Regulating or Reorganizing?: Depriving Federal Bankruptcy Courts of Their Statutory Authority and Misapplying Fundamental Tenets of Bankruptcy Law in *In re Cajun Electric Power Cooperative, Inc.*

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Regulating or Reorganizing?: Depriving Federal Bankruptcy Courts of Their Statutory Authority and Misapplying Fundamental Tenets of Bankruptcy Law in In re Cajun Electric Power Cooperative, Inc.*

I. INTRODUCTION

On August 16, 1999, the United States Court of Appeals for the Fifth Circuit deprived the United States Bankruptcy Court for the Middle District of Louisiana of its jurisdiction authority over Chapter 11 reorganizations and misapplied "fundamental tenets of bankruptcy law." More specifically, the Fifth Circuit granted a state regulatory agency extraordinary jurisdiction over Chapter 11 issues typically within the jurisdiction of a bankruptcy court and gave unusual application to the bankruptcy codes and case law governing the "breathing spell" granted to debtors under sections 502(b)(2) and 362 and the absolute priority rule under section 1129(b).

The Fifth Circuit justified its holding on two primary factors: the debtor in the case, Cajun Electric Power Cooperative, Inc. ("Cajun") is a billion dollar regulated utility with over seven hundred creditors; and the appellant, Louisiana Public Service Commission ("LPSC"), is the guardian of the interest of Louisiana residents (i.e., public interest). This Note examines whether Fifth Circuit's analysis and justifications were sufficient to warrant depriving the Bankruptcy Court of its jurisdictional authority and the misapplication of fundamental tenants of bankruptcy law in In Re Cajun. Accordingly, Part II provides the background relating to a bankruptcy court's jurisdiction both over matters relating to bankruptcy and over the interpretation of the Bankruptcy Code, particularly in contrast to a state regulatory agency and administrative law judge. In addition, this section will set out the background of the "breathing spell" un-

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1. See In re Cajun Elec. Power Coop., 185 F.3d 446 (5th Cir. 1999).
2. See Brief of Appellee Ralph R. Mabey, Chapter 11 Trustee for Cajun Electric Power Cooperative, Inc., et. al. at 1, in Re Cajun, 185 F.3d at 446 (No. 98-31258) (hereinafter "Brief of Mabey") (on file with the author).
3. See id.
4. In re Cajun, 185 F.3d at 448, 454.
5. See id. at 454.

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der sections 502(b)(2) and 362 and the absolute priority rule under section 1129(b). Part III contains the facts of In re Cajun Electric Power Cooperative, Inc., and a short recitation of the court's reasoning. Finally, Part IV analyzes the reasoning of the court. This Note concludes that the Fifth Circuit's justifications for its holding were not sufficient to warrant the court's unusual application of the bankruptcy law.

II. BACKGROUND

Chapter 11 of the Bankruptcy Code was enacted in 1978 to enable reorganization of both solvent and insolvent entities.\(^6\) To ensure a successful reorganization, bankruptcy courts were given the remarkable power to "issue any order, process, or judgment that is necessary or appropriate" to enforce the provisions of the Bankruptcy Code and exercise jurisdiction over all matters relating to the bankruptcy case.\(^7\) In addition, the Bankruptcy Code contains specific rules that govern the relationship between the debtor and its creditors and that are intended to grant the debtor a "breathing spell" from financial obligations owed to its creditors.\(^8\) Because the creditors of a debtor often have conflicting interests and claims, the Bankruptcy Code enforces the so-called "absolute priority rule."\(^9\) This rule prevents a junior class of creditors from leapfrogging senior classes of creditors (unless the senior class of creditors agree) to obtain a greater distribution.\(^10\) Since all of these rules play an important role in the analysis and holding of In Re Cajun, the background of each will be considered in turn.

A. The Broad Power of the Bankruptcy Court

Under 28 U.S.C. § 1334(e), "the district court in which a case under title 11 is commenced or pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate."\(^11\) This broad jurisdictional grant to district courts is intended to centralize all proceedings related to the bankruptcy into one court.\(^12\) The federal court's jurisdiction, how-

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7. 11 U.S.C. § 105(a) (1999); see also infra Part II.A.


10. See id.


ever, is not absolute. For example, state law can exercise authority over the debtor’s property, such as property taxes, state licensing requirements and state environmental law requirements. In addition, the state can exercise “traditional ratemaking” authority over public utilities in Chapter 11, as discussed in Part II.B.1 below. The state’s authority, however, is not limitless and may be restricted by the bankruptcy court if used to substantially impede the rights of other, more senior creditors.

To ensure the centralization of the bankruptcy proceeding, Congress has given bankruptcy courts power, pursuant to 11 U.S.C. §105(a), to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.” One equitable remedy available under section 105(a) is an injunction. For a court to issue an injunction, the debtor must show that it will otherwise suffer irreparable harm. Once the bankruptcy court issues the injunction, it will be reviewed only for an abuse of discretion. Thus, Congress has given bankruptcy courts not only original jurisdiction over the debtor’s property but also flexibility as to the disposition of that property.

B. The Breathing Spell

The purpose of Chapter 11 is to reorganize “financially distressed” businesses by adjusting its “debt obligations and equity interest.” The reorganization of the debtor would be impossible without allowing the debtor a “breathing spell” from its creditors and debts. This “breathing spell” takes many forms under the Bankruptcy Code and often remains in force until the debtor’s plan of reorganization has been confirmed by the bankruptcy court or the debtor has been liquidated. Pertinent to this Note are two “breathing spell” rules: section 362(a) and section 502(b)(2).

