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Government Activism in Bankruptcy

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GOVERNMENT ACTIVISM IN BANKRUPTCY

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ABSTRACT

It is widely recognized that bankruptcy law can stymie regulatory enforcement and present challenges for governments when regulated businesses file for Chapter 11. It is less-widely understood that bankruptcy law can present governments with opportunities to advance policy goals if they are willing to adopt tactics traditionally associated with activist investors, a strategy we call "government bankruptcy activism." The bankruptcy filings by Chrysler and General Motors in 2009 are a famous example: the government of the United States used the bankruptcy process to help both auto manufacturers resolve their financial distress while promoting the policy objectives of protecting union workers and addressing climate change. A decade later, the government of California applied its bargaining power in the Pacific Gas & Electric Company's Chapter 11 case to protect climate policies and the victims of wildfires. These examples illustrate that, by tapping into the bankruptcy system, governments gain access to the exceptional powers that a debtor enjoys under bankruptcy law, which can complement the traditional tools of appropriations and regulation to facilitate and accelerate policy outcomes. This strategy is especially useful in times of urgency and policy paralysis, when government bankruptcy activism can provide a pathway past veto players in the political system. However, making policy through the bankruptcy system presents potential downsides as well, as it may also allow governments to evade democratic accountability and obscure the financial losses that stakeholders are forced to absorb to help fund those policy outcomes.

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INTRODUCTION

In the United States, governments—federal, state, and local—engage in an unending dance with businesses. Governments aim to implement policy goals and shape corporate conduct through legislation and regulation, and they give their dictates teeth by enforcing rules with the threat of criminal and civil liability. Governments also promote policy goals by spending, including through procurement, subsidies, and tax policy. For their part, business entities lobby against adverse proposed regulation and maneuver to avoid the costs of enacted mandates.[1] Businesses can also take refuge from governments in federal bankruptcy courts, where they are shielded temporarily by bankruptcy law's automatic stay of regulatory enforcement. But bankruptcy law offers more than a temporary refuge: businesses can unravel regulatory schemes that depend on deterrence by seeking to discharge fines for past violations[2] and can reorganize their business in ways that thwart regulatory designs.[3] In response, many governmental agencies contest the ability of bankruptcy judges to stay their enforcement efforts or issue orders, but they are often unsuccessful.

In this Article, we argue that the bankruptcy system offers more than challenges to regulatory authority: it presents opportunities for governments to advance policy agendas that go beyond what a government can achieve outside of bankruptcy. The basic thrust of our argument is that governments can engage in what we refer to "government bankruptcy activism," where they seek to influence the outcome of the restructuring process to promote their policy goals. It is well-established that activist investors like hedge funds can gain influence over Chapter 11 firms, chiefly by providing the debtors with post-petition financing conditioned on advancing the investors' goals or by litigating to acquire favorable judicial orders and negotiating settlements in the shadow of

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1 *See* Tarek A. Hassan et al., *Firm-Level Political Risk: Measurement and Effects*, 134 Q. J. OF ECON. 2135, 2136 (2019).

2 For a recent example, La Paloma Generating Station was discharged of cap-and-trade allowance surrender liabilities and subsequent response by CARB (the state covered the allowances out of a reserve pool). *See* Ken W. Irvin & David E. Kronenberg, *Acquiring Bankrupt Energy Assets Clear of Compliance Obligations*, POWER MAG. (Feb. 22, 2018), https://www.powermag.com/white-papers/acquiring-bankrupt-energy-assets-clear-of-compliance-obligations/.

3 National Rifle Association is a current notable attempt; it filed in Texas to avoid regulation by New York state. *See* Danny Hakim, *N.R.A. Declares Bankruptcy and Seeks to Exit New York*, N.Y. TIMES (Jan. 15, 2021), https://www.nytimes.com/2021/01/15/us/politics/nra-bankruptcy.html. A prominent past example was by Pacific Gas & Electric Company to implement a "regulatory jailbreak" in its 2001 Chapter 11 case. *See* Press Release, Cal. Pub. Util. Comm'n, PUC Files Opposition to PG&E Bankruptcy Reorganization Plan (Nov. 27, 2011), https://docs.cpuc.ca.gov/published/News_release/11313.htm.

that litigation.[4] Governments can adopt these hedge fund tactics and enjoy added leverage from their authority as regulators, such as when a firm's continuation depends on regulatory reforms or permits that cannot be implemented by bankruptcy court order alone. In short, the bankruptcy of an important corporation can present governments with long-term opportunities that outweigh the short-term challenges of the bankruptcy stay and discharge.

Through government bankruptcy activism, the bankruptcy system can be a force multiplier for government policymaking. By influencing a bankruptcy proceeding, a government can benefit from the same bankruptcy powers that otherwise bedevil regulatory enforcement—such as the powers to stay creditor enforcement, reject contracts, shed assets and modify obligations—and to do in a matter of weeks what could take years outside of bankruptcy. To be sure, the Bankruptcy Code contains safeguards against third party abuse of Chapter 11, but governments can harness the bankruptcy system to advance the interests of politically important groups and policies, as well as to impose on debtors governance structures and business plans that they would not have agreed to outside of bankruptcy, at least not without new regulation or public spending. This opportunity is particularly valuable when governments face log jams, vetoes, and policy gridlock in enacting the enabling legislation or regulation. Even with highly regulated firms, government agencies each have narrowly defined jurisdiction over parts of a firm's activities. Bankruptcy law, on the other hand, assumes jurisdiction over the entire firm, giving governmental entities the ability to promote more comprehensive adjustments and to influence aspects of a firm's business that otherwise might have been otherwise out of reach. Moreover, the bankruptcy system is populated by expert lawyers and financial advisors who may lack domain knowledge but have deep expertise in resolving disputes by trading off concessions across the debtor firm and forcing changes on reluctant stakeholders.

We conclude by discussing ways in which this policymaking strategy in bankruptcy can be problematic. The accountability and transparency that are essential to a democratic system can sometimes be enhanced and at other time impaired in the bankruptcy system. For example, if the government intends to provide a company with an ad hoc bailout loan, doing so through the bankruptcy process could make the loan process more transparent than if the oversight was provided by a legislature or an administrative agency. Bankruptcy law requires

[4] Jared A. Ellias, The Law and Economics of Investing in Bankruptcy in the United States (Feb. 10, 2020) (unpublished manuscript at 11–14), https://ssrn.com/abstract=3578170.

disclosure of the terms of the loan in the motion for judicial approval.[5] But advancing, for example, climate policy through the bankruptcy system may result in less transparency than would be the case if the climate policy was enacted through normal legislative and regulatory pathways. By proceeding through bankruptcy activism, a partisan government may be able to enact policies that would have been blocked otherwise. Whether one sees this as a societal advantage—for overcoming gridlock—or an undesirable end-run around democratic processes, might well depend on one's perspective on the policy in question.

We begin in Part I by reviewing how governments usually play defense in Chapter 11. In Part II, we then describe the goals and methods of government activism in bankruptcy. Instead of resisting the incursion of bankruptcy on regulatory efforts, governments have begun to more aggressively harness the process to promote and amplify the execution of policy goals—in other words, to "play offense." In Part III, we describe two prominent examples of government policy execution through the bankruptcy system. In Section IV.A, we highlight the Obama Administration's 2009 decision to use the bankruptcy system to implement climate-change and worker-protection policies while financing the restructurings and recoveries of Chrysler and General Motors. We then discuss in Section IV.B California Governor Newsom's activist strategy a decade later to use the 2020 bankruptcy of California's giant utility, the Pacific Gas & Electric Company, to promote the State's ongoing shift to clean energy, as well as its interests in promoting the safe operation of its power grid and the compensation of wildfire victims. In both sets of cases, governments convened a group of bankruptcy and policy experts to implement strategies that allowed them to achieve policy "wins" in the bankruptcy forum. While the federal government combined the bankruptcy process with executive action to provide Trouble Asset Relief Program (TARP) funding to Chrysler and GM, Governor Newsom used litigation in the bankruptcy process in tandem with both regulatory and legislative action.

Finally, in Part IV, we briefly outline the democratic, political, and economic concerns raised by governmental bankruptcy activism. Commentators, as well as creditors who objected to the bankruptcy resolution in Chrysler and GM, have argued that the Obama Administration abused the bankruptcy process for partisan purposes, in order to aid its political ally, the United Auto Workers. We set aside the question of whether the executive's use of TARP funds in bankruptcy for these purposes was consistent with the enabling legislation and

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5 *E.g.*, FED. R. BANKR. P. 4001(c)(1).

ask instead whether it was consistent with bankruptcy policy. In the past few months, members of Congress have criticized the Department of Justice's settlement with Purdue Pharma, now approved by the bankruptcy judge, for requiring that the company exit bankruptcy as a public benefit corporation. While the substance of the Purdue settlement has attracted much criticism, it is noteworthy for our purposes that, in a letter to the Attorney General, forty-six members of Congress stated that "[t]hese are questions of policy that must be resolved by Congress, not the courts."[6] Here again, we set aside the question of whether the settlement was a constitutionally valid use of the government's enforcement power and focus on the appropriateness of the bankruptcy forum.

Our Article may be thought of as an extension of the classic debate ignited by Elizabeth Warren and Douglas Baird in 1987 on the scope of bankruptcy policy.[7] The question there was whether bankruptcy is an appropriate forum for redistribution and business rehabilitation to vindicate policies such as the protection of workers and communities from the dissolution of companies. Warren saw such policies at the core of bankruptcy's purpose while Baird viewed it as being more appropriately addressed in non-bankruptcy (or "state") law. Their respective views of the discretion of the judge were accordingly different, with Warren urging bankruptcy courts to embrace their equitable jurisdiction to promote such policies. Our focus here is not on the merits of distributive policies implemented by bankruptcy courts, but rather activism by the executive branch in promoting an even wider range of policies, such as climate change, than the protection of vulnerable parties from the dissolution of the debtor business. We conclude briefly in Part VI.

I. DEFENSIVE GOVERNMENT ACTION IN BANKRUPTCY

In this Part, we briefly review the major challenges that a bankruptcy filing presents to governmental regulatory capacity. Bankruptcy law undermines

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[6] Letter from Katherine Clark, Member of Congress, et al., to Hon. William Bar, U.S. Att'y Gen. (Nov. 10, 2020) (available at https://katherineclark.house.gov/_cache/files/2/d/2dcd9718-3c10-4b98-ad40-782844eff102/1EF22593BD913787CB832BF8A3339A47.11.10.20-letter-to-ag-barr-on-sweetheart-provision-in-purdue-settlement-final.pdf).

[7] *See* Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987); Douglas G. Baird, *Loss Distribution, Forum Shopping and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987) [hereinafter Baird, *Forum Shopping*]. Later scholarship developing these two positions include: Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 719–20 (1997); KAREN GROSS, FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM 1424 (Yale Uni. Press, 1996); Elizabeth Warren & Jay L. Westbrook, *Searching for Reorganization Realities*, 72 WASH. U. L. Q. 1257, 1265–86 (1994); Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 103 YALE L.J. 573 (1998) [hereinafter Baird, *Uncontested Axioms*].

systems of regulation with three tools: (1) the automatic stay on enforcement actions; (2) the prohibition on discriminating against insolvent or bankrupt debtors in some forms of regulatory enforcement; and (3) the discharge of claims after confirmation of a reorganization plan.

First, the automatic stay under Code section 362(a) stops judicial, administrative, or any other action or proceeding against the debtor that was or could have been initiated before the bankruptcy filing, and the enforcement of any judgment or the collection of any claim against the debtor. Congress anticipated the problem this would pose for regulators and created the so-called "police power" exception, that allows a government to "enforce such governmental unit's police and regulatory power, including the enforcement of a judgment other than a money judgment . . . ."[8] Case law interpreting this exception makes clear that a regulatory agency cannot enforce or collect a penalty or fine arising from the debtor's actions before bankruptcy.[9] However, some courts have allowed agencies to continue litigation to liquidate such a claim with the goal of preserving the deterrence objective of the regulation (even if the enforcement of the judgment is stayed).[10] Of course, regulators may otherwise move to have the automatic stay lifted, but showing the required cause for judicial relief is usually an uphill battle.

