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On Second Thought: EFH Court's Extraordinary Move

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In an extraordinary move, on Oct. 3, 2017, the U.S. Bankruptcy Court for the District of Delaware granted a motion to reconsider a decision it made over a year ago in the bankruptcy of Energy Future Holdings Corp. and its co-debtors ("debtors") and in doing so disallowed a $275 million breakup fee to a prospective asset purchaser that it had previously approved.[1] The court found that it had made errors of both fact and law requiring it to overturn its previous decision. The decision is consequential because it effectively denied promised compensation to a prospective buyer that had invested "tens of millions of dollars" in legal fees and presumably more than that in opportunity costs to pursue the transaction, and because it underscores the importance of full and forthright practical (rather than merely technical) disclosure to a court and other parties by parties in interest hoping to rely on its rulings.

Factual Background

The original decision ("termination fee order") arose out of part of the debtors' bankruptcy. NextEra Energy Inc. was set to purchase the debtors' interest in Oncor Electric Delivery Co. LLC.[2] As part of the sale of that interest, the parties negotiated an agreement whereby one of the debtors, Energy Future Holdings Corp. (EFH) would have become a wholly owned subsidiary of NextEra with an approximately $18.7 billion implied Oncor total enterprise value. Included in the merger agreement was a "termination fee" in the amount of $275 million in favor of NextEra (the "termination fee").[3]

The court heard argument on the motion to approve the merger agreement, which included a discussion of the termination fee. However, confusion arose regarding the circumstances under which the termination fee would be triggered. Declarations submitted in support of the motion to approve noted that "Upon Court approval of the Merger Agreement, EFH Corp. and EFIH are liable for the Termination Fee, in the amount of $275 million, as an allowed administrative expense claim, in the event of termination of the Merger Agreement."[4] Further, the motion to approve explained that "The Termination Fee is not payable in the event of, among other things, certain terminations resulting from breaches by NextEra or Merger Subsidiary or following a termination by NextEra at the Termination Date (as defined in the Merger Agreement) where PUCT[5] approval is the only closing condition not satisfied."[6]

However, the merger agreement did not set a date by which PUCT approval had to be obtained and, no party alerted the court that if PUCT did not approve the NextEra transaction, the debtors could eventually be required to terminate the merger agreement and trigger the termination fee unless NextEra voluntarily terminated first.[7] Unappreciated by the court was the fact that NextEra had no obligation to terminate even if PUCT approval was not obtained. It could (and ultimately did) simply wait for the debtors to do so instead.[8]

Because the risk of nontermination by NextEra was never raised (including by any of the numerous objecting parties), the court approved the merger agreement, including the termination fee. However, the merger ran into regulatory approval issues. PUCT, concerned with the termination fee among other terms that NextEra deemed "deal killers," denied the parties' application for regulatory approval twice.[9] With the deal now clearly dead, NextEra did nothing to terminate the merger agreement. Indeed, as the court explained, "it was clear that NextEra would appeal the PUCT's decision to all levels of review, leaving the Debtors no choice but to terminate the Merger Agreement …."[10]

The debtors thereupon did terminate the merger agreement and enter into a different merger agreement with another party. Shortly thereafter, on July 29, 2017, certain of the debtors' largest creditors filed a motion to reconsider the termination fee order.

The Court's Ruling on Reconsideration

In reviewing the motion, the court had to first determine whether the termination fee order was an interlocutory or final order, and then decide whether the motion was properly construed as a motion to alter or amend a judgment as an interlocutory order under Federal Rule of Bankruptcy Procedure (FRBP) 9023 (incorporating Federal Rule of Civil Procedure (FRCP) 59(e)), or whether the termination fee order was a final order, where the motion to reconsider would be construed as a motion seeking relief from an order as permitted by FRBP 9024 (incorporating FRCP 60(b)). The court concluded that the termination fee order was interlocutory because the termination fee order "d[id] not resolve all issues relating to the Termination Fee."[11]