16. See, e.g., NORTON, supra note 6, at 95-97 (citing numerous examples of cases of bankruptcy courts using their injunctive powers).
17. See, e.g., In re Heiney, 858 F.2d 548, 20 Collier Bankr. Cas. 2d (MB) 5 (9th Cir. 1988) (Bankruptcy Court has the power to enjoin if there is no adequate remedy of law and if there is a showing of irreparable injury if equitable relief is denied.); see also In re Cajun, 185 F.3d at 455.
18. See Indian Motorcycle Assocs. III Ltd. Partnership v. Massachusetts Hous. Fin. Agency, 66 F.3d 1246, 1249 (1st Cir. 1995) (“A bankruptcy court’s decision granting or denying injunctive relief pursuant to Bankruptcy Code § 105(a) is reviewed only for abuse of discretion.”); Commonwealth Oil Refining Co. v. United States EPA (Matter of Commonwealth Oil Refining Co.), 805 F.2d 1175, 1188 (5th Cir. 1986) (reviewing bankruptcy court’s refusal to grant stay under § 105(a) for abuse of discretion); Cargill, Inc. v. United States, 173 F.3d 323, 341 (5th Cir. 1999) (stating that a court abuses its discretion in granting injunctive relief when it “relies on erroneous conclusions of law, or . . . misapplies its factual or legal conclusions”).
19. NORTON, supra note 6, at 963.
1. The automatic stay under section 362(a)

When the Bankruptcy Code was enacted in 1978, the House Report said about 11 U.S.C. § 362(a)(1):

The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or organization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy . . . . The automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property . . . . Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are created equally . . . . Subsection (a) defines the scope of the automatic stay, by listing the acts that are stayed by the commencement of the case . . . . The scope of the paragraph is broad. All proceedings are stayed, including arbitration, license revocation, administrative, and judicial proceedings.20

There are, however, exceptions to the automatic stay. One of these, found in 11 U.S.C. § 362(b)(4), allows "the commencement or continuation of an action or proceeding by a governmental unit . . . to enforce such government unit's . . . police and regulatory power."21 The application of this section was recently discussed in Board of Governors, FRS v. MCORP Financial, Inc.22 The MCORP court held that the automatic stay did not authorize the district court to enjoin "ongoing, nonfinal administrative proceedings."23 To hold otherwise, the court opined, would "render subsection (b)(4)'s exception almost meaningless."24

Supportive of the section 362(b)(4) exception is 11 U.S.C. § 1129(a)(6). Section 1129(a)(6) provides that the court cannot approve a Chapter 11 plan unless, "[a]ny governmental regulatory commission with

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20. Id. at 267-68 (emphasis added).
21. Id.; see also In re Cajun, 185 F.3d at 457. The House Report adds:
Thus, where a governmental unit is suing a debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws, or attempting to fix damages for violation of such a law, the action or proceeding is not stayed under the stay.

This section is intended to be given a narrow construction in order to permit governmental units to pursue actions to protect the public health and safety and not to apply to actions by a governmental unit to protect a pecuniary interest in property of the debtor or property of the estate.

NORTON, supra note 6, at 269.
23. Id. at 41.
24. Id.
jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.” 25 This section has been interpreted as giving regulatory commissions “traditional” rate-making power while the regulated entity is still undergoing reorganization under Chapter 11. 26

The police and regulatory power exception of section 362(b)(4) does not mean a bankruptcy court is powerless to enjoin such an action or proceeding under 11 U.S.C. § 105(a). 27 Indeed, “significant authority” permits a court to enjoin a section 362(b)(4) action. 28 For example, in Commonwealth Oil Refining Co. v. United States Environmental Protection Agency, the Fifth Circuit found that although a court’s power was not unlimited under section 105, “[c]ourts considering the scope of section 105 have seen it as an avenue available for staying actions that are found to fall within an exception to the automatic stay.” 29 In Browning v. Navarro, the Fifth Circuit also held that “[a] bankruptcy court has the power to enjoin proceedings excepted from § 362 stay under 11 U.S.C. § 105.” 30 In the case In re Javens v. City of Hazel Park, the Sixth Circuit held that “[b]y creating exceptions for police and regulatory actions, Congress removed local regulation only from the effect of the automatic stay; it did not eliminate the bankruptcy court’s power to enjoin the enforcement of local regulation which is shown to be used in bad faith.” 31

26. See In re Cajun, 185 F.3d at 451-52, 453; see also Frank P. Darr, Federal-State Comity in Utility Bankruptcies, 27 AM. BUS. L. J. 63, 98-90 (1989) (arguing that section 1129(a)(6) “suggests that the commission retains significant authority to govern rates throughout the bankruptcy . . . . [A] regulatory commission retains its traditional control over rates prior to the finalization of the plan.”).
27. See In re Cajun, 185 F.3d at 452-53; see also 11 U.S.C. § 105, discussed at infra Part II.A. As one of the appellees points out:
Section 362(a)(3) of the Bankruptcy Code imposes an automatic stay applicable to the LPSC and protects property of the Debtor’s estates. The LPSC asserts that the recent amendment of Section 362(b)(4) of the Bankruptcy Code evidences a Congressional intent to allow governmental agencies to obtain property of the estate without implicating the automatic stay. If that interpretation is true, then the necessity and wisdom of the lower courts injunction is evident; it prevents the wholesale destruction of the bankruptcy system by allowing state agencies carte blanche to take estate property and distribute it according to principles in clear derogation of bankruptcy law. Newly amended 362(b)(4), however, may be read more narrowly than prior to its amendment if it only applies to governmental units exercising authority under the Convention on the Prohibition of the Development, Stockpiling, and Use of Chemical Weapons—a reading which is not unreasonable.