Second, under Code section 525(a), a governmental unit may not revoke or deny a license to a debtor solely because the debtor is in bankruptcy, has been insolvent, or has not paid a debt that is dischargeable in bankruptcy. This shield has been interpreted expansively and allows regulated entities to enjoy broad protection from government threats to terminate licenses, which is often an important method of enforcing a broader regulatory scheme. For example, in 2003, the Supreme Court applied this provision to prevent the Federal Communications Commission from revoking auctioned spectrum licenses on the grounds that the licensee had failed to pay the price of the licenses in full.[11]

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[8] *See* 11 U.S.C. § 362(b)(4) (2019).

[9] *See, e.g.*, *In re* FirstEnergy Solutions Corp., 945 F.3d 431, 446 (6th Cir. 2019) (preventing the Federal Energy Regulatory Commission from taking action related to contracts of the debtor pursuant to 11 U.S.C. § 362(b)(4)).

[10] *See, e.g.*, Memorandum and Order at 5, Solis v. SCA Restaurant Corp., 463 B.R. 248 (Bankr. E.D.N.Y. 2011) (No. 2:09-cv-02212) (stating that litigation falls within the police and regulatory power exception of section 364(b)(4) because, "should the DOL [Department of Labor] succeed in obtaining a money judgment against the defendant, such a judgment could deter unlawful behavior by others."); United States v. Nicolet, 857 F.2d 202, 210 (3d Cir. 1988) ("The recoupment mandate interjects a valuable deterrence element into the CERCLA scheme, ensuring that responsible parties will be held accountable for their environmental misdeeds. These considerations make it plain that the present action falls within the 'related to police or regulatory powers' category." (internal citations omitted)).

[11] *See* FCC v. NextWave Personal Communications, Inc., 537 U.S. 293, 296 (2003).

Third, a reorganizing debtor may avoid regulatory liability by confirming a reorganization plan that discharges the liability upon paying cents on the dollar. The government's objection can be outvoted under bankruptcy's class-voting process and the debtor has substantial leeway to gerrymander the classes to ensure that the government's (typically unsecured claim) vote is defeated.[12] As a result, government agencies sometimes seek to avoid discharge by arguing that their remedies are not "claims" under the Code. This argument too is an uphill battle if the regulatory violation occurred prior to the bankruptcy filing.[13]

Given this framework of federal law, government agencies are often left to argue that they fall within one of the exceptions to bankruptcy powers prescribed by the Code (such as exemption from the stay or exclusion from the definition of "claim"). The exercise of discretion by bankruptcy judges under these exceptions effectively shape the boundaries between those regulatory actions that are subordinated to bankruptcy's goals and those that are not. In general, bankruptcy judges allow government regulators to act narrowly under the exception for police and regulatory power to protect the most pressing public policies but push back on everything else. Bankruptcy judges, for example, allow regulators to enforce laws against racial discrimination,[14] the False Claims Act's protections against government fraud,[15] and to protect the public from the distribution of adulterated drugs.[16] But less pressing public policies that are more purely economic or financial in nature tend fall by the wayside, even if they are deeply important to a governmental entity. For example, the International Trade Commission has usually been unsuccessful in gaining exception from the stay by arguing the economic significance of protecting intellectual property rights.[17]

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[12] Chapter 11 guarantees the objecting claimant only the liquidation payout of its claim and, even if the government's class dissents as a whole, it may have no ability to prevent the cramdown of the plan if the court finds it to be fair and equitable. *See* 11 U.S.C. § 1129(a)(7), (b).

[13] *But cf.* United States v. Apex Oil Co, Inc., 579 F.3d 734, 735–36 (7th Cir. 2009) (holding that the injunctive remedy of the Environmental Protection Agency was not a claim that could be discharged because the EPA did not have the right to sue for money damages under the governing Act).

[14] *See* EEOC v. Rath Packing Co., 787 F.2d 318, 321 (8th Cir. 1986) (holding that subjective hiring practices discriminating women was not justified by business necessity); *In re* Mohawk Greenfield Motel Corp., 239 B.R. 1, 7 (Bankr. D. Mass. 1999) (noting that if a state has, "a strongly felt public policy against discrimination," then it can be, "protected by a legislative scheme.").

[15] *See* United States v. Vanguard Healthcare, LLC, 565 B.R. 627, 632 (Bankr. M.D. Tenn. 2017) (holding that a suit "brought pursuant to the Federal False Claims Act is sufficient to satisfy the section 362(b)(4) exception.") (quoting *In re* Commonwealth Companies, Inc., 913 F.2d 518, 526 (8th Cir. 1990)).

[16] *In re* Cantrell Drug Co., 585 B.R. 555, 587 (Bankr. E.D. Ark. 2018) (holding that, "the Court declines to scrutinize the FDA's legal authority" to bring regarding adulterated drugs).

[17] *See, e.g.*, *In re* Qimonda AG, 425 B.R. 256, 263 (Bankr. E.D. Va. 2010), *rev'd sub nom.* U.S. Int'l Trade Comm'n v. Jaffe, 433 B.R. 538 (E.D. Va. 2010); *see also In re* Spansion, Inc., 418 B.R. 84, 95 (Bankr. D. Del. 2009) (holding that "ITC [was] not exercising police and regulatory power," and, "therefore, the action [was] not exempted from the automatic stay.").

The Federal Energy Regulatory Commission tries to protect its jurisdiction by arguing that bankruptcy courts cannot void pre-bankruptcy energy purchase contracts without their express permission, and these arguments also usually fail.[18] Finally, coal companies frequently use bankruptcy to avoid environmental liabilities despite objections by government regulators tasked with enforcement.[19] In the constant tug of war between bankruptcy law and governments, it is fair to say that governments often lose, undermining the execution of their regulatory objectives.

II. GOALS AND METHODS OF GOVERNMENT BANKRUPTCY ACTIVISM

In this Part, we discuss how governments can utilize the financial distress and bankruptcy of a business to accomplish policy objectives. While the traditional government posture is to try to defend its regulatory authority by "opting out" of bankruptcy stay and discharge, there are also ways in which government actors can further important policy goals by playing a larger role in shaping the outcome of the bankruptcy case. Two sets of factors combine to give government extra policy leverage in bankruptcy. The first is the financial distress of the debtor's business. The debtor's insolvency leaves it vulnerable to influence by new liquidity providers who either provide fresh financing or relieve some of the overhang of existing liabilities. All levels of government can and do provide relief through loans or procurement contracts and, in either case, can condition their contribution to promote policy objectives. These instruments are well known and have been studied. The motivating question for this Article is how the bankruptcy process amplifies the government's impact through these instruments. In the Chrysler and GM case (Part IV.A), the government executed

[18] *See, e.g.*, *In re* PG&E Corp., 603 B.R. 471, 486 (Bankr. N.D. Cal. 2019) (rejecting an attempt by FERC to preempt the bankruptcy judge's powers to void contracts); *In re* Mirant Corp., 378 F.3d 511, 519–24 (B.A.P. 5th Cir. 2004); *In re* Calpine Corp., 337 B.R. 27, 30 (Bankr. S.D.N.Y. 2006); *In re* FirstEnergy Solutions Corp., 945 F.3d 431, 446 (6th Cir. 2019).

[19] *See, e.g.*, United States', States', and Tribe's Objection to the Plan at 1, *In re* Peabody Energy Corp., 579 B.R. 208 (Bankr. E.D. Mo. 2017) (No. 16-42529-399) (EPA and DOI called Peabody's reorganization plan "obviously a carefully constructed scheme to evade environmental liabilities through discriminatory classifications and treatments of environmental general unsecured creditors as opposed to other general unsecured creditors."); Reservation of Rights of United States of America in Response to Motion of the Debtors, Pursuant to Bankruptcy Rule 9019, for Entry of Stipulation & Order Concerning Reclamation Bonding of Their Surface Coal Mining Operations in Wyoming at 4, *In re* Alpha Nat. Res., Inc., 552 B.R. 314 (Bankr. E.D. Va. 2015) (No. 15-33896) (EPA and DOI objected that Alpha Natural Resources' reorganization would "render[] it unable to comply with significant environmental compliance obligations under federal and state law for the mines it will continue to own."); *see generally* Joshua Macey & Jackson Salovaara, *Bankruptcy As Bailout: Coal Company Insolvency and the Erosion of Federal Law*, 71 STAN. L. REV. 879, 885 (2019) (arguing that "coal companies have used the Bankruptcy Code to evade congressionally imposed liabilities requiring that they pay lifetime health benefits to coal miners and restore land degraded by surface mining.").

policy goals through the rescue financing combined with the structure of the bankruptcy sale under section 363(b) of the Code. In the Pacific Gas & Electric Company (PG&E) case, government's primary tool was the fund established under California Assembly Bill 1054 to pay the costs of wildfire damages caused by equipment of public utility companies.[20]

The second set of levers are features of bankruptcy law. Specifically, bankruptcy gives the debtor a range of powers that it would not have outside of bankruptcy. Activist investors have been known to exert control over those powers to enrich themselves.[21] Similarly, government actors can influence the debtor's use of these powers to advance policy goals. Indeed, as we discuss in Part V, they may do so to advance political goals of the party in government. Perhaps the most significant of the bankruptcy features in this respect is debtor-in-possession (DIP) financing. This is a favored tool of activism among investors because the terms and conditions of such financing give the lender control over aspects of the bankruptcy case. While activists can also acquire bargaining power by litigating motions and objections, the most direct route to control of a Chapter 11 case comes through providing the company with needed financing.

Under Code section 364, the court may authorize the debtor to borrow and give the new lender priority over unsecured creditors and also over a secured creditor if that creditor's interest is adequately protected.[22] These loans, which are referred to as debtor-in-possession loans or "DIP loans," have become a very common and significant feature of bankruptcy reorganization. The debtor's ability to give a new lender a higher priority than prebankruptcy creditors is one of the principal attractions of a bankruptcy filing. By attaching conditions to the

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[20] *See infra* Part IV.B.

[21] *See, e.g.*, Ellias, *supra* note 4, at 11–17 (discussing how activist investors utilize contracting, litigation, and other methods for improving the value of their claims); *see* Jared A. Ellias, *Do Activist Investors Constrain Managerial Moral Hazard in Chapter 11?: Evidence from Junior Activist Investing*, 8 J. LEGAL ANALYSIS 493, 534–35 (2016); Edward I. Altman, *The Role of Distressed Debt Markets, Hedge Funds and Recent Trends in Bankruptcy on the Outcomes of Chapter 11 Reorganizations*, 22 AM. BANKR. INST. L. REV. 75, 75 (2014); Michelle M. Harner et al., *Activist Investors, Distressed Companies, and Value Uncertainty*, 22 AM. BANKR. INST. L. REV. 167, 175–185 (2014); Wei Jiang, Kai Li & Wei Wang, *Hedge Funds and Chapter 11*, 67 J. FIN. 513, 556 (2012).

[22] George G. *Triantis*, *A Theory of the Regulation of Debtor-in-Possession Financing*, 46 VAND. L. Rev. 901, 920 (1993) (explaining how DIP financing addresses dual problems of debt overhang and overinvestment); George Triantis, *Financial Slack and the Laws of Secured Transactions*, 29 J. LEGAL STUD. 35 (2000) (explaining how bankruptcy law addresses liquidity needs of distressed firms and promotes optimal liquidity or financial slack); *accord* Kenneth Ayotte & David A. Skeel, *Bankruptcy Law as a Liquidity Provider*, 80 U. CHI. L. REV. 1557 (2013). After examining all the large bankruptcies between 1988–2008, it has been found that around 44% of firms borrowed to fund the bankruptcy, with these firms borrowing more than $5.5 billion in capital. *See* B. Espen Eckbo, Kai Li & Wei Wang, *Rent Extraction by Super-Priority Lenders* 9, 16 (Tuck Sch. of Bus. Working Paper, No. 3384389, 2020), https://ssrn.com/abstract=3384389.