Next, the court addressed its own "fundamental misunderstanding" of when the termination fee would be payable. In its own words, "[t]he Court simply did not understand that if the PUCT declined to approve the NextEra Transaction and the Debtors (as opposed to NextEra) terminated the Merger Agreement the Termination Fee would be payable to NextEra."[12] Had the court understood that, in addition to the fact that under no foreseeable circumstances would NextEra terminate the merger agreement if the PUCT declined to approve it, it never would have granted the motion to approve the merger agreement.[13]

In addition to the factual error, the court also claimed it had made a legal error as well in determining whether the termination fee met the O'Brien standard.[14] As articulated by the court, under that standard, "[t]he Court is required to determine whether the movant has carried the 'heavy burden' of demonstrating that a post-petition transaction 'provided an actual benefit' to the debtor's estate, justifying the future payment of a termination fee as one of the necessary costs or expenses of the estate."[15] However, here, as the court explained, the termination fee was payable to NextEra even if the PUCT declined to approve the NextEra transaction and the debtors (as opposed to NextEra) terminated the merger agreement. The court determined that payment of a termination or breakup fee when a court (or regulatory body) declines to approve the related transaction cannot provide an actual benefit to a debtor's estate sufficient to satisfy the O'Brien standard.[16]

While the court readily acknowledged its own errors, it did not go without admonishing the parties for creating the confusion as well. The court noted that its "misapprehension of the facts was based, in part, on the presentation of an incomplete and confusing record by the Debtors and NextEra."[17]

Analysis

The Delaware bankruptcy court's granting reconsideration and denying NextEra its breakup fee is at once troubling as well as instructive. On the one hand, any decision that would disallow what appears to have been a fully due and payable fee one year after the fact, based purely on a court's misapprehension of facts that presumably could have been gleaned from transactional documents that were part of the record, has the potential to raise doubts about the reliability of breakup fee approval orders in future cases. It also has the potential of infecting the approval process with at least a subtle hindsight bias that is hard for any court to avoid when conducting an after-the-fact review of a failed transaction.

On the other hand, the decision is also instructive and perhaps justifiable in light of what appears to have been a conscious effort of the stalking horse not to clarify for the court what it, and perhaps only it, fully appreciated, which was that the debtors, and not the stalking horse, ultimately would be made to bear the entire burden of nonapproval by PUCT. Bankruptcy courts both appreciate and expect candor from all parties that appear before them, and when that is perceived as lacking, the consequences can sometimes be severe.

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1. In re Energy Future Holdings Corp., 11636, 2017 WL 4404238 (Bankr. D. Del. Oct. 3, 2017).
2. Id. at *1.
3. Id.
4. Id. at *2.
5. PUCT stands for Public Utility Commission of Texas, the regulatory body whose approval was required in connection with the sale.

6. Id.
7. Id.
8. Unlike NextEra, the debtors did not have the luxury of time, because the proceeds of the NextEra transaction (or an alternative transaction) was needed to repay the debtors' debtor-in-possession financing facility, which otherwise would have continued to accrue interest and fees.
9. Id. at 6.
10. Id. at *7.
11. Id. at *11.
12. Id. at *12.
13. Id.
14. Id. at *13
15. Id.
16. Id. The court's articulation of the O'Brien standard appears to have been somewhat overbroad, whether or not so intended. According to the court, O'Brien would never allow payment of a breakup fee "in the event that the court declines to approve the actual sale (regardless of whether the stalking horse is the winning bidder)[.]" But there are numerous instances in which courts approve breakup fees for contingencies other than the "actual sale" to a higher bidder. See, e.g., In re Antaramian Properties LLC, 564 B.R. 762, 768 (M.D. Fla. 2016) (applying O'Brien in approving breakup fee for stalking horse that lacked a binding purchase agreement, and where the debtor abandoned a pure sale in favor of a sponsored plan of reorganization).
17. Id. at *15

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