28. See In re Cajun, 185 F.3d at 457 n.18.
29. Commonwealth Oil Refining Co. v. United States EPA (In re Commonwealth Oil Refining Co.), 805 F.2d 1175, 1188 n.16 (5th Cir. 1986).
30. 743 F.2d 1069, 1084 (5th Cir. 1984).
31. 107 F.3d 359, 366 (6th Cir. 1997).
The First Circuit held that "a bankruptcy court does possess the power, in exceptional circumstances, to enjoin even administrative proceedings that are exempt from the automatic stay pursuant to section 364(b)(4), (5)."32

2. Interest quandary under § 502(b)(2)

Pursuant to 11 U.S.C. § 502(b)(2), claims for interest unmatured as of the time of the bankruptcy filing are disallowed.33 The rationale behind section 502(b)(2) was stated as early as 1946:

Exaction of interest, where the power of a debtor to pay even his contractual obligations is suspended by law, has been prohibited because it was considered in the nature of a penalty imposed because of delay in prompt payment—a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of all interests involved.34

This rationale is reiterated in the legislative history to section 502(b) which states that bankruptcy filing stops interest from accruing on any prepetition debt.35 Nevertheless, in cases such as In re Johnson, courts have held that creditors may continue to accrue postpetition interest on non-dischargeable debts.36 Additionally, any interest that matures postpetition is only discharged if and when the debtor is discharged from bankruptcy.37

Because section 502(b)(2) only provides temporary relief for the debtor from interest payments, which may or may not later be discharged, this rule acts very much like an automatic stay or "breathing spell" against postpetition interest until the debtor is either discharged or liquidated. In this manner the debtor is able to use the funds it would have otherwise had to pay for postpetition interest and apply it towards administrative and reorganizational costs and the payment of pre-petition debt. More importantly, however, the debtor's interest payments can amount to millions of dollars, the payment of which during bankruptcy may deprive both the debtor of much needed funds to facilitate reorganization and the unsecured creditor of equal treatment.38

35. See NORTON, supra note 6, at 404.
36. See In re Johnson, 146 F.3d 252, 260 (5th Cir. 1998).
37. See 11 U.S.C. §§ 727(b), 1141(d); see also In Re Cajun, 185 F.3d at 455.
38. See, e.g., In re Fesco Plastics Corp. 996 F.2d 152, 155 (7th Cir. 1993) (section 502(b)(2) furthers the fresh start by "saving the estate" from "having to pay extra for the delay in payment when that delay is necessary if the courts are to preserve and protect the estate for the benefit of all
C. The Absolute Priority Rule

Predating the Bankruptcy Code, the absolute priority rule was generally formulated as follows: "fairness and equity require[] that 'the creditors . . . be paid before the stockholders could retain [equity interest] for any purpose whatever." The absolute priority rule has since been codified in the Bankruptcy Code. The primary purpose of the absolute priority rule is to ensure that "no junior class of unsecured creditors or equity holders may receive or retain any property or value on account of that junior claim or interest unless senior classes of claims or interests consent or are paid in full." Thus, the absolute priority rule protects senior creditors from being leap-frogged by junior creditors, trying to share in the pie before the crumbs are gone.

At the bottom of the senior-junior line-up of creditors are the equity holders of the debtor. These creditors are the ones that stood to gain the most from the now bankrupt entity and, simultaneously, stood to lose the most if the business failed. Generally, in bankruptcy plans equity holders are paid only a few cents on the dollar and are never paid a penny until both senior and junior claim holders are paid in full, or otherwise consent.

III. IN RE CAJUN ELECTRIC POWER COOPERATIVE, INC.

A. The Facts

Cajun generates and sells electricity to twelve electric distribution cooperatives ("Members"—the equivalent of equity holders in a corporation) and others at wholesale rates. These Members and customers in turn sell the electric power to retail consumers in Louisiana and elsewhere. At the time Cajun filed for reorganization, it was more than four billion dollars in debt and had over seven hundred creditors. Over four billion dollars of Cajun's debt was owed to the Rural Utilities Service of the United States Department of Agriculture (RUS).

Two years after Cajun filed for reorganization, on January 23, 1996, the Louisiana Public Service Commission (LPSC), the administrative agency that sets Cajun's wholesale rates, "reopened a rate investigation of Cajun." The LPSC decided to reduce Cajun's rates by $48,437,462 per year, "because Cajun is not paying or accruing interest on its underlying debt during the pendency of its bankruptcy proceeding." In addition, the LPSC required that the "interest expense component of Cajun's rates be collected subject to refund, pending a determination by the bankruptcy court concerning Cajun's interest expense liability during bankruptcy."

The Chapter 11 bankruptcy trustee for Cajun, Ralph Mabey (Mabey), filed an injunctive and a declaratory relief suit in the United States Bankruptcy Court for the Middle District of Louisiana on September 11, 1996. Mabey's request for a preliminary injunction was denied, and the LPSC required Cajun to place its "interest-expense" proceeds in escrow eventually to be refunded to the consumers. On April 2, 1998, the bankruptcy court addressed Mabey's request for a permanent injunction and enjoined LPSC from considering any argument that [Cajun's] wholesale rate to its [M]embers should be lowered during this proceeding based solely upon the suspension of

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45. See In re Cajun, 185 F.3d at 448.
46. See id.
47. See id.
48. See id. at 449.
49. See id.; see also LA. CONST. art. IV, § 21; LA. REV. STAT. ANN. § 45:1163 (West 1999).
50. In re Cajun, 185 F.3d at 449.
52. Id.
53. See id.
54. See id. at 450.
debt service occasioned by the filing of this proceeding, and ruled that Cajun's wholesale rates to its members may not be reduced during this proceeding where such reduction is based solely upon the filing of this case.\textsuperscript{55}

The escrow terminated in April of 1998.\textsuperscript{56} The United States District Court for the Middle District of Louisiana affirmed the bankruptcy court on October 1, 1998.\textsuperscript{57} Ten months later, on August 16, 1999, the United States Court of Appeals, Fifth Circuit, reversed the District Court and held that the issuance of an injunction and termination of the escrow constituted an abuse of the bankruptcy court's discretion.\textsuperscript{58}