DIP loan. often in the form of covenants and events of default, activist investors can gain enormous influence over the bankruptcy process and shape its outcome.[23] For example, a DIP loan may have a provision that forces the Chapter 11 firm to implement a transaction that protects the DIP lenders' interests, such as a speedy auction or a restructuring plan that ensures favorable treatment of the DIP lenders' claims.[24]

Through the leverage obtained in a financing contract, a government can influence the debtor's decision to exercise several important powers in bankruptcy, including: (1) to assume or reject executory contracts and leases; (2) to sell some or all of its assets;[25] and (3) to restructure its liabilities through majority class voting or judicial cramdown. While an investor activist would be exerting its control over the debtor to maximize its financial return, government would do so to pursue policy (or political) goals. So, for example, a government might pressure the debtor to assume a contract it would otherwise reject or keep assets that the debtor would otherwise sell, to maximize the return to other creditors. We briefly outline these powers here and how a government with influence might advance policy through them.

Code section 365 allows the debtor to assume or reject executory contracts and leases.[26] Of course, contracting parties are free even outside bankruptcy to avoid their promised performance: the remedy for breach outside of bankruptcy is typically the payment of expectation damages. But the judgment creditor of an insolvent debtor gets cents on the dollar even outside of bankruptcy. So, how does the right to reject in bankruptcy improve the position of the debtor outside bankruptcy? Arguably, the right to reject in bankruptcy legitimizes the breach of the contract because it is viewed as being in the interest of the overall welfare of the debtor's stakeholders. The debtor may use the threat of rejection to force a renegotiation of some of its contracts with a particular blend of advantages: it can threaten reducing the counterparty's right to an unsecured claim while also assuring that its obligation under a renegotiated contract is likely to be fully

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[23] *See, e.g.*, AM. BANKR. INST., COMMISSION TO STUDY THE REFORM OF CHAPTER 11: 2012-2014 FINAL REPORT AND RECOMMENDATIONS 80–81 (2014) ("The Commissioners discussed at length the potential impact of terms in a postpetition credit agreement that dictate or attempt to influence the course of the chapter 11 case, or that implement waivers of, or otherwise affect, rights under the Bankruptcy Code."); *see* GEORGE TRIANTIS, DEBTOR-IN-POSSESSION FINANCING (B. Adler ed., Edward Elgar Pub., 2019).

[24] Kenneth Ayotte & Jared A. Ellias, *Bankruptcy Process for Sale*, 39 YALE J. ON REGUL. (forthcoming 2021) (manuscript at 58) (on file with authors) (demonstrating how lenders benefit from making DIP loans).

[25] The debtor can also propose, for authorization by the court, the method of sale. This was an important power in the Chrysler sale. *See* Peter Valdes-Dapena, *Chrysler Closing 789 Dealerships*, CNN MONEY (May 14, 2009, 10:39 AM), https://money.cnn.com/2009/05/14/autos/chrysler_dealer_closings/index.htm.

[26] *See* 11 U.S.C. § 365 (2019).

performed. The Code also provides the debtor with the right to assume contracts, effectively by curing and compensating for the breach, and it need not worry about existing breaches of solvency or other financial conditions. So, the debtor has the enhanced option in bankruptcy to accept beneficial and reject (or renegotiate) unprofitable contracts and leases.

The right to reject long-term contracts such as distributorships, franchises, and leases are particularly important and their treatment in bankruptcy is significantly different from outside bankruptcy.[27] Some courts have authorized franchisees to reject their agreements and continue to operate free of covenants not to compete (other than an unsecured damages claim). Franchisors or manufacturers can shed underperforming or redundant dealerships (as Chrysler did) notwithstanding restrictions in distributorship agreements, federal or state statutes[28] and the political hurdles that would impede such termination outside bankruptcy.[29]

Bankruptcy can also be used to exit or renegotiate union contracts, although the Code provides unionized workers with more protection than other contractual counterparties to block Chapter 11 firms from forcing concessions on them.[30] The debtor must satisfy the burden of proving that rejection of the contract is necessary for reorganization, bargaining in good faith, providing fair and equitable treatment, and giving complete information necessary for the court to evaluate the debtor's modified proposal. For example, Northwest Airlines filed for bankruptcy in 2005 because of spikes in jet fuel prices and the competition from rivals with lower labor costs. Northwest was able to force its

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[27] *See generally* Kenneth Ayotte, *Leases and Executory Contracts in Chapter 11*, 12 J. EMPIRICAL LEGAL STUD. 637, 637 (2015) (noting that Chapter 11 "allows debtors to choose whether to keep [], abandon [], or transfer [] their contracts").

[28] State statutes often require notice and/or cause before termination, cancellation, or non-renewal. *See, e.g.*, Michigan Vehicle Franchise Act § 7, MICH. COMP. LAWS SERV. § 445.1567 (LexisNexis 2019) ("a manufacturer or distributor shall not cancel, termination, fail to renew, or refuse to continue any dealer agreement . . . .").

[29] Valdes-Dapena, *supra* note 25; *see In re* Old Carco LLC, 406 B.R. 180, 212–13 (Bankr. S.D.N.Y. 2009).

[30] 11 U.S.C. § 1113. *See, e.g.*, *In re* Patriot Coal Corporation, 493 B.R. 65, 139–40 (Bankr. E.D. Mo. 2013) (rejecting coal miner union contracts); *In re* Chicago Const. Specialties, Inc., 510 B.R. 205, 224 (Bankr. N.D. Ill. 2014) (terminating construction and general laborer's pension and welfare funds); *In re* N.W. Holding Co., 533 B.R. 753, 765 (Bankr. E.D. Mo. 2015) (tearing up union contracts and ceasing the funding of retired machinist's benefits); *In re* Bowen Enter., Inc., 196 B.R. 734, 747 (Bankr. W.D. Pa. 1996) (destroying supermarket union workers union contracts).

flight attendants to take $195 million in pay reductions after the bankruptcy judge permitted Northwest to reject their collective bargaining agreement.[31]

One can speculate about the government's policy interest in a debtor's decision to assume or reject contracts. Environmental policy may dictate that a debtor should reject fossil fuel supply contracts or assume even unprofitable ones for the supply of clean alternative energy. Similarly, concern with the economic health of a depressed community may indicate that franchises or distributorships should not reject contracts with local workers. And, of course, there is a distinctive policy perspective on the renegotiation or rejection of union contracts, which we will turn to in the Chrysler case study. What these foci of government influence have in common is that the financial cost, if any, of pursuing such policy goals is borne by another claimholder in bankruptcy. Arguably, this is an unlegislated tax or unfunded mandate, implemented in the bankruptcy reorganization plan and imposed on one or more classes of other creditors.

Although business entities may sell assets outside of bankruptcy, the bankruptcy process facilitates sales by allowing assets to be sold free and clear of third-party interests, particularly unencumbered by security interests and successor liability.[32] Companies commonly also use bankruptcy to shed underperforming assets and refocus on their core business.[33] Government control (again, like the influence of activist investors) can be applied in two ways. First, the government can influence whether and what assets are sold. In a similar respect to the decision to assume, reject or modify contracts, the government may promote the retention or disposal of assets that promotepolicy goals. Second, the government can use its leverage to influence how assets are sold. In Chrysler, the government required that some liabilities must be assumed

31 Section 1113 requires negotiations in good faith, and the bankruptcy judge found that the flight attendants, who had previously rejected the pay cuts, had done so without good cause and that the pay cuts were necessary to reorganize. *See In re* Northwest Airlines Corp., 346 B.R. 307, 331–32 (Bankr. S.D.N.Y. 2006). In contrast, in the American Airlines 2012 bankruptcy proceedings, the airline sought to annually lower costs by modifying their collective bargaining agreement. *See In re* AMR Corp., 477 B.R. 284, 398–99 (Bankr. S.D.N.Y. 2012). However, the bankruptcy judge denied American Airlines' proposal to cut annual costs of $370 million by rejecting its CBA with its union pilots because the airline failed to show its plan was justified by its reference to the Business Plan or the practices of their competitors. *Id.* at 454. *Compare id., with In re* Pinnacle Airlines Corp., 483 B.R. 381, 424 (Bankr. S.D.N.Y. 2012) (denying the debtor's rejections because the pilot union had good cause for declining to accept the overreaching proposed modifications).

32 11 U.S.C. § 363(b), (f).

33 In a recent example, Sears sold 235 properties with unprofitable stores in bankruptcy. *See* Lauren Zumbach, *To Avoid Bankruptcy, Sears CEO Proposes Selling off Real Estate. The Retailer Has Tried That Move Before*, CHI. TRIBUNE (Sept. 28, 2018, 2:40 PM), https://www.chicagotribune.com/business/ct-biz-sears-lampert-esl-proposal-store-sales-0928-story.html.

by the purchaser, while the sale is free and clear of all others.[34] This is a distinction with great distributional—and therefore potentially policy—impact because assumed liabilities are usually satisfied in full.

Finally, bankruptcy law provides debtors with the means to restructure and discharge their prebankruptcy liabilities without the consent of their affected creditors: notably, the majority voting rule within any given class of claimants[35] and the cramdown option when a court finds that a proposed plan is "fair and equitable."[36] While under the best interests test each creditor is guaranteed the payout it would have received in a Chapter 7 liquidation,[37] the debtor has significant discretion in distributing the going concern surplus among its creditors. Government activism can prefer policy-favored claimants at the expense of the others, if the dissenters can be outvoted or if the court finds that the reorganization is fair and equitable. Many restrictions in the Code, such as the best interest or cramdown tests, rely on asset valuations and the typically broad range of plausible valuation methods and parameters give the debtor and hence its influencers, like the government, a significant amount of leeway. Moreover, in some situations, creditors have the valuable right to seek adjudication of tort claims by juries, and bankruptcy law may allow the debtor to force estimation of the claim by a bankruptcy judge instead.[38] Particularly given that bankruptcy judges have in mind the impact of estimations on the recovery of other claimholders and on the survival of the going concern, this can lead to lower claim amounts for tort creditors than outside bankruptcy.

III. GOVERNMENT ACTIVISM IN CHRYSLER AND PG&E

In this Part, we present two case studies that illustrate how a government can "play offense" when a business entity files a bankruptcy petition and emerge from the chaos of a Chapter 11 filing with policy wins. As the cases show, the tools of bankruptcy law and the bargaining power created by financial distress can combine to allow the government to obtain results that would have been harder to achieve in the same time frame outside of bankruptcy. We present two case studies here and, before turning to them, highlight some of the contrasts between them. First, while each company filed for bankruptcy because of

[34] *Infra* Section III.A.2.

[35] 11 U.S.C. §§ 1129(a)(8), 1126(c).

[36] *Id.* § 1129(b).

[37] *Id.* § 1129(a)(7).

[38] Michael Liedtke, *PG&E Could Avoid Jury Trial if $13.5 Billion Settlement Gets OK From Governor, Judge*, ASSOCIATED PRESS (Dec. 9, 2019), https://www.kqed.org/news/11790379/pge-could-avoid-jury-trial-if-13-5-settlement-approved.

financial distress, the federal government had firm control of the GM and Chrysler bankruptcy filings on the petition date while California's government would only take control of the PG&E bankruptcy later in the bankruptcy process. Second, Chrysler and GM were formally bankruptcy sales under section 363, while PG&E exited after confirmation of a Chapter 11 plan. These differences meant that the government used somewhat different tools in each of them to achieve desired outcomes.

A. Chrysler

The Chrysler and General Motors bankruptcies in 2009 were unprecedented in terms of size, speed, public focus, and degree of government intervention. As a major intervenor in these auto bankruptcies, the Obama Administration was able to further its general economic policy objective of ensuring that the manufacturers survived the financial crisis, along with their workers and communities.[39] The government was also able to leverage powers available only in bankruptcy to achieve other political wins outside of, and arguably at odds with the bankruptcy goal of maximizing the return to claimholders. Our description will focus on Chrysler, but the approach was very similar in GM.

1. Chrysler's Distress and Bankruptcy Proceeding

In 2008, Chrysler and GM experienced severe financial distress—losses, illiquidity, and insolvency—that threatened their survival.[40] Their financial distress was largely due to the cost-structure of auto manufacturing in the United States and intense product market competition.[41] The companies previously had made expensive commitments to labor for wages and benefits, as well as other concessions in elaborate work rules such as job classifications. The companies also sold their vehicles through costly and inefficient dealership networks. As a result of these burdens, the rise in gas prices and the shift of consumer demand to smaller cars, American car companies could not compete against foreign (particularly Japanese) manufacturers. The drying up of consumer credit and the general drop in demand for automobiles during the 2007 to 2009 great recession accelerated their decline. By the fall of 2008, both companies were incurring

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[39] Jeffery McCracken, John D. Stoll & Neil King Jr., *U.S. Threatens Bankruptcy for GM, Chrysler*, WALL. ST. J. (Mar. 31, 2009, 12:02 AM), https://www.wsj.com/articles/SB123845591244871499.

