Energy pled claims under Canadian and federal law. Still, as discussed below, the Court found that the remaining four factors weighed heavily in favor of abstention;
2. **Whether the case involves unsettled state law or detailed local facts**: The Fifth Circuit found that the merits of Just Energy's case would require the court to weigh competing local interests and review agency decisions in an area in which the agency and local courts would be vastly more qualified;
3. **The importance of the state's interest in the litigation**: The Fifth Circuit found that Texas has an unquestionable interest in regulating and litigation involving its state utilities. The Court emphasized that regulating utilities is one of the most important functions performed by the states, thus creating strong support for abstention;
4. **The state's need for coherent policy**: The Fifth Circuit likewise found that this factor favored abstention because federal interference in the state's complex utility scheme could cause significant harm; and
5. **Whether there is a special state forum for judicial review of the issue**: The Fifth Circuit reasoned that Texas law and ERCOT policy dictates that disputes over invoices must be brought first before the regulator, appealed to the Public Utility Commission of Texas, and, finally, to the Travis County district court.

Accordingly, the Fifth Circuit ultimately determined abstention was appropriate, vacated the bankruptcy court's order, and remanded the energy pricing dispute to the bankruptcy court to abstain so that the dispute would ultimately be decided by a local state court. The Fifth Circuit noted that "for this Court to inject itself into the matter could be exactly the type of interference *Burford* abstention exists to avoid."[9]

Following this decision, ERCOT may seek to have other Uri-related matters pending in bankruptcy court remanded to state court, which could further delay the administration of the associated bankruptcy—and not just in chapter 15

cases. Further, bankruptcy courts may hesitate to exercise jurisdiction over any issues that rest arguably in the states' arena, especially if they raise novel or complex state issues.

While Texas's energy management system is unique in the United States, this decision could have implications outside of ERCOT, especially with similarly situated state regulatory bodies. While the *Just Energy* opinion notes that regulating utilities is an especially important interest of state governments, there is little about the *Burford* doctrine that would not apply, at least in part, to other state entities.

That said, the Court did note that, because Texas's electricity grid is entirely intrastate, management of the market is of particular importance to Texas. Other states do not have a similar concern, as the other 47 contiguous states use a national electricity grid. This intrastate vs. interstate analysis could be a crucial factor in determining how much consideration to give this opinion and the *Burford* doctrine generally.

Either way, any party considering filing a complaint against a state actor or other entity entwined with a state should consider the *Burford* doctrine and the Court's opinion to determine whether abstention could be an issue.

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[1] 11 U.S.C. §§ 101 *et seq.* The point of chapter 15 is to recognize foreign insolvency proceedings in the United States and provide a framework to administer the assets in the United States. Some of the provisions of chapter 11 are available under chapter 15.

[2] "Except with respect to a case under chapter 15 of title 11, nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11." 28 U.S.C. § 1334(c)(1).

[3] *Just Energy Tex., L.P. v. Elec. Reliability Council of Tex., Inc.*, (Case No. 21-04399).

[4] Section 95(1) of the Canadian Bankruptcy and Insolvency Act provides that "[a] transfer of property made, a provision of services made, a charge on property made, a payment made, an obligation incurred or a judicial proceeding taken or suffered by an insolvent person (a) in favour of a creditor who is dealing at arm's length with the insolvent person, or a person in trust for that creditor, with a view to giving that creditor a preference over another creditor is void as against ... the trustee if it is made, incurred, taken or suffered, as the case may be, during the period beginning on the day that is three months before the date of the initial bankruptcy event and ending on the date of the bankruptcy[.]" Thus, under Canadian law, a preferential transfer is a payment made to a creditor in the three months before a debtor's bankruptcy filing.

[5] *Harrison v. Young*, 48 F.4th 331, 339–40 (5th Cir. 2022) (citing *Grace Ranch, L.L.C. v. BP Am. Prod. Co.*, 989 F.3d 301, 313 (5th Cir. 2021), *as revised* (Feb. 26, 2021)); *see also Burford v. Sun Oil Co.*, 319 U.S. 315 (1943) (hereinafter *Burford*).

[6] The bankruptcy court also dismissed other counts of the complaint before denying the remainder of ERCOT's motion.

[7] *Elec. Reliability Council of Tex., Inc. v. Just Energy Tex. L.P. (In re Just Energy Grp., Inc.)* 57 F.4th 241 (5th Cir. 2023) (hereinafter *Just Energy*).

[8] *Id.* at 248.

[9] *Id.* at 254.

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