\textbf{B. The Fifth Circuit Court's Reasoning}

The Fifth Circuit began its analysis by establishing that both the LPSC and Mabey agreed that "Cajun is a regulated utility and that the LPSC has an obligation under state law to protect the public interest,"\textsuperscript{59} but disagreed "as to whether a public utility commission may properly consider one of the effects of bankruptcy in setting a debtor utility's rates."\textsuperscript{60} In order to resolve the issue of what a public utility commission may or may not consider in setting the utility rates of a debtor under Chapter 11, the Fifth Circuit turned its attention to three determinative issues: (1) whether the "bankruptcy court's conclusion that interest continues to 'accrue' postpetition and that Cajun's interest obligation terminates only if the bankruptcy court grants a discharge" warrants "the injunction that it entered in this appeal";\textsuperscript{61} (2) whether "fundamental" of bankruptcy law (i.e., the "breathing spell" under 11 U.S.C. § 502(b)(2) and 11 U.S.C. § 362, and the absolute priority rule) "provide a proper basis for the bankruptcy court to exercise any discretion that it may have under § 105(a) by enjoining the LPSC's consideration of the proper impact of the suspension of Cajun's interest obligation on its wholesale rates and terminating the escrow provision in the LPSC's rate order";\textsuperscript{62} and (3) whether the "bankruptcy court's assertion that the principles of the absolute priority rule 'permeate the entire chapter 11 case' and that any rate reduction would 'elevate' the [M]embers' equitable interests
over the interests of creditors is similarly insufficient to justify the injunction that the court entered."\(^{63}\)

With regard to the first issue of Cajun’s interest obligation, the Fifth Circuit agreed with the bankruptcy court that “a debtor’s obligation with respect to postpetition interest terminates only ‘if and when’ the debtor obtains a discharge from the bankruptcy court.”\(^{64}\) But, the court did not understand why “an injunction was necessary to carry out the provisions of the Bankruptcy Code.”\(^{65}\) Indeed, the court could see “no meaningful difference” between the bankruptcy court’s original denial of Mabey’s request for a preliminary injunction with regards to the net and the escrow established by the LPSC’s rate order.\(^{66}\) Thus, the court held that because the LPSC’s amended rate order did not make a “final disposition of the contested interest expense component,” the bankruptcy court’s injunction was not warranted.\(^{67}\)

The Fifth Circuit then turned to the issue of whether the “fundamental” tenets of bankruptcy law gave the bankruptcy court discretion under section 105(a) to issue the injunction. Referring to section 502(b)(2), the court reasoned that although the suspension of debt service may enable a debtor to pay for its current operating expenses and administrative costs, it could find no support for Mabey’s “claim that § 502(b)(2) is intended to provide the debtor, a regulated public utility, an unfettered right, vis-a-vis Louisiana consumers, to build up money to give to its undersecured and unsecured creditors.”\(^{68}\) Furthermore, with regards to Mabey’s “breathing spell” argument under both section 502(b)(2) and section 362(a), the court held that the LPSC was a “government unit” exempt from the “breathing spell” under section 362(b)(4).\(^{69}\) Therefore, the court held, “[b]ecause [Mabey] do[es] not argue that the rate-making proceeding at issue in this appeal falls within the automatic stay provided by § 362(a) or else outside the exception to stay provided by § 362(b)(4), the injunction cannot properly rest on the ‘breathing spell’ afforded by § 362(a).”\(^{70}\)

Finally, the court addressed the issue of the absolute priority rule. The court said that the fact that the “rate reduction would ‘elevate’ the [M]embers’ equitable interests over the interests of creditors” was insuf-

\(^{63}\) Id. at 458 (citations omitted).
\(^{64}\) Id. at 455.
\(^{65}\) Id.
\(^{66}\) See id.
\(^{67}\) Id.
\(^{68}\) Id. at 457 (emphasis in original).
\(^{69}\) See id.
\(^{70}\) Id.
ficient "to justify the injunction." The court justified its reasoning because LPSC's rate order explicitly provided that all amounts from the escrow would be refunded to the consumers.

IV. Analysis

This Note disagrees with the Fifth Circuit's analysis and conclusion. According to the Fifth Circuit, the primary issue in the case concerns "whether a public utility commission may properly consider one of the effects of bankruptcy in setting a debtor utility's rates." The court then proceeded to analyze this issue by asking whether the bankruptcy court abused its discretion by enjoining the public utility commission from making such a consideration. The court, applying the points of law discussed above, held that the bankruptcy court did abuse its discretion.

The Fifth Circuit analyzed the issues and reached its conclusion, "[k]eeping in mind the role of the LPSC as a guardian of the public interest and Cajun as a regulated utility."

This Note's analysis begins by placing the Fifth Circuit's statement of the primary issue into context. This Note will then demonstrate that the court improperly deprived the bankruptcy court of its jurisdictional authority. Next, this Note will argue that the court wrongly applied "fundamental tenants of bankruptcy law": the "breathing spell" and the "absolute priority rule." Finally, this Note asserts that it was not proper for the court to treat this Chapter 11 case differently from other cases because the LPSC was a "guardian of the public interest" and Cajun was a regulated utility.

A. The Court's Primary Issue in Proper Context

The court's statement of the primary issue of the case is oversimplified and does not set up a proper analysis of the sub-issues. The court's statement of the issue declares merely that the LPSC had considered "one of the effects of bankruptcy in setting a debtor utility's rates." But, perhaps not surprisingly, the court did not say: (1) what the "one" effect was that the LPSC considered in setting Cajun's utility rates; and (2) that based solely on this "one" effect (i.e., Cajun was in bankruptcy), the LPSC decided to reduce Cajun's rate's 19% (or approximately

71. Id. at 458 (citations omitted).
72. See id.
73. Id. at 454.
74. See id. at 453.
75. See id.
76. Id. at 454.
77. Id. at 454.
$48,000,000 per year). As will be discussed below, by permitting the LPSC to reduce Cajun’s rates because Cajun was in Chapter 11 the court violates the Bankruptcy Code, including the bankruptcy court’s exclusive jurisdiction over the debtor’s property.