[40] SEPTEMBER OVERSIGHT REPORT: THE USE OF TARP FUNDS IN THE SUPPORT AND REORGANIZATION OF THE DOMESTIC AUTOMOTIVE INDUSTRY, CONG. OVERSIGHT PANEL 7–8 (Sept. 9, 2009), http://online.wsj.com/public/resources/documents/tarpautoreport.pdf [hereinafter Oversight Report].

[41] *Id.* at 7.

large quarterly losses and were burdened by enormous unfunded healthcare and retiree pension obligations.[42]

Given the credit crunch in the recession, Chrysler and GM had no feasible source of new funding and Congress denied their request in the fall of 2008 for $25 billion in new loans.[43] The outgoing Bush Administration drew from the TARP funds and conditioned the loan extension on Chrysler and GM submitting viable plans to restore solvency and profitability.[44] When the Obama Administration assumed office in the winter of 2009, it appointed a Presidential Auto Task Force to assess, advise, and guide the restructuring of the companies.[45]

The Auto Task Force was dissatisfied with the restructuring proposals presented to them by the auto manufacturers and, given the urgency of stemming losses and restoring consumer and investor confidence in the companies, it settled in the Spring of 2009 on a plan to use the bankruptcy process: Chrysler filed first on April 30[46] and General Motors on June 1.[47] The government's $20 billion investment in these companies and its offer to fund the company through bankruptcy essentially allowed the government to steer the restructuring.[48] The government decided that Chrysler should be reorganized in bankruptcy under a section 363(b) sale: Chrysler would sell substantially all of its operating assets to a new entity ("New Chrysler") who would assume portions of Chrysler's liabilities to trade creditors, unfunded pensions, and unfunded health benefits, and pay $2 billion that would be distributed among Chrysler's secured and priority claims.[49] Fiat S.p.A. would provide New Chrysler with fuel-efficient vehicle platforms, a worldwide distribution network and new management, in return for 20% of the common stock and rights to acquire additional 15% stake upon meeting specified performance milestones, including fuel-efficiency

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[42] *Id.*

[43] *Id.* at 8.

[44] *Id.* at 8–10.

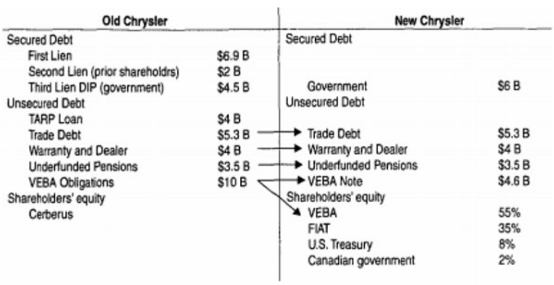
[45] *Id.* at 10–12; *see* Jesse Lee, *GM & Chrysler*, WHITE HOUSE: PRES. BARACK OBAMA (Mar. 30, 2009, 12:53 PM), https://obamawhitehouse.archives.gov/blog/2009/03/30/gm-chrysler.

[46] *See* Oversight Report, *supra* note 40, at 13.

[47] Oversight Report, *supra* note 40, at 19.

[48] For example, when the Task Force determined that the GM CEO, Rick Wagoner, should be replaced, it was able to effect the change without having the customary shareholder control rights. *See* Oversight Report, *supra* note 40, at 21.

[49] Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 748 (2010). The chart below summarizes the treatment of the various unsecured claims. *Id.* at 754.



Old Chrysler		New Chrysler	
Secured Debt		Secured Debt	
First Lien	$6.9 B		
Second Lien (prior shareholdrs)	$2 B		
Third Lien DIP (government)	$4.5 B	Government	$6 B
Unsecured Debt		Unsecured Debt	
TARP Loan	$4 B		
Trade Debt	$5.3 B	Trade Debt	$5.3 B
Warranty and Dealer	$4 B	Warranty and Dealer	$4 B
Underfunded Pensions	$3.5 B	Underfunded Pensions	$3.5 B
VEBA Obligations	$10 B	VEBA Note	$4.6 B
Shareholders' equity		Shareholders' equity	
Cerberus		VEBA	55%
		FIAT	35%
		U.S. Treasury	8%
		Canadian government	2%

standards.[50] The majority (55%) of the stock ownership went to the trust that had been set up to pay health benefits to Chrysler employees and retirees (VEBA).[51] The federal government received a much smaller stake of 8%.

2. *The Obama Administration's Policy Objectives*

Clearly, one of the Obama Administration's policy goals was to resolve the financial distress of Chrysler and GM, and the bankruptcy sale—free and clear of lien obligations—was the way it chose to do it. However, the financial recovery of these companies was not the only policy driving the Administration's efforts. The federal government pursued two additional policy goals: (1) protecting auto workers and particularly their union, the United Auto Workers (UAW)[52] and (2) promoting climate goals by building Chrysler's ability to manufacture and sell smaller, more fuel-efficient cars in the United States.[53]

First, as unfunded obligations of Chrysler and of GM, pensions and health benefits would recover nothing if the company liquidated. At the time of the bankruptcy filing, Chrysler owed $10 billion to the Voluntary Employees' Beneficiary Association (VEBA) and had $3.5 billion in unfunded pension obligations.[54] The protection of these benefits for retirees, even though an unsecured claim, was a key policy objective. The government's plan for the bankruptcy sale ensured that the payout on these claims was vastly enhanced, with the VEBA receiving a new note for $4.6 billion and 55% of the common

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50 *See In re* Chrysler LLC, 576 F.3d 108, 113 (2d Cir. 2009). Chrysler and Fiat, in fact, had been negotiating a collaboration before the government bailout, under which Fiat would produce small cars for Chrysler. *See* Oversight Report, *supra* note 40, at 12 n.37. The Obama Administration modified that relationship into one that would essentially merge the companies. Oversight Report, *supra* note 40, at 12–13, n.37. The Task Force claimed that Fiat was the only option available at that time. Oversight Report, *supra* note 40, at 12 n.37.

51 *See* Oversight Report, *supra* note 40, at 14–15. The restructuring of GM had a similar design as a section 363(b) sale from "Old GM" to "New GM". Oversight Report, *supra* note 40, at 19. New GM also assumed liabilities and VEBA receiving (on account of its $20 billion claim) a new $2.5 billion note as well as $6.5 billion of the new entity's preferred stock and 17.5%. Oversight Report, *supra* note 40, at 19–20. In GM's bankruptcy, the government focused more on protecting labor interests rather than any environmental goals. Oversight Report, *supra* note 40, at 23.

52 *See* Todd J. Zywicki, The Chrysler and General Motors Bankruptcies, *in* RESEARCH HANDBOOK ON CORPORATE BANKRUPTCY LAW 298, 305–06 (Barry E. Adler ed., 2020).

53 *See* DAVID SKEEL, THE NEW FINANCIAL DEAL 35 (2011) (observing that the Obama Administration pursued its energy policy in the Chrysler bankruptcy); Zywicki, *supra* note 52, at 305 (suggesting that the goal of shifting Chrysler manufacturing to smaller cars did not promote the standard bankruptcy goal of reorganization).

54 *See* Oversight Report, *supra* note 40, at 14 n.49.

stock of New Chrysler.[55] The bankruptcy sale was a more effective way of pursuing this objective than the confirmation process for a reorganization plan.

Second, the Obama Administration hoped the United States auto industry would align with the government's climate goals by producing and selling smaller, more fuel-efficient vehicles in the United States. The Obama Administration entered office with ambitious environmental objectives related to vehicle emissions.[56] It reversed the decision of the Bush Administration to not regulate vehicle greenhouse gas emissions, accepted California's application under the Clean Air Act to tighten requirements, and struck a deal with auto manufacturers on a single-tailpipe greenhouse gas emissions standard for the United States vehicle fleet.[57] During Chrysler and GM's period of financial distress, President Obama also promoted the Car Allowance Rebate System ("CARS" or commonly known as "Cash for Clunkers").[58] This program provided incentives for Americans to trade in "gas-guzzling" vehicles for more fuel-efficient alternatives.[59] The program would hopefully boost car sales in the struggling economy and promote the purchase of greener cars.[60]

As noted earlier, American auto manufacturers were saddled by cost structures that left them unable to compete globally in the manufacturing of fuel-efficient vehicles. As Chrysler and GM began descending into financial trouble, President Obama famously asked his advisors, 'why can't they make a Corolla?'[61] Historically, American companies manufactured larger vehicles like

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[55] Oversight Report, *supra* note 40, at 15.

[56] The Administration addressed energy more broadly in its second term; it committed the United States to the Paris Agreement and enacted the Clean Power Plan to reduce carbon emissions from electricity generation. *See Climate Change and President Obama's Action Plan*, WHITE HOUSE: PRES. BARACK OBAMA, https://obamawhitehouse.archives.gov/president-obama-climate-action-plan (last visited Mar. 28, 2021).

[57] Its new regulations doubled the fuel efficiency standards for cars. *See* Press Release, White House, Pres. Barack Obama, Obama Administration Finalizes Historic 54.5 MPG Fuel Efficiency Standards (Aug. 28, 2012) (available at https://obamawhitehouse.archives.gov/the-press-office/2012/08/28/obama-administration-finalizes-historic-545-MPG-fuel-efficiency-standard).

[58] Jennifer Liberto, *Cash for Clunkers Extension Signed into Law*, CNN MONEY (Aug. 7, 2009, 11:43 AM), https://money.cnn.com/2009/08/07/autos/clunkers_continues/ (quoting President Obama: "Now, more American consumers will have the chance to purchase newer, more fuel-efficient cars and the American economy will continue to get a much-needed boost.").

[59] *Id.*

[60] *See id.* (noting that "[t]he sales results indicate that consumers are buying more fuel-efficient vehicles than most people expected" and that "many of the . . . biggest reported year-over-year sales gains were small crossovers, a fact that several of the top automakers attributed to the Cash for Clunkers program.").

[61] *See* Andrew Clark, *GM Nearly Quit Detroit, Says Ex-Car Tsar* (Sept. 10, 2010), https://www.theguardian.com/business/2010/sep/06/general-motors-bailout-rattner-obama; *see generally* Todd J. Zywicki, *The Auto Bailout and the Rule of Law*, 7 NAT'L AFFS. 66 (2011), https://www.nationalaffairs.com/publications/detail/the-auto-bailout-and-the-rule-of-law (highlighting the Obama Administration's frustration with GM and Chrysler).

pickup trucks and SUVs because their prices could cover the high union labor costs in the United States.[62] Without significant encouragement or influence from the government, American companies like Chrysler and GM were unlikely to adapt to shifting consumer demand and transition to smaller vehicles.

The federal government has tools to pursue both these policy goals: protecting the pension and health benefits of workers in the industry and encouraging the production of smaller, fuel-efficient cars. It could, for example, guarantee retirement benefit plans and be subrogated to the rights of the plans against the employer. But this would require very substantial appropriation and bureaucratic structure. With respect to fuel efficiency, regulation was used to tighten fuel efficiency standards. However, this was far from easy politically. It is therefore not surprising that the government would seize on the bankruptcy process to amplify the influence from its TARP-sourced funding and promote these policy goals.

3. *How Government Used Its Leverage in Bankruptcy*

As we noted earlier, the government gained control of the governance of Chrysler and GM through its investment in the two distressed companies and, once in control, the government restructured the auto manufacturers through a 363(b) sale.[63] Although a debtor must obtain judicial approval of its sale, the courts are particularly deferential if they perceive urgency in preventing further losses of value (the "melting ice cube") and there are unlikely to be many bidders.[64] The bankruptcy court authorized the proposed sale transaction in Chrysler on June 1, 2009, and the authorization was upheld by the Second Circuit Court of Appeals.[65]

The government's design of the sale was profoundly influenced by its policy goals. The Obama Administration sought to pursue its fuel efficiency goal by ensuring that Fiat would be the controlling shareholder of New Chrysler, while also ensuring that the company would subsequently not oppose the proposed

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[62] *See* Todd J. Zywicki, *The Corporatist Legacy of the Auto Bailouts*, L. & LIBERTY (Jan. 13, 2014), http://www.libertylawsite.org/2014/01/13/the-corporatist-legacy-of-the-auto- bailouts/.

