

Make (Whole) A Minute: Brazos Bankruptcy Update

July 26, 2021

Beginning on February 13, 2021, something unprecedented happened in the state of Texas—a winter storm caused temperatures to dip well-below freezing. This event, dubbed the “Black Swan Winter Event,” caused Texas to experience a catastrophic energy crisis. As demand for energy soared, supply plummeted as power plants tripped offline and natural gas supply lines froze. The storm raged on, and on February 16, the Public Utility Commission of Texas (“PUCT”), which oversees the Electric Reliability Council of Texas, Inc. (“ERCOT”), issued a directive to ERCOT (an independent system operator that serves as a clearinghouse for market transactions between electricity buyers and sellers throughout the majority of Texas) instructing it to raise prices to \$9,000 per MWh. The previous three months’ average was between \$21 and \$29 per MWh.

In connection with the Black Swan Winter Event, ERCOT billed Brazos Electric Power Cooperative, Inc. (“Brazos”), Texas’s largest and oldest generation and transmission electric cooperative, more than \$2.1 billion for a seven-day period. By comparison, in 2020, Brazos’ total power costs to its cooperative members was about \$774 million. The \$2.1 billion came due during the week of February 22. Unsurprisingly, this was a bill Brazos could not pay, and on March 1, Brazos commenced a chapter 11 bankruptcy case in the U.S. Bankruptcy Court for the Southern District of Texas.

Throughout Brazos’ four months in bankruptcy, the key players have expressed a commitment to the Debtor’s reorganization and exit from bankruptcy by way of a chapter 11 plan. At the same time, the Texas legislature, governor and others have made various proclamations on the winter storm and also passed related legislation. It is with this background and within this context that, on June 28, 2021, Brazos filed a motion seeking fairly standard relief—an extension of the period during which only it can file a plan of reorganization. In the motion, Brazos described the recently passed legislation as appearing to “compound the complexities of the Debtor’s case, raising potential hurdles to the Debtor’s ability to continue as a market participant in the ERCOT power region and complicating the Debtor’s restructuring strategy and ongoing plan negotiations.”

In response to the motion, ERCOT filed a statement that disclaimed any opposition to Brazos’ motion but previewed two other issues with respect to its claim. First, ERCOT

Contact Information

If you have any questions concerning this alert, please contact:

Renée M. Dailey

Partner

renee.dailey@akingump.com

Hartford

+1 860.263.2922

Sarah Link Schultz

Partner

sschultz@akingump.com

Dallas

+1 214.969.4367

J. Porter Wiseman

Senior Counsel

jwiseman@akingump.com

Washington, D.C.

+1 202.887.4219

Rachel Biblo Block

Counsel

rbibloblock@akingump.com

Dallas

+1 214.969.2736

argues that its alleged nearly \$1.9 billion claim must be paid in order for Brazos to continue participating in the ERCOT market. This is so, ERCOT contends, because to participate in the market, Brazos must assume its contracts with ERCOT,¹ and the Bankruptcy Code requires a debtor to cure monetary defaults contemporaneously with assumption of a contract. If ERCOT is correct, then a debtor participant in the ERCOT market could never reject any contract with ERCOT and continue to participate in ERCOT as a reorganized debtor without separate agreement from ERCOT. Pursuant to the Bankruptcy Code, only “executory” contracts—contracts where each party has remaining material obligations as of the date a bankruptcy case is commenced—can be assumed or rejected by a debtor, and whether ERCOT’s agreements and protocols fall within the “executory” umbrella has not yet been presented to the Bankruptcy Court for a determination.

Second, ERCOT alleges that its claim is for “goods” that Brazos received in the twenty days prior to the filing of its bankruptcy case, and therefore, pursuant to section 503(b)(9) of the Bankruptcy Code, must be paid in full in cash as part of any plan of reorganization for Brazos. Courts are divided as to whether electricity constitutes a “good” under section 503(b)(9), and the Bankruptcy Court may have the opportunity to weigh in on this debate.

ERCOT’s position is likely related to the requirements of the Texas securitization legislation which states, among other things, that (1) all market participants have to pay amounts owing to ERCOT in full and ERCOT shall pursue such payment in full and (2) ERCOT shall not serve an entity’s loads or permit an entity to be a market participant until ERCOT is paid in full.

ERCOT certainly teed up some important and interesting issues, even though, at the time of filing its response, these issues were not yet ripe. Brazos, however, brought those issues to the forefront, when it filed an objection to ERCOT’s claim eight days later. In the objection, Brazos argues that ERCOT’s claim should be disallowed in part, reduced, and reclassified as a general unsecured claim because: (1) ERCOT’s decision to follow PUCT’s order instead of complying with the terms of the ERCOT Contracts constituted a material breach that excused Brazos’ performance under those contracts; (2) ERCOT made no effort to mitigate its claim; (3) Brazos was not in default prior to commencing its bankruptcy case, so any part of ERCOT’s claim based on an alleged default should be disallowed; (3) Brazos faced an impossible decision of going along with ERCOT’s pricing during the storm or objecting and putting its members’ customers’ lives and property in danger; (4) ERCOT’s charges for ancillary services during the storm far exceeded the applicable cap; (5) ERCOT’s failure to protect the market during the storm was a material breach of the ERCOT Contracts; and (6) ERCOT’s claim is not entitled to the benefits of section 503(b)(9) because, among other reasons, electricity is not a “good.”

The Bankruptcy Court scheduled a status conference on ERCOT’s claim and Brazos’ objection on August 10, 2021. We will continue to monitor Brazos’ bankruptcy case to see whether the Debtor can reach an agreement with ERCOT or whether the parties will battle over ERCOT’s claim and consequently, the Debtor’s path to exit bankruptcy.

¹ The contracts that ERCOT believes must be assumed are: (1) an ERCOT Private Wide Area Network (WAN) Agreement, (2) a Standard Form Market Agreement, (3) a Standard Form Emergency Response (ERS) Supplement to the Standard Form Market Agreement, and (4) the ERCOT Nodal Protocols (the rules and policies governing the ERCOT wholesale market) (collectively, (1) through (4), the “ERCOT Contracts”).