Returning to the Fifth Circuit’s decision, there was little argument that the LPSC had the authority to reduce or increase Cajun’s rates under their “traditional ratemaking authority.” Indeed, prior to the present case, the LPSC reopened Cajun’s “rate docket” and exercised its traditional authority several times by reducing Cajun’s average wholesale electric rates to Members. These rate proceedings and subsequent reductions of Cajun’s rates were initially challenged by Mabey, Cajun’s Chapter 11 trustee. The bankruptcy court, however, held that “LPSC retained ‘traditional’ ratemaking authority over Cajun’s rates during the pendency of Cajun’s Chapter 11 proceedings.” But, the court added “that it would continue to monitor the rate docket for ‘particular problems that may result from the conduct of the rate docket’ and that the court would continue ‘to be interested in what’s taking place insofar as the rate docket is concerned.’” Soon thereafter, the bankruptcy court’s interest perked up.

On October 29, 1996, LPSC ordered a third reduction of Cajun’s revenues from Member rates. In contrast to the two previous reductions ordered by the LPSC (8% and 3%), this reduction was 19% (or $48,437,462 in annual revenues). In addition to this large reduction, the rate reduction was “based solely upon the post-filing suspension of Cajun’s debt service obligation pursuant to [section 502(b)(2) of] the Bankruptcy Code.” When the issue reached the bankruptcy court, the court held that the LPSC could not base a rate reduction solely on the fact that Cajun was operating under Chapter 11. The LPSC conceded that the bankruptcy court had jurisdiction over the legal issue of Cajun’s debt service obligation. But the LPSC maintained that it continued to have authority to “order the rate reduction.”

79. See id. at 6.
80. See id. at 7-8.
81. Id. at 7.
82. Id.
83. See id. at 8.
84. Id.
85. See id. at 5.
86. See id. at 10.
87. Id.
Thus, the LPSC allowed Cajun to collect, but escrow, the $48,437,462 annual interest expense pending the bankruptcy court's determination of the debt service obligation.\footnote{\textsuperscript{88}}

The Fifth Circuit concluded that "[b]ecause the LPSC's amended rate order merely sets aside and does not purport to make a final disposition of the contested interest expense component, the bankruptcy court's conclusion that interest continues to 'accrue' postpetition and that Cajun's interest obligation terminates only if the bankruptcy court grants a discharge does not warrant the injunction that it entered in this appeal."\footnote{\textsuperscript{89}} The court reached this conclusion because it saw "no meaningful difference" between the escrow LPSC wanted to establish for Cajun's equity holders (Member/ratepayers) and a potential bankruptcy court decision, under section 502(b)(2) at the end of the bankruptcy, that Cajun would owe the Members any interest that had accrued during the Chapter 11 proceedings.\footnote{\textsuperscript{90}}

The differences between the two possibilities, however, are both obvious and very meaningful. The first meaningful difference is that the Fifth Circuit's decision gives the LPSC authority to exercise substantial control over Cajun's property that is strictly under the jurisdiction of the bankruptcy court. Second, giving the LPSC authority to control Cajun's property deprives Cajun of the "breathing spell" granted to all debtors under Chapter 11. Third, allowing the LPSC to dispose of the property through an escrow, with the intention to refund it to the Members and eventually the consumers, violates the absolute priority rule under section 1129(b). Finally, permitting the LPSC to exercise control over Cajun's property is not warranted simply because the LPSC is "guardian of the public interest." Moreover, this line of analysis ignores the bankruptcy court's jurisdictional authority and the "fundamental tenets" of bankruptcy law.

\textbf{B. The Jurisdictional Authority of the Bankruptcy Court}

The Fifth Circuit stated that it could "see no meaningful difference" between a bankruptcy court, at the end of bankruptcy, ordering the debtor to repay post-petition interest on debts (under section 502(b)(2)) and LPSC's escrow established by the rate order.\footnote{\textsuperscript{91}} Even before the merits of this statement are reached, there is an important, underlying problem that the Fifth Circuit overlooked. By asserting that there is no mean-

\footnotesize\textsuperscript{88} Debt service obligations, as discussed above, are almost always discharged, but not until the end of bankruptcy. \textit{See supra} Part II.B.2.

\footnotesize\textsuperscript{89} \textit{In re Cajun}, 185 F.3d at 455.

\footnotesize\textsuperscript{90} \textit{See supra} note 66 and accompanying text.

\footnotesize\textsuperscript{91} \textit{See In re Cajun}, 185 F.3d at 455.
meaningful difference between a bankruptcy court's decision under the Bankruptcy Code and the LPSC's decision interpreting the Bankruptcy Code (because both decisions potentially have the same effect), the Fifth Circuit is asserting that the interpretation of the Bankruptcy Code by the LPSC, a state regulatory agency, is just as authoritative as a bankruptcy court's. Certainly there is a huge difference between how these two entities interpret and apply the Bankruptcy Code.