[63] *See* Oversight Report, *supra* note 40, at 21 (highlighting how the government's investment put it in the driver seat, steering the restructuring).

[64] *In re* Chrysler, 576 F.3d 108, 113–14 (2d Cir. 2009).

[65] *Id.* at 127. The Second Circuit's judgment was vacated by the United States Supreme Court on grounds of mootness. *See In re* Chrysler, 592 F.3d 370, 370 (2d Cir. 2010) (holding that the judgement be vacated and remanded "with instructions to dismiss the appeal as moot.").

increases in fuel economy standards.[66] Although Chrysler had contacted unsuccessfully a number of other auto manufacturers in 2008 and although the Auto Task Force alleged that there were no other bidders, the design of the sale process made it highly unlikely that any new bidder would emerge. First, the auction was set so that any potential buyer had to bid for the company as a whole, rather than a piecemeal sale. There may have been competing interests in buying just Chrysler's Jeep business or some of its real estate holdings and such fragmented sale might have yielded a higher payout for creditors. However, the bankruptcy judge authorized the auction of Chrysler only as a going concern. Second, the bidder would have to assume very significant liabilities for pension and health benefits, as well as some dealership contracts.[67] This would ensure that these liabilities would be covered without the federal government needing to pay them, while also further limiting the likelihood of another bidder. As we discuss below, a sale subject to liabilities yields less than otherwise, raises the recovery of assumed liabilities, and lowers the bankruptcy payout to other claims. Third, other bidders would have been discouraged by knowing they were disfavored by the federal executive's policy-motivated strategy.[68]

4. *Who Bore the Cost of Policy Goals?*

Several pension and retirement funds—including those of police and teachers—had invested in first-lien bonds issued by Chrysler. Although they would receive first priority against the cash proceeds from the sale ($2 billion), their payout would be only about 29% of the amount of their claims. They objected to the sale on the grounds that, given the value distributed to the unfunded pensions and VEBA in the form of new debt and stock, the transaction effectively subordinated their first liens to those unsecured claims. Chrysler argued in response that, in return for these benefits, the company received value

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66 *See* Motion of Debtors and Debtors in Possession, Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Bankruptcy Rules 2002, 6004 and 6006 at 19, *In re* Chrysler, 405 B.R. 84 (Bankr. S.D.N.Y. 2009) (No. 09-50002) [hereinafter Motion of Chrysler to Approve Bidding Procedures] (stating that debtor had scoured the globe and only found Fiat as a buyer). Critics argued the sale was intended to allow Chrysler to fail slowly over the course of several years in a way that would coincide with Fiat's entry into the U.S. market, instead of closing Chrysler immediately. *See, e.g.*, Douglas G. Baird, *Car Trouble* 4 (Univ. of Chi. Law & Econ., Olin Working Paper No. 551, 2011) (arguing that the hope was that "[w]ith luck, Fiat could make its cars at factories that had been producing Chryslers while taking advantage of part of Chrysler's existing distribution system.").

67 *See* Roe & Skeel, *supra* note 49, at 747–48 (observing that "[b]ids proposing alternative configurations of the UAW and VEBA obligations were discouraged or, more realistically, barred.").

68 Roe & Skeel, *supra* note 49, at 748. In addition, potential bidders were given only a week in bankruptcy to submit bids because the court had determined the sale as an emergency. To be sure, Chrysler's distress was well known, and any other auto manufacturer would have had plenty of time to begin diligence and negotiations before the bankruptcy filing. Roe & Skeel, *supra* note 49, at 747.

in return for concessions in a new agreement with the UAW that included, for example, a commitment not to strike for six years.[69] But there was no support for the argument that this consideration was reasonably equivalent. Although the government publicly rationalized this special treatment as necessary to prevent worker strikes, this threat of strikes was speculation at the time.[70] The lienholders also had grounds to question whether Fiat's contribution was reasonably equivalent to its acquired stake in Chrysler's operations.

While bankruptcy law tends to require that distributions follow absolute priority—to ensure that the higher priority claim is paid in full before anything is distributed to a lower priority claim or interest—claimholders are free to consent to lesser treatment. In Chrysler, the court found that a substantial majority of the first-lien holders had voted, consistent with the requirements under their loan and collateral agreements, to approve the sale.[71] However, pension funds holding these liens argued that 70% of this debt was held by Citigroup, JP Morgan, Goldman Sachs, and Morgan Stanley—financial institutions who were beholden to the U.S. government's bank bailouts earlier in the financial crisis. The four banks had together received $90 billion from the Treasury.[72] In the end, the court was not persuaded by the objection and allowed the consummation of the sale.[73]

In sum, the federal government executed two policy goals—protecting worker benefits and promoting manufacture of fuel-efficient cars—by combining the leverage from its distressed financing with the power of the debtor to structure a sale in bankruptcy. Although the government bore the risk

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[69] *In re* Chrysler, LLC, 576 F.3d 108, 119 (2d Cir. 2009).

[70] Professor Zywicki notes that:

> neither Rattner nor any other member of the Auto Task Force provides any evidence to support the assertion that career GM and Chrysler employees would strike the companies into liquidation instead of accepting wage and benefit concessions that would bring them into line with foreign transplants but still far exceeded the wages of most U.S. manufacturing workers.

Zywicki, supra note 52, at 306.

[71] *In re Chrysler*, 576 F.3d at 119–20. Technically, a majority of the lienholders had the right to authorize the collateral agent who would then direct the collateral trustee to authorize the sale. Under the terms of the debt issuance, the majority vote was binding on all the lienholders holding notes under that indenture.

[72] *See* Neil King Jr. & Jeffrey McCracken, *U.S. Forced Chrysler's Creditors to Blink*, WALL ST. J. (May 11, 2009), https://www.wsj.com/articles/SB124199948894005017. Additionally, these banks, particularly Citigroup, were under threat of nationalization. *See* Roe & Skeel, *supra* note 49, at 743.

[73] *See In re Chrysler*, 576 F.3d at 118–19; *see* Brief of Appellants Indiana State Police Pension Trust et al. at 61–63, *In re* Chrysler, 576 F.3d 108 (2d Cir. 2009) (No. 09-2311-bk) [hereinafter Brief of Indiana State Police Pension Trust]; Christopher Jensen, *Chrysler Reverses Stance on Product Liability*, N.Y. TIMES (Aug. 28, 2009), https://wheels.blogs.nytimes.com/2009/08/28/chrysler-reverses-stance-on-product-liability/?mtrref=www.google.com&assetType=REGIWALL.

of providing the financing, the first-lien holders pointed out that they were compelled to bear a large cost. Other creditors were similarly subordinated effectively to the workers' claims, including pre-bankruptcy products liability holders who were arguably as vulnerable to Chrysler's insolvency as its workers.[74] Our discussion of the policy of protecting the claims of wildfire victims in the PG&E bankruptcy (below) provides a contrast to the treatment of products liability claimants in Chrysler and GM. One might speculate that this reflects the political clout of (in descending order) workers, California residents who lost property to wildfires because of the actions of their public utility, and purchasers of defective vehicles. In Part V, we revisit these important distributional issues as we examine the dangers of using bankruptcy to promote public policy goals. Before we do, we describe the activism of the government of California in the PG&E bankruptcy, a decade after Chrysler and GM.

B. Pacific Gas & Electric

Perhaps the most recent and salient example of a governmental entity using bankruptcy law to implement government policy is the 2019 bankruptcy filing of California's giant privately owned public utility, the 150-year-old PG&E which serves more than 16 million people.[75] PG&E filed for bankruptcy because of its role in a series of wildfires that caused more than $30 billion in damages and its inability to defend itself against a flood of tort litigation.[76] But, as we will

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[74] Christopher Jensen reported that:

> consumer groups, such as Public Citizen, the Center for Auto Safety and the Center for Justice & Democracy, remain unhappy that Chrysler had not changed its position on another element of the bankruptcy settlement. It persuaded the court not to make the new company responsible for suits that had already been filed. That means people who were previously injured and filed suits have no chance of recovering any significant funds because they are among the so-called unsecured creditors.

Jensen, *supra* note 73.

[75] *150 Years of Growth and Change*, PG&E CORP., http://www.pgecorp.com/150_non_flash/index.html (last visited Oct. 4, 2020) (showing timeline of electrification of California); Guy Kovner, *PG&E Trims or Removes 30,000 Fire-Damaged Trees in Northern and Central California*, PRESS DEMOCRAT (Jan. 24, 2018), https://www.pressdemocrat.com/article/news/pge-trims-or-removes-30000-fire-damaged-trees-in-northern-and-central-cal/ (showing PG&E service territory).

[76] By the time PG&E filed for bankruptcy, it was already on probation for a pipeline explosion in San Bruno in 2010 which killed eight people and destroyed thirty-eight homes. Maria Dinzeo, *PG&E Accused of Violating Probation With 2018 Wildfires*, COURTHOUSE NEWS SERV. (Jan. 9, 2019), https://www.courthousenews.com/pge-accused-of-violating-probation-with-2017-wildfires/. It remained on probation in front of Judge Alsup of the Northern District of California for the entire pendency of the bankruptcy period, which created a strange dynamic as the company was faced with two federal judges with enormous power over its operations—Judge Alsup in the criminal probation proceedings and the bankruptcy judge. *See* Rebecca Smith & Peg Brickley, *In PG&E Bankruptcy, Another Judge May Play Key Role*, WALL ST. J. (Jan. 30, 2019, 8:15 AM), https://www.wsj.com/articles/in-pg-e-bankruptcy-another-judge-may-play-key-role-11548854129.

explain, the bankruptcy is better understood as being driven by climate change and PG&E's complicated role as a vehicle for California's energy policies. PG&E's problems could have been solved by the state legislature's powers to regulate and appropriate, had the legislature chosen to do so. But by using the bankruptcy process as a vehicle for PG&E's restructuring, the government of California was able to resolve, at least for now, the thorny problem oof PG&E's solvency,with the aid of private sector capital, and to protect important public policies. Importantly, the outcome of the bankruptcy was different than what would have happened if it were a purely private sector bankruptcy, where the reorganization might have compromised all unsecured liabilities, including those of fire survivors.

In this Part, we describe the policy goals that the government of California implements through its regulation of PG&E, how the State was able to protect those goals through the Chapter 11 proceeding, particularly by forcing PG&E to make concessions towards policy goals that may have been much harder without the bargaining power that Chapter 11 provided to the State.

1. *The State's Policy Goals with PG&E*

Like all public utilities, PG&E is a highly regulated firm, but it advances State policies that are far greater than its role as a mere supplier of power.[77] The company is regulated directly by the California Public Utilities Commission (CPUC), and CPUC has an oversight role over basic corporate decisions such as the price that PG&E customers pay for electricity.[78] For the purposes of our discussion, we will focus on two public policies that PG&E advances within California's system of government: (1) the transition to clean energy; and (2) subsidizing the insurance of the households of Californians against the risks of

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[77] *See* PG&E, PUBLIC SAFETY POWER SHUTOFF POLICIES AND PROCEDURES 3 (2020), https://www.pge.com/pge_global/common/pdfs/safety/emergency-preparedness/natural-disaster/wildfires/Public-Safety-Power-Shutoff-Policies-and-Procedures.pdf (providing PG&E's internal policies and guidelines regarding the prevention of wildfires); *see also* Anne C. Mulkern, *California Tests New Strategies to Prevent Deadly Wildfires*, SCI. AM. (Sept. 30, 2019), https://www.scientificamerican.com/article/california-tests-new-strategies-to-prevent-deadly-wildfires (describing statewide fire prevention projects and priorities).

[78] *See* Nicholas Iovino, *PG&E Seeks Rate Hike to Fund Wildfire Safety Measures*, COURTHOUSE NEWS SERV. (Sept. 23, 2019), https://www.courthousenews.com/pge-seeks-rate-hike-to-fund-wildfire-safety-measures/ (describing PG&E's twenty-day hearings with CPUC in response to a proposed utility rate increase). This oversight role had unprecedented consequences in the bankruptcy case as fire survivors were able to use CPUC processes to obtain access to PG&E's management that otherwise does not occur in Chapter 11 cases. For example, Will Abrams, an outspoken fire survivor who is not an attorney by training, was able to use CPUC processes to question PG&E's CEO for about two hours. *See* J.D. Morris, *'Sometimes Things Just Break': PG&E CEO Grilled by Fire Victim*, S.F. CHRON. (Feb. 25, 2020, 8:08 PM), https://www.sfchronicle.com/business/article/Sometimes-things-just-break-PG-E-CEO-15084426.php.

wildfires, which have greatly increased over the past decade due to climate change. We discuss each in turn.

First, California had been using PG&E as a catalyst for its transition to clean energy before the most recent bankruptcy filing.[79] Essentially, the State implemented a series of purchase mandates that required PG&E to purchase progressively more and more of its energy from clean energy suppliers.[80] PG&E had to search for sufficient supply to meet these new requirements and an entire new industry grew up around PG&E, as PG&E long-term purchase orders enabled many suppliers of clean energy to get the financing they needed to build or expand facilities.[81] The program was extremely successful, stimulating the development of the clean energy industry in California and setting the State on a track to be 100% reliant on clean energy sources.[82]

Second, PG&E had implicitly been transformed into an insurer of last resort for Californians living in areas that suddenly had much higher wildfire risk because of climate change.[83] This was the unintentional result of two laws that constrain PG&E's activities. First, PG&E is legally required to provide services to Californians in remote regions, which it did through an electric grid with equipment that was so old that PG&E had, in some cases, lost track of how old some of it was.[84] As the climate warmed in the 21st century, California was beset by an unprecedented drought that left the State's forests a veritable tinderbox, waiting for a spark from a PG&E tower that could cause billions of dollars in

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[79] *See* Dale Kasler, *California Seeks 100% Clean Energy. Why PG&E's Bankruptcy Could Imperil That Plan*, SACRAMENTO BEE (June 11, 2019, 10:20 AM), https://www.sacbee.com/news/politics-government/capitol-alert/article231413083.html (discussing PG&E's role in California's clean energy infrastructure).

[80] S.B. 1078, 2002 Leg., 527th Sess. (Cal. 2002) (outlining clean energy initiative that initially begun in 2002); *see* AMANDA SINGH, 2018 CALIFORNIA RENEWABLES PORTFOLIO STANDARD ANNUAL REPORT 2 (2018) (describing successive laws that have expanded California's renewable purchase mandates).

[81] Christine Cordner, *Sempra, Con Edison Development Partner on Renewable Energy Development*, SNL ENERGY POWER DAILY (May 22, 2013), https://www.proquest.com/docview/1356819864/C32FC1778B684290PQ/1 (describing the sale of two photovoltaic plants which were developed under a Power Purchase Agreements ("PPA") with PG&E); *see PG&E Awards 20-Year PPA for 3 California Solar Power Projects*, POWER ENG'G (May 18, 2016), https://www.power-eng.com/2016/05/18/pg-e-awards-20-year-ppa-for-3-california-solar-power-projects/#gref (illustrating how PPAs with PG&E allow companies to build and commission power plants).

[82] Betsy Lillian, *PG&E Hits California's Renewables Goal Years Ahead of Schedule*, N. A. WINDPOWER (Feb. 21, 2018), https://nawindpower.com/pge-hits-californias-renewables-goal-years-ahead-schedule.

[83] *See* PG&E, *Comments to Commission on Catastrophic Wildfire Cost and Recovery* 1, 3 (Apr. 22, 2019), https://opr.ca.gov/wildfire/docs/comments/20190424-wildfire_comments_04-22-2019_Pacific_Gas_and_Electric.pdf ("IOUs [investor-owned utilities] (through their investors) are left to shoulder all costs of property damage from catastrophic wildfires, as well as all attorneys' fees and expert costs from litigation, if their facilities were involved in ignition of a fire.").

[84] Russell Gold, *PG&E: The First Climate-Change Bankruptcy, Probably Not the Last*, WALL ST. J. (Jan. 18, 2019), https://www.wsj.com/articles/pg-e-wildfires-and-the-first-climate-change-bankruptcy-11547820006.

damages with a single gust of wind.[85] Second, under the California State Constitution, private parties charged by the State to carry out public uses have a responsibility to pay damages for damages caused to others.[86] For PG&E this means, in effect, that the company is strictly liable for any fires caused by its equipment, regardless of fault.[87] Even if a homeowner had insurance, the insurance company would normally bring a subrogation claim against PG&E and the entire system of home insurance in growing swaths of California depended on PG&E's role as insurer of last resort.[88]

2. *Background to the Bankruptcy Filing*

PG&E's Chapter 11 filing was driven by its inability to reduce significantly the dangers that running power lines over increasingly dry fire-prone land created for the company.[89] The company's crisis began in October 2017 as heavy winds buffeted Northern California and a series of wildfires caused by PG&E equipment left the company as much as $15 billion in dollars in potential liability.[90] The company could not eliminate the risk that wind posed to its equipment in the near-term, as "undergrounding" its above-ground power equipment was cost prohibitive and reducing the risk posed by high winds would require cutting down more than 100 million trees, many of which were not located on PG&E property, the cost of which the company estimated at $150 billion.[91] PG&E was also unable to offload this risk to the insurance market and could not obtain private insurance that came close to the scale of the risks it took

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85 *Id.*

86 *See* Cal. Const., art. I, § 19 (stating that "[p]rivate property may be taken or damaged for a public use and only when just compensation, ascertained by a jury unless waived, has first been paid to, or into court for, the owner"); Arvo Van Alstyne, *Inverse Condemnation: Unintended Physical Damage*, 20 HASTINGS L.J. 431, 431 (1969).

87 *See* Declaration of Jason P. Wells in Support of First Day Motions and Related Relief at 3, *In re* PG&E, 603 B.R. 471 (Bankr. N.D. Cal. 2019) (No. 19-30088) [hereinafter Wells Declaration].

88 *See* David R. Baker, *Fight Over PG&E's Liability in Wine Country Fires Just Beginning*, S.F. CHRON. (June 9, 2018), https://www.sfchronicle.com/business/article/Fight-over-PG-E-s-liability-in-Wine-Country-12981642.php.

89 Peter Eavis & Ivan Penn, *The Struggle to Control PG&E*, N.Y. TIMES (Feb. 13, 2019), https://www.nytimes.com/2019/02/13/business/energy-environment/pge-wildfire-bankruptcy-control.html

90 *See* Wells Declaration, *supra* note 87, at 21–22 (describing passage of S.B. 901 fire relief bill, estimating PG&E's liability for damages at $15 billion); *accord* Jeff St. John, *California Lawmakers Pass PG&E Wildfire Relief Bill, Let Grid Regionalization Expire*, GREENTECH MEDIA (Sept. 4, 2018), https://www.greentechmedia.com/articles/read/california-passes-pge-wildfire-relief-bill-but-grid-regionalization-fails.

91 Jim Christie, *PG&E Puts Cost of Judge's Wildfire Plan at up to $150 Billion*, REUTERS (Jan. 23, 2019), https://www.reuters.com/article/us-pg-e-us-wildfire/pge-puts-cost-of-judges-wildfire-plan-at-up-to-150-billion-idUSKCN1PI00P.

on.[92] Making things worse, CPUC decided that fire-related damages beyond a public utility's commercial insurance would need to be paid by the company's shareholders and not through higher rates on end-users, leaving PG&E on the brink of insolvency.[93] While the California State Legislature allowed PG&E to borrow money to pay some of the damages from the 2017 fires, it did not provide a long-term solution to the company's basic dilemma of strict liability, climate change and fire risk.[94]

The next year quickly turned into PG&E's worst nightmare, as dry weather conditions and high winds led to a string of destructive fires and California's government signaled disinterest in providing additional assistance. The fires of 2018 included the worst fire in California history, the Camp Fire, which destroyed 14,000 homes and killed 84 people[95] and caused more than $16.5 billion in estimated losses.[96] If this was a preview of what PG&E's "new normal" of "hotter, dryer summers" would look like, the company would need substantial help from the State.[97] Adding the Camp Fire onto PG&E's existing fire liability from 2017 as well as some earlier fires, the company faced as much as $30 billion in damages.[98] The weight of tort litigation took a continuing toll

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92 PG&E only had $800 million insurance for the entire 2017 fire season. *See* Nicole Friedman, *Disaster Losses Close in on Record*, WALL ST. J. (Dec. 12, 2017) https://www.wsj.com/articles/with-california-wildfires-insurers-losses-keep-spiraling-higher-1513083600. For the 2018 fire season, PG&E was able to obtain $1.4 billion in insurance. *See* Wells Declaration, *supra* note 87, at 16.

93 Historically, utilities had been able to convince regulators to pass tort costs on to ratepayers when they convinced their regulator that they had "acted prudently." *See* Order Denying Application for Decision at 5, *In re* San Diego Gas & Electric Co., Case No. 17-11-033 (Cal. Pub. Util. Comm'n 2017). In a November 2017 decision, CPUC denied San Diego Gas & Electric's application to raise customer electricity rates to recover money for three 2007 fires. Dale Kasler, *This State Ruling Could Hurt PG&E in Fight Over Who Pays in Wine Country Fires*, SACRAMENTO BEE (Nov. 30, 2017), https://www.sacbee.com/news/local/article187429948.html.

94 In September 2017, the State passed a law that allowed PG&E to borrow money to pay for some of the 2017 fire costs if it could prove it had "acted reasonably" and surcharge its customers to pay for the borrowings. *See* CAL. PUB. UTIL. CODE § 8386 (Deering 2018). The State also agreed to spend $1 billion to help PG&E reduce fire risk by clearing brush and setting controlled fires. *See* Melody Gutierrez & David R. Baker, *Legislature Passes Bill to Help Protect PG&E from Wildfire Damage Suits*, S.F. CHRON. (Sept. 2, 2018), https://www.sfchronicle.com/politics/article/Legislature-passes-bill-to-help-protect-PG-E-from-13199141.php. While helpful, this bill was nowhere near enough to offer PG&E a long-term solution to its problems.

95 Ray Sanchez & Augie Martin, *84 Victims of 2018 Camp Fire Given Voice at Emotional PG&E Hearing*, CNN (June 17, 2020), https://www.cnn.com/2020/06/17/us/pge-camp-fire-california-victim-impact-statements/index.html.

96 Alejandra Reyes-Velarde, *California's Camp Fire Was the Costliest Global Disaster: Last Year, Insurance Report Shows*, L.A. TIMES (Jan. 11, 2019), https://www.latimes.com/local/lanow/la-me-ln-camp-fire-insured-losses-20190111-story.html.

97 Phil Matier & Andy Ross, *Capitol Debate on Utilities' Fire Liability Sparks a Lobbying Frenzy*, S.F. CHRON. (Aug. 15, 2018), https://www.sfchronicle.com/bayarea/matier-ross/article/Capitol-debate-on-utilities-fire-liability-13156339.php.

98 J.D. Morris, *Legal Barrage Has PG&E on the Ropes*, S.F. CHRON. (Dec. 2, 2018), https://www.pressreader.com/usa/san-francisco-chronicle-late-edition-sunday/20181202/281522227155243.

on PG&E, bleeding the company of more than $70 million in attorneys' fees.[99] California's legislature considered providing help to PG&E,[100] but PG&E withdrew from negotiations with the legislature and decided to look somewhere else for relief—the bankruptcy court.[101]

3. The Chapter 11 Petition

PG&E filed for Chapter 11 bankruptcy on January 29, 2019 and it quickly became very clear that PG&E's path out of bankruptcy ran through Sacramento.[102] While Chapter 11 provided PG&E with a refuge from lawsuits, the company needed regulatory relief to reorganize successfully.[103] The federal bankruptcy judge could not solve PG&E's situation, which was a function of regulatory mandates (providing power to climate changed afflicted areas) and state law (strict liability). PG&E could only become solvent again if it won liability reform or permission to raise electricity rates, which had to come from the California State Legislature and the CPUC.[104]

Sacramento's bargaining power was crucial because the company could have used bankruptcy law in two ways that would have been inimical to the State government's policy priorities. First, PG&E could have sought to confirm a plan

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99 *See* Declaration of Paul H. Zumbro in Support of Application of Debtors Pursuant to 11 U.S.C. § 327(a) and Fed. R. Bankr. P. 2014(a) and 2016 for Authority to Retain and Employ Cravath, Swaine & Moore LLP as Corporate and Litigation Counsel for Debtors Effective as of the Petition Date at 8, *In re* PG&E, 603 B.R. 471 (Bankr. N.D. Cal. 2019) (No. 19-30088).