The Fifth Circuit relies on sections 362(b)(4) and section 1129(a)(6) to support its conclusion that the LPSC can reduce Cajun's rate by 19%. The extent of a regulatory commission's control over a Chapter 11 debtor's property under the section 362(b)(4) exception was addressed by the Supreme Court in Board of Governors, FRS v. MCORP Financial, Inc, a case not discussed by the Fifth Circuit. As stated above, the MCORP court held that the "automatic stay provisions of the Bankruptcy Code [do not] have any application to ongoing, nonfinal administrative proceedings." But, concerning the administrative proceedings, the court stated:

It is possible, of course, that the Board [regulatory agency] proceedings, like many other enforcement actions, may conclude with the entry of an order that will affect the Bankruptcy Court's control over the property of the estate, but that possibility cannot be sufficient to justify the operation of the stay against an enforcement proceeding that is expressly exempted by § 362(b)(4)... If and when the Board's proceedings culminate in a final order, and if and when judicial proceedings are commenced to enforce such an order, then it may well be proper for the Bankruptcy Court to exercise its concurrent jurisdiction under 28 U.S.C. § 1334(b).

In Cajun the bankruptcy court followed the guidelines set by MCORP by not prohibiting the LPSC from exercising its "traditional" ratemaking authority over Cajun. Furthermore, the bankruptcy court did not prohibit the LPSC from holding administrative proceedings on rate reductions while Cajun was in Chapter 11. But when the LPSC's rate reduction order was put into force and Cajun was deprived of more than $48,000,000 in annual assets, the bankruptcy court correctly saw that reduction as a threat to its "control" over Cajun's property and properly exercised its "concurrent jurisdiction" over the property. In other words, the applica-

92. See id. at 453.
94. See id. at 41.
95. Id. (emphasis in original).
96. See In re Public Serv. Co. of New Hampshire, 108 B.R. 854, 891 (Bankr. D.N.H 1989) (In a utility bankruptcy case, the debtor's value is determined primarily by the rates it can charge.).
tion of MCORP demonstrates that the bankruptcy court did not abuse its discretion by enjoining the LPSC from siphoning a substantial portion of Cajun’s assets from secured creditors to unsecured creditors. More importantly, however, the MCORP decision clearly showed that there can be a “meaningful difference” between a regulatory agency’s control over the debtor’s property and the bankruptcy court’s jurisdiction.

Finally, the LPSC’s “traditional ratemaking” authority does not include interpreting and applying bankruptcy law and appropriating interest assets for equity holders (Members).97 The LPSC’s escrow rate order far exceeds its “traditional ratemaking principles” because the “interest suspension” afforded a Chapter 11 debtor is based solely on (1) the debtor’s filing of a Chapter 11 petition and (2) section 502(b)(2) of the Bankruptcy Code,98 and not on a state regulatory agency’s interpretation of the Bankruptcy Code. Similarly, the LPSC reduced Cajun’s rates because “the record in this proceeding supports a finding that Cajun’s interest expense should be excluded from its rates for the reason that Cajun’s debt service obligation has been suspended during the pendency of its bankruptcy.”99 From this statement it is evident that the LPSC’s sole justification for reducing Cajun’s rates were based on a specific provision of the Bankruptcy Code — 11 U.S.C. § 502(b)(2). Therefore, the LPSC’s action can hardly be justified as “traditional” and clearly falls within the jurisdictional authority of the bankruptcy court.100

C. The Interest Quandary and the “Breathing Spell”

The Fifth Circuit treated the “interest” issue under section 502(b)(2) separately from the “breathing spell” issues, also involving section 502(b)(2).101 This was presumably done because appellees argued that section 502(b)(2) was the proper mechanism for dealing with the interest accruing on Cajun’s debts, as opposed to the LPSC’s escrow, and the postponement under section 502(b)(2)’s of the debtor’s obligation to pay interest on this debt provides a “breathing spell” for the debtor.102 This Note’s analysis will do the same, even though the issues under the two arguments overlap.

97. See Joint Brief of RUS & UCC, supra note 78, at 14 n.11.
98. See id. at 18.
99. Id. at 19.
100. Appellees RUS and UCC provide a nice example of how the LPSC traditionally sets rates. See id. at 18-19.
101. See In re Cajun, 185 F.3d at 456.
102. See id. at 454-58.
1. Adoption of the LPSC’s position would result in a distribution of estate assets contrary to the express statutory provisions of § 502(b)(2) of the Bankruptcy Code. 103

The LPSC reduced Cajun’s rate and set up the escrow because it believed, under section 502(b)(2), that the interest Cajun owed on its debts to the Members ceased to accrue when Cajun filed bankruptcy. 104 This belief is incorrect. Under section 502(b)(2), “postpetition interest continues to accrue until discharge” even if interest may be allowable only on an oversecured claim. 105 Indeed, according to section 502(b)(2), a creditor’s interest claims are not simply cut off when the debtor files for bankruptcy. 106 This principle was upheld in In re Johnson, when the Fifth Circuit (this court) held that creditors can continue to accrue postpetition interest on non-dischargeable debts. 107 In addition, a bankruptcy commentator noted:

Section 502(b)(2) of the Bankruptcy Code prescribes the grounds for objecting to claims in a title 11 case. By itself, it does not change the legal rights of the holder of an obligation against the debtor. There is no discharge. Put another way, the general rule in title 11 cases that there is no accrual of postpetition interest is a rule of convenience governing distributions [i.e., the allowance/disallowance issue] to creditors. It is not a rule of substantive law that converts an interest bearing indebtedness to an nonenforceable, non-interest-bearing indebtedness. 108

On appeal LPSC cited In re Wabash in order to support its proposition that the escrow ordered was appropriate and that interest on the Member’s debt was not owed for the postpetition period. 109 The Fifth Circuit, however, noted that Wabash did not involve a court’s discretion to enjoin a public utility commission’s consideration of a rate decrease based on the suspension of debt service or to terminate a commission’s establishment of an escrow for such funds, and the decision therefore does not affect our resolution of that issue in this appeal. 110

103. See Joint Brief of RUS & UCC, supra note 78, at 21-22 n.14.
104. See id.
105. Id. at 21.
106. See id.
107. See In re Johnson, 146 F.2d 252, 260 (5th Cir. 1998).
108. MYRON M. SHEINFELD ET AL., COLLIER ON BANKRUPTCY, ¶TX 15.05[3][a][i] at TX 15-44 (15th ed. 1998).
109. See In re Cajun, 185 F.3d at 452.
110. Id. at 452 n.8.
Whether intentionally avoiding the consequences of *Wabash* or not, the Fifth Circuit quickly closed the door on a case in which a bankruptcy court had not abused its discretion by enjoining an escrow intended to benefit Cajun’s unsecured creditors (i.e., the Members).