100 David R. Baker & Romy Varghese, *California Fire Relief for PG&E May Not Include the Fix It Wants*, BLOOMBERG (Nov. 26, 2018), https://www.bloomberg.com/news/articles/2018-11-26/pg-e-california-fire-relief-may-not-include-fix-utility-wants?sref=E6x1oDFD (discussion of S.B. 901's implications for PG&E and consumers).

101 Lily Jamali, *Lawmakers Say No PG&E Bailout for 2018 Wildfires*, KQED (Jan. 24, 2019), https://www.kqed.org/news/11720734/lawmakers-say-no-pge-bailout-for-2018-wildfires.

102 J.D. Morris, *PG&E Files for Bankruptcy, Seeking Protection from Wildfire Costs*, S.F. CHRON. (Jan. 29, 2019), https://www.sfchronicle.com/business/article/PG-E-officially-files-for-bankruptcy-seeking-13569611.php.

103 PG&E's conduct heading into bankruptcy suggests that the company's board understood this, even if they did not file for Chapter 11 with a clear way through the process. In S.B. 901, California required PG&E to provide "15 days notice" before any bankruptcy filing. *See* Dale Kasler, *PG&E Is Going Bankrupt. What that Means for Ratepayers, Wildfire Survivors*, SACRAMENTO BEE (Jan. 15, 2019), https://www.sacbee.com/news/business/article224525395.html. PG&E complied with this law in mid-January 2019 even though the law was likely not enforceable. This notice was not costless to PG&E, as it created all the disruption associated with a bankruptcy filing without the protection that bankruptcy courts can offer to debtors in Chapter 11. *See* Russell Gold et al., *PG&E Prepares for Bankruptcy Amid Wildfire Fallout*, WALL ST. J. (Jan. 14, 2019), https://www.wsj.com/articles/pg-e-initiates-chapter-11-reorganization-for-utility-11547465293.

104 *In re* PG&E, 611 B.R. 110, 115 (Bankr. N.D. Cal. 2019). PG&E could have also obtained relief from the California Supreme Court, which could have interpreted the State Constitution to not require privately owned public utilities to be strictly liable to wildfire victims. *Id.* at 117–18. PG&E asked the California Supreme Court to address the issue in 2018, but they denied certiorari.

that did not pay fire survivors—owed some $30 billion—in full.[105] This would have caused an uproar among fire survivors and jeopardized the willingness of private sector investors to finance the privately owned public utilities in Los Angeles and San Diego.[106] Second, PG&E could have jeopardized the State's clean power goals by tearing up power purchase agreements to buy clean power.[107] Chapter 11 allows firms to exit contracts that are unfavorable and to use the threat of doing so to force contractual counterparties to renegotiate deals. PG&E could have saved somewhere between $1 billion[108] and $2.5 billion[109] a year by tearing up clean energy contracts.[110]

With this in mind, Governor Newsom immediately convened a 'strike team' of bankruptcy attorneys and energy experts to study the situation for sixty days and produce a framework balancing California's competing policy goals.[111] The strike team produced a public report that offered a menu of solutions to PG&E's predicament, including the one that Newsom would settle on: creating a catastrophic wildfire fund to provide billions of dollars in insurance to the State's major utilities, including PG&E.[112] The wildfire fund would be capitalized with

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105 Ivan Penn, *PG&E Says Wildfire Victims Back Settlement in Bankruptcy*, N.Y. TIMES (June 16, 2020), https://www.nytimes.com/2020/05/18/business/energy-environment/pge-bankruptcy-wildfire-victims.html (noting that PG&E was, "[f]acing an estimated $30 billion in wildfire liabilities.").

106 Romy Varghese, *PG&E, Edison May Not Get California Help on Fires by July 12*, BLOOMBERG (July 5, 2019 12:11 PM), https://www.bloomberg.com/news/articles/2019-07-05/pg-e-edison-may-not-get-california-s-help-on-fires-by-july-12.

107 Indeed, PG&E started the Chapter 11 by immediately filing a request for the bankruptcy judge to declare the company had the authority to break these contracts. *See* Jeff St. John, *PG&E's Bankruptcy Judge Leaves Door Open to Shedding Renewables Contracts*, GREENTECH MEDIA (June 10, 2019), https://www.greentechmedia.com/articles/read/pge-bankruptcy-judge-leaves-door-open-to-severing-renewable-energy-contract.

108 Garrett Hering, *PG&E Could Save Billions by Shedding Pricey Power Supply Deals, Moody's Finds*, S&P GLOB. (Apr. 1, 2019), https://www.spglobal.com/marketintelligence/en/news-insights/trending/r3wsfcG5olaZwvNUizePeQ2.

109 *See* St. John, *supra* note 107.

110 Jeff Manning & Steven Wilamowsky, *Will PG&E Be Forced to Turn to PPAs to Get a Bankruptcy Exit Plan Confirmed?*, UTILITY DIVE (Mar. 31, 2020), https://www.utilitydive.com/news/will-pge-be-forced-to-turn-to-ppas-to-get-a-bankruptcy-exit-plan-confirmed/575045/.

111 Julia Pyper, *Governor Newsom Convenes 'Strike Team' to Release PG&E Strategy Within 60 Days*, GREENTECH MEDIA (Feb. 12, 2019), https://www.greentechmedia.com/articles/read/newsom-pge-strike-team-60-days; *see* WILDFIRES AND CLIMATE CHANGE: CALIFORNIA'S ENERGY FUTURE, REPORT FROM GOVERNOR NEWSOM'S STRIKE FORCE 1–4 (2019) [hereinafter Strike Force Report].

112 In addition to the wildfire fund, the report also considered a solution that would be less helpful to PG&E (a 'liquidity fund' that would provide PG&E with money to pay wildfire damages claims while awaiting CPUC permission to pass costs onto ratepayers) and something PG&E would have liked more (a state law abandoning strict liability and moving to a negligence standard for fire claims). *See* Strike Force Report, *supra* note 111, at 3. Given PG&E's unpopularity, it was unsurprising that State Legislature offered a cool response to the most helpful solution, which could have been seen as letting PG&E 'off the hook' for future fires. *See* Rob Nikolewski,

contributions from each of the State's major public utilities' shareholders and ratepayers and would function as a vehicle for spreading risks over all three major utilities' customer bases.[113] In exchange for liability reform, PG&E would need to commit to paying pre-bankruptcy fire survivors in full, maintain commitments to clean energy goals, and commit to a "safety-first culture."[114]

As the bankruptcy began to move forward, Governor Newsom filed a pleading in the bankruptcy court demanding that PG&E make significant policy concessions and satisfy the State's interest if it wanted to emerge from bankruptcy.[115] He also put PG&E on notice that the State would only create the proposed new regulatory framework if PG&E demonstrated, among other things: (1) an improvement in their safety culture to reduce the risk of fires; and (2) significant contributions from PG&E's shareholders towards reducing the risks of wildfires. [116] He noted that the strike team had only recently completed its work and that he was working to turn it into legislation that would "circumscribe the [restructuring] options for PG&E."[117] PG&E had also appointed a new board of directors shortly after filing for bankruptcy, and Governor Newsom expressed skepticism in the new directors:

> PG&E's governance actions following the commencement of the Chapter 11 Cases also raise concern. PG&E's newly appointed board of directors is populated by hedge fund financiers, out-of-state executives and other individuals with little or no experience in utility operations, regulation and safety. PG&E has done little to instill confidence that it appreciates the urgency of resolving wildfire claims or that it is developing with due dispatch a viable business plan that will allow PG&E to provide safe, reliable, and affordable power to the people of Northern California.[118]

4. *AB1054: The State Charts the Path PG&E Would Walk Through Chapter 11*

Subsequently, the State Legislature unveiled a law, Assembly Bill 1054

Mixed Reaction to Newsom's 'Strike Force' Report on California Wildfires, SAN DIEGO UNION-TRIB. (April 12, 2019, 3:58 PM), https://www.sandiegouniontribune.com/business/energy-green/story/2019-04-12/mixed-reaction-to-newsoms-strike-force-report-on-california-wildfires.

[113] *See* Strike Force Report, *supra* note 111, at 38.

[114] Strike Force Report, *supra* note 111, at 46.

[115] Limited Objection of Governor Gavin Newsom to Corrected Motion of Debtors Pursuant to 11 U.S.C. § 1121(d) to Extend Exclusive Periods, *In re* PG&E, 611 B.R. 110 (Bankr. N.D. Cal. 2019) (No. 19-30088).

[116] *Id.* at 3–4.

[117] *See id.* at 6.

[118] *See id.* at 4.

(AB1054),[119] that offered PG&E the liability protection it needed to restructure in Chapter 11 in exchange for concessions that protected the State's policy interests.[120] As this is the first state law that we are aware of that effectively dictated the outcome of a Chapter 11 plan, it is worth tracing its contours in detail.

Essentially, the State used PG&E's need for the wildfire fund to dictate the remaining course of the bankruptcy process. The law put the bankruptcy case on a tight leash, giving the company until June 30, 2021—about a year after AB1054 was passed—to leave bankruptcy.[121] Any plan of reorganization would need acceptance of the CPUC, which was directed to review the company's board and management team "in light of the electrical corporation's safety history."[122] AB1054 required PG&E to propose a "rate neutral" plan, which would guard lawmakers against the inevitable outrage that would have accompanied PG&E appearing to pay for wildfire damages by passing the costs onto customers.[123] Importantly, all pre-bankruptcy fire victims would need to be paid in full.[124] Taken together these provisions would force PG&E to implement a solvent debtor plan that paid all fire survivors in full and reorganized very quickly with a board of directors and management team that met the State's approval. As an added benefit, fire survivors and bondholders each had claims of the same priority, so the requirement that fire survivors had to be paid in full also meant that bankruptcy law would require the similarly situated bondholders to be paid in full, protecting (perhaps unintentionally) the State's reputation for credit-worthiness on Wall Street. If PG&E ended up being sold in a bankruptcy auction, the State added a new requirement that any buyer of PG&E would guarantee the wages and benefits of its workforce for three years. This helped to lock in the deal structure that the State envisioned.[125]

The State also used AB1054 to protect the State's climate goals and increase its ability to oversee PG&E's conduct. To get access to the wildfire fund, PG&E would need to propose a plan that was consistent with the State's climate

[119] Assembly Bill 1054 was codified into California law as Section 3291 of the California Public Utility Code. *See* CAL. PUB. UTIL. CODE § 3291 (Deering 2019).

[120] Chron. Ed. Bd., *Editorial: AB1054 Will Change the Way California Deals with Wildfires, so the Legislature Needs to Get It Right*, S.F. CHRON. (July 9, 2019, 5:02 PM), https://www.sfchronicle.com/opinion/editorials/article/Editorial-AB1054-will-change-the-way-California-14083760.php.

[121] CAL. PUB. UTIL. CODE § 3291(b) (Deering 2019).

[122] *Id.* § 3291(b)(1)(C).

[123] *Id.* § 3291(b)(1)(E).

[124] *Id.* § 3291(b)(1)(B).

[125] *Id.* § 3291(b)(1)(D).

goals.[126] This blocked PG&E from using bankruptcy powers to exit clean energy purchase agreements, forcing PG&E to keep its promises to clean energy producers that California's transition to renewables had been built on.[127] The State also increased its oversight of PG&E by establishing a new Wildfire Safety Advisory Board and bolstering the CPUC with a new Wildfire Safety Division.[128]

In exchange for these new burdens, PG&E's shareholders were given significant protection from future fire liability through favorable changes to the "cost recovery" process. In general, utilities like PG&E can only pass costs from wildfires on to ratepayers as "rate increases" if CPUC finds the increase justified andthe Commission became much less willing to allow PG&E to pass fire costs onto customers in 2017, effectively rendering the company insolvent.[129] AB1054 created a much more predictable cost recovery process with the discretionary portions of CPUC's review reoriented in favor of the utilities. Going forward, PG&E would be able to obtain cost recovery if it could demonstrate it had acted reasonably[130] and, if PG&E went through a regulatory process to obtain a safety certificate,[131] the safety certificate would transfer the burden of proof to CPUC or any other third parties to rebut a presumption that PG&E's conduct had been reasonable.[132]

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126 *Id.* § 3291(b)(1)(D).