In *Wabash* it was the debtor that contended its rates should be reduced. The court there, however, rejected the debtor’s contention and ordered the funds that had been held in escrow to be paid over to REA (now RUS — same main secured creditor as this case) to reduce the principal of REA’s debt. The court in *Wabash* reasoned that it was “pointless to allow Wabash’s rates to be adjusted downward due to the temporary suspension of its obligation to pay the debt.” Therefore, just because *Wabash* did not officially address a bankruptcy court’s discretion to enjoin a public utility’s rate decrease, *Wabash* certainly stands for the proposition that such an injunction would not have been an abuse of a bankruptcy court’s discretion because such a rate reduction and escrow based on the temporary suspension to pay the debt is “pointless.”

2. The bankruptcy court’s decision, not the LPSC’s order, is “entirely consistent with the important ‘breathing spell’ that Congress provided to debtors under the Bankruptcy Code”.

The Fifth Circuit made short work of the appellee’s “breathing spell” arguments that were based on sections 502(b)(2) and 362(a) of the Bankruptcy Code. First, the Fifth Circuit held that section 502(b)(2) does not provide a breathing spell for Cajun, primarily because Cajun is a “regulated public utility.” Second, the Fifth Circuit argued, there was a better basis for claiming a breathing spell under section 362(a), but that section didn’t apply because LPSC was excepted from the automatic stay under sections 362(b)(4) and 1129(a)(6), discussed above. These arguments will be considered together.

The Fifth Circuit argued:

Although the effect of suspending debt service may be to make it possible for the debtor to use income to pay its current operating expenses and the administrative expenses of the proceeding, we find no support for appellee’s claim that § 502(b)(2) is intended to provide the debtor, a regulated public utility, an unfettered right, *vis-a-vis* Louisiana con-

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111. *See generally In re Wabash Valley Power Ass’n, 72 F.3d 1305 (7th Cir. 1995).*
112. *See Joint Brief of RUS & UCC, supra note 78, at 24; see also infra Part IV.E.*
113. *See Joint Brief of RUS & UCC, supra note 78, at 24-25.*
114. *Id. at 25.*
115. *Id. at 15.*
116. *See In re Cajun, 185 F.3d at 457-58.*
sumers, to build up money to give to its undersecured and unsecured creditors.\(^\text{117}\)

The court makes the assumption that appellees have argued that Cajun is entitled to a breathing spell under either section 502(b)(2) or section 362(a). This assumption is incorrect. The appellees argued that section 502(b)(2) combined with section 362(a) provide the debtor with a "breathing spell."\(^\text{118}\) This distinction is important because section 362(a) (subject to certain exceptions) prohibits the debtor's creditors from collecting both the "principal" of their obligations and the prepetition interest. Likewise, section 502(b)(2) postpones the accrual of postpetition debt on each creditor's claim.\(^\text{119}\) During the debtor's reorganization, the debtor benefits by not having to pay the principal and prepetition interest and by not having to make payments for postpetition debt service.\(^\text{120}\) These two benefits combine in a Chapter 11 case and allow the debtor an opportunity to compile funds that may be used for additional reorganization purposes by making required payments in cash to the senior classes of creditors and other payments to junior classes of creditors to persuade these creditors to approve a plan of reorganization.\(^\text{121}\)

By denying Cajun the "breathing spell" provided under section 362(a), combined with section 502(b)(2), the court has allowed the LPSC to: (1) disrupt the bankruptcy priority scheme;\(^\text{122}\) (2) provide a windfall for the consumers;\(^\text{123}\) and, (3) institute a "myopic and piecemeal setting of rates based upon select bankruptcy provisions."\(^\text{124}\)

\textit{a. Providing a windfall for consumers.} Holding that the "breathing spell" does not apply here and thereby granting the consumers, through the Members, $48,000,000 of Cajun's assets per year provides the consumers with a windfall.\(^\text{125}\) In other words, the consumers receive a tremendous amount of money refunded to them that they otherwise would not have been entitled to had Cajun not filed bankruptcy. Windfalls, however, through the "happenstance" of bankruptcy, are forbidden.\(^\text{126}\)

\(^{117}\) Id. at 457.

\(^{118}\) See Joint Brief of RUS & UCC, supra note 78, at 29; Brief of Mabey, supra note 2, at 36 n.24.

\(^{119}\) See Joint Brief of RUS & UCC, supra note 78, at 27.

\(^{120}\) See \textit{id.} at 27.

\(^{121}\) See Brief of Mabey, supra note 2, at 37.

\(^{122}\) See \textit{id.} at 38. This issue is discussed in this Note's "absolute priority rule" analysis. See supra Part IV.D.

\(^{123}\) See Brief of Mabey, supra note 2, at 39-40.

\(^{124}\) Id. at 40-41.

\(^{125}\) See generally \textit{id.} at 39-40.

\(^{126}\) See Patterson v. Shumate, 504 U.S. 753, 763 (1992) (prohibiting windfalls to a party "merely by reason of the happenstance of bankruptcy").
Therefore, the “breathing spell” should have been enforced, thus preventing the consumers from receiving a windfall.

b. Instituting a shortsighted and fragmented setting of rates. Although bankruptcy provides the debtor with tremendous relief, many costs are associated with a bankruptcy proceeding. Such costs include “administrative costs, professional fees, adequate protection awards, satisfaction of creditors by funding a plan of reorganization, and potential awards of interest based upon one of the exceptions to interest suspension.”

Never did the LPSC raise Cajun’s rates to compensate for these costs during its bankruptcy. By this the LPSC has demonstrated that it is ill-equipped to view all costs and issues since it has only lowered Cajun’s rates in favor of the Members and in disfavor of all other creditors. Thus, relying on the LPSC’s one-sided disposition to view the bankruptcy proceedings in favor of just one party would be detrimental to a successful reorganization of Cajun.

D. The Absolute Priority Rule

Underlying the issues involved in the Fifth Circuit’s decision is the absolute priority rule. As mentioned above, the absolute priority rule, codified in section 1129(b)(2)(B)(ii), precludes a junior class of creditors from receiving property from the bankrupt’s estate before the claims of the senior classes are satisfied. The Fifth Circuit, however, said that the absolute priority rule was not violated when the LPSC decided to place Cajun’s property in escrow, which was later to be refunded to the Members (i.e., equity holders). The court based its conclusion on the fact that the LPSC’s rate order explicitly provided that all monies placed in the escrow account would be refunded to consumers.

The Fifth Circuit misapplied the absolute priority rule. Just because the money was intended to be given eventually to “consumers” does not mean that the absolute priority rule has not been violated. Not surprisingly, the court offers no support for this contention. Instead, the court seems to think that because the money was ultimately being refunded to consumers, not Members, the Members’ interests are not being placed in

127. See Brief of Mabey, supra note 2, at 40.
128. Id.
129. See id. at 41.
130. See id.
131. See id.
133. See In re Cajun, 185 F.3d at 458.
134. See id.
135. See id.
front of more senior creditors. Technically this may be true. Substantively it is not. The money is being refunded to the Members. This is a violation of the absolute priority rule because the money is given to a junior class, the Members, before the claims of more senior classes have been satisfied. This violation is not diminished simply because Members are, in turn, obligated to refund the money to consumers. If anything, the absolute priority rule is violated even more because the money is intended to go to neither creditors of Cajun nor parties to the action. Even the Members recognized this problem and withdrew their support for the LPSC’s position in this appeal. In sum, diverting $48,000,000 of Cajun’s property into escrow to be paid to Cajun’s equity holders, before Cajun’s secured creditors were paid in full and before the bankruptcy court could properly decide the fate of these monies, was clearly a violation of the absolute priority rule.

E. The LPSC as a Public Guardian and Cajun as a Regulated Utility

At the beginning of its analysis of the issues, the Fifth Circuit stated that it would view the issues in light of the fact that the LPSC was a guardian of the public interest and Cajun was a regulated utility. Examining the bankruptcy issues on these two factors above is insufficient to justify unprecedented interpretations of the Bankruptcy Code. Indeed, only once does the Bankruptcy Code suggest that these factors should make any difference in a bankruptcy proceeding. This exception was discussed above and concerns section 362(b)(4) — but it is doubtful whether this section would even apply to the LPSC under the current version of the code. Neither the Bankruptcy Code nor case law suggest that a regulated utility, regulated by guardian of the public interest, should be treated any differently from a normal Chapter 11 debtor.

Substantial abuses could arise if regulated utilities and guardians of the public interest were treated differently from other Chapter 11 debtors. As one appellee explained, the Fifth Circuit’s differentiation based on these factors is contrary to common sense and basic notions of equality. If the LPSC’s approach were correct, an electric cooperative could immediately and

136. See id. ("By the explicit terms of the amended rate order, ‘all amounts refunded to the distribution cooperatives [Members] from the escrow account must be in tum refunded to consumers.’").

137. See Brief of Mabey, supra note 2, at 20-21 ("[T]he Members, the real parties in interest here, . . . [argued] for immediate rate reductions and the retroactive imposition of the interest escrow. The Members have now agreed to the Trustee’s position in this case and withdrawn their demands for rate reductions or the reinstatement of the escrow.").

138. See supra note 21.
drastically reduce its rates, by a third or perhaps more, through the simple expediency of filing a bankruptcy petition. Such a holding would sabotage the RUS's lending program and jeopardize billions of dollars of taxpayer money. Moreover, ensuring that artificially reduced rates remain in effect for as long as the debtor continues in bankruptcy would eliminate any motivation to resolve bankruptcy actions. Under that scenario, the Members and the LPSC would have no incentive to ever support a plan and the longer they delay the case, the more equity and Member-ratepayers would benefit at creditors' expense.\(^\text{139}\)

Thus, the Fifth Circuit's different treatment of a regulated utility and a guardian of the public interest is supported by neither bankruptcy law nor common sense.

V. CONCLUSION

The Fifth Circuit stripped the bankruptcy court of its jurisdiction and held that a state regulatory agency's interpretation was just as authoritative as a bankruptcy court's interpretation. This is false. First, the state regulatory agency did not interpret the Bankruptcy Code correctly. Second, decisions regarding where and how the assets of a debtor under Chapter 11 will be applied are solely within the jurisdiction of the bankruptcy court.

In addition to misconstruing the bankruptcy court's jurisdiction, the Fifth Circuit misapplied "fundamental tenants of bankruptcy law": the breathing spell (including the "interest quandary" and "automatic stay") and the "absolute priority rule." These rules are designed to ensure a fair, uniform management and distribution of the debtor's assets during and after bankruptcy. Instead, under the Fifth Circuit's ruling, a state regulatory agency is able to withhold millions of dollars intended for the survival and proper reorganization of a debtor for the benefit of the lowest Members in the lowest class of a bankruptcy reorganization plan. Finally, these conclusions were incorrectly based on the fact that LPSC was a guardian of public interest and Cajun was a regulated utility.

Scott Kent Brown II

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\(^{139}\) Joint Brief of RUS & UCC, supra note 78, at 32.