127 Jeff St. John, *California Assembly Passes $21B Wildfire Fund for Utilities*, GREENTECH MEDIA (July 11, 2019), https://www.greentechmedia.com/articles/read/california-assembly-passes-21b-wildfire-fund-for-utilities. This decision cost PG&E's shareholders billions of dollars but ensured that the State's climate goals would not be negatively impacted by the PG&E Chapter 11. *See* Julian Spector, *PG&E Pledges to Keep All Power Purchase Agreements Despite Bankruptcy*, GREENTECH MEDIA (Aug. 9, 2019), https://www.greentechmedia.com/articles/read/pge-pledges-to-keep-all-power-purchase-agreements-but-some-already-took-a-h.

128 CAL. PUB. UTIL. CODE § 326.1, 326.2.

129 Cost recovery had historically been granted so long as an electrical utility could show that it had acted "reasonably and prudently" based on what the utility knew or should have known at the time. *See, e.g.*, *In re* S. Cal. Edison Co., No. 87-08-021, 1987 Cal. PUC LEXIS 588, at *28–29 (Cal. Pub. Util. Comm'n June 15, 1987) ("The term 'reasonable and prudent' means that at a particular time any of the practices, methods, and acts engaged in by a utility follows the exercise of reasonable judgment in light of facts known or which should have been known at the time the decision was made.").

130 "Reasonableness" would require a showing that the conduct leading to the cost increase was consistent with what a reasonable utility would have undertaken in good faith, under similar circumstances, at that relevant point in time. *See* CAL. PUB. UTIL. CODE § 451.1(b).

131 *Id.* § 451.1(c).

132 *Id.*

5. *Amid a Hedge Fund Brawl, the State Takes Control of the Bankruptcy Process*

At the same time that the State was busy crafting PG&E's regulatory future, PG&E's shareholders and creditors were engaged in a classic bankruptcy contest for control. PG&E's shareholders were a group of deep-pocketed hedge funds who wanted to implement a restructuring plan that would leave them owning as much of the post-bankruptcy equity as possible.[133] On the other side, the firm's bondholders were a different group of deep-pocketed hedge funds that also wanted to control the company after bankruptcy.[134]

The wildfire survivors entered the clash of Wall Street titans by joining forces with the company's bondholders and bringing Governor Newsom into the fray. The wildfire survivors negotiated with both sides before declining PG&E's (really their shareholders') offer of $8.4 billion in payments to the fire victims and settling instead with bondholders for $13.5 billion.[135] Judge Montali then gave the bondholders and fire survivors permission to sponsor their own rival plan of reorganization.[136] PG&E's shareholders decided to go forward with their own plan despite the objections of wildfire victims, who argued that PG&E's plan would not pay them in full.[137] Governor Newsom objected to this effort, filing an objection with the court arguing that the shareholders were engaged in:

> legal maneuvering . . . more focused on securing procedural advantages for their own pecuniary interests than on reaching a fair and expeditious resolution of this bankruptcy . . . These tactics may be commonplace in bankruptcy proceedings but they are unacceptable in these chapter 11 cases, which are causing ongoing harm to California, its residents and economy.[138]

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[133] J.D. Morris, *Why Hedge Funds Are Fighting for Control of PG&E–and What It Means for You*, S.F. CHRON. (July 23, 2019, 3:13 PM), https://www.sfchronicle.com/business/article/Why-hedge-funds-are-fighting-for-control-of-PG-E-14115025.php (noting that the hedge fund shareholders seek to implement a bankruptcy plan that would "allow the current equity owners to maintain control of the company during its reorganization.").

[134] *Id.*

[135] Peg Brickley & Katherine Blunt, *PG&E Bondholders Ally with Wildfire Victims to Propose New Bankruptcy Exit Plan*, WALL ST. J. (Sept. 19, 2019, 8:18 PM), https://www.wsj.com/articles/pg-e-bondholders-ally-with-wildfire-victims-to-propose-new-bankruptcy-exit-plan-11568930574?mod=article_inline.

[136] Peter Eavis, *PG&E Bankruptcy Judge Gives Outside Group's Plan a Chance*, N.Y. TIMES (Oct. 9, 2019), https://www.nytimes.com/2019/10/09/business/energy-environment/pge-bankruptcy.html.

[137] Objection of the Ad Hoc Committee of Senior Unsecured Noteholders to Debtors' Motion to Enter into Restructuring Support Agreement with the Consenting Subrogation Claimholders at 3, *In re* PG&E, 603 B.R. 471 (Bankr. N.D. Cal. 2019) (No. 19-30088).

[138] Objection of Governor Gavin Newsom to Debtors' Motion Pursuant to 11 U.S.C. 363(B) and 105(A) and Fed. R. Bankr. P. 6004 and 9019 For Entry of an Order (I) Authorizing the Debtors to Enter into

By intervening in bankruptcy court, Governor Newsom protected the fire survivors and bolstered their bargaining power. Governor Newsom then reiterated the goals that AB1054 had created for the bankruptcy, which would require PG&E to implement a Chapter 11 plan that improved safety and reliability, paid fire victims in full, protected California's climate goals, and would not fund the plan with higher rates for ratepayers.[139] He also reminded the company that it had until June 30 to confirm a plan and that he would step in if the company failed to meet the State's goals:

> The seemingly incessant litigation and stalling tactics undertaken by the financial stakeholders in these chapter 11 cases—often at the expense of involuntary creditors (e.g. the wildfire victims)—inspires little confidence that they can achieve resolution of these cases on a schedule and in a manner that meets the expectations of California. In the event they cannot or will not do so, the state of California will present its own plan for resolution of these cases.[140]

In making this objection, Governor Newsom hired one of the leading bankruptcy law firms to represent him, signaling that he had the legal resources to propose his own plan of reorganization. Governor Newsom also wrote a letter to Judge Montali thanking him for forcing the parties into mediation, further reinforcing that the State was a key stakeholder in setting the terms of the bankruptcy.[141] Both PG&E and its bondholders appeared to recognize this, as they collectively spent millions lobbying the legislature to curry favor in Sacramento.[142]

Following the Governor's intervention, PG&E reached a deal with wildfire victims to pay them the same $13.5 billion that the bondholders had promised, but this did not cause Governor Newsom to reduce his involvement in shaping the outcome of the case and he would go on to force PG&E to make additional

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Restructuring Support Agreement with the Consenting Subrogation Claimholders, (II) Approving the Terms of Settlement with such Consenting Subrogation Claimholders, Including the Allowed Subrogation Claim Amount, and (III) Granting Related Relief at 2, *In re* PG&E, 603 B.R. 471 (Bankr. N.D. Cal. 2019) (No. 19-30088) [hereinafter Newsom Rejection].

139 *See* Newsom Rejection, *supra* note 138, at 3.

140 Newsom Rejection, *supra* note 138, at 4.

141 Letter from Gavin Newsom, Governor of California, to Hon. Dennis Montali, United States Bankruptcy Court, Northern District of California (Nov. 1, 2019) (available at https://restructuring.primeclerk.com/pge/Home-DownloadPDF?id1=MzA0OTAw&id2=0).

142 Lee Fang, *PG&E Spent Millions on Lobbying Following Bankruptcy, Wining and Dining Lawmakers Who Sponsored Bailout*, THE INTERCEPT (Nov. 4, 2019, 11:56 AM), https://theintercept.com/2019/11/04/pge-bailout-bankruptcy-lobbying/; *see also* Colby Bermel @ColbyBermel, TWITTER (Feb. 3, 2020, 11:44 AM), https://twitter.com/ColbyBermel/status/1224418507154059264?s=20 (reporting that PG&E "spent big to press their bankruptcy plans with Gov. Newsom and lawmakers.").

concessions.[143] The week after PG&E reached a deal with fire survivors, Governor Newsom wrote a five-page public letter detailing his objections to the debtor's amended plan that incorporated the fire survivor settlement.[144] Governor Newsom's demands would effectively change PG&E's post-bankruptcy governance structure and create an enforcement process to allow the State to seize the company's operating license and transfer it to a new owner or a public entity in the event PG&E's equipment caused significant fires after bankruptcy.[145] Governor Newsom also continued to use his bargaining leverage in the bankruptcy process, informing Judge Montali that he was concerned that the plan was not yet acceptable to the State of California.[146]

In the weeks to follow, Newsom would make repeated public threats to take over PG&E if the company could not produce a plan to his liking, leading to a final settlement and a plan of reorganization that Judge Montali would confirm in mid-June 2020.[147] This plan of reorganization appeared to meet the State's goals of paying the wildfire victims in full, bolstering PG&E's solvency and ability to act as an insurer of last resort through the new state wildfire insurance fund, protecting the State's climate goals, and preserving the credit-worthiness of California. Importantly, the State also would continue to have control PG&E with new oversight powers and a process for dismantling the company in the event of additional destructive wildfires.[148] From PG&E's perspective, the bankruptcy was a resounding success: the company's owners and managers were able to keep the company together and overcome efforts by several California

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[143] Dale Kasler, *PG&E Makes Deal to Pay California Wildfire Victims. What It Means for Utility's Future*, SACRAMENTO BEE (Dec. 6, 2019, 11:02 AM), https://www.sacbee.com/news/california/fires/article238138009.html.

[144] Letter from Gavin Newsom, Governor of California, to William D. Johnson, Chief Exec. Off., PG&E Corp. (Dec. 13, 2019) (available at https://www.courthousenews.com/wp-content/uploads/2019/12/PGECh11-NewsomRejection.pdf).

[145] *Id.*

[146] Governor Gavin Newsom's Reservation of Rights in Connection with Hearing to Consider Approval of [Proposed] Disclosure Statement for Debtors' and Shareholder Proponents' Joint Chapter 11 Plan of Reorganization at 2, *In re* PG&E, 603 B.R. 471 (Bankr. N.D. Cal. 2020) (No. 19-30088).

[147] Colby Bermel @ColbyBermel, TWITTER (Jan. 29, 2020, 3:48 PM), https://twitter.com/ColbyBermel/status/1222667766093582336 ("'If we don't see real progress in the next few weeks' on PG&E's bankruptcy plan, Gov. Newsom told reporters, 'then we will be laying out the architecture for a very detailed plan for a state takeover.' It's not preferred, he said, but could be necessary."); *see* News Release, PG&E, PG&E Achieves Bankruptcy Court Confirmation of its Plan to Reorganize (June 20, 2020), https://www.pge.com/en/about/newsroom/newsdetails/index.page?title=20200620_pge_achieves_bankruptcy_court_confirmation_of_its_plan_of_reorganization.

[148] Emily Hoeven @emily_hoeven, TWITTER (July 9, 2020, 12:12 PM), https://twitter.com/emily_hoeven/status/1281305186699366405 (quoting Gavin Newsom: "'None of us were shy about our condemnation of [PG&E]. PG&E is now out of bankruptcy, but they're coming out a new company, with new expectations and accountability. And new criteria, that if they don't perform, CA can intervene in ways we couldn't in past.'").

mayors to seize portions of their assets[149] and by some members of the California legislature to make the company a public entity or a customer-owned cooperative.[150]

6. Bankruptcy Law as a Force Multiplier for State Policy Goals

In this case study, bankruptcy law provided a framework for resolving PG&E's problems that supplemented the State's existing regulatory powers. To be sure, the State could have implemented a similar deal outside of bankruptcy using the same basic framework of passing a state law with eligibility requirements for a new wildfire insurance fund and expanding regulatory capacity at CPUC. However, bankruptcy law offered important benefits that are both political and practical. Politically, the bankruptcy filing may have created a crisis atmosphere for the State government to provide a workable liability regime for a corporation that was publicly reviled for causing massive destruction. The bankruptcy filing also pushed PG&E to the top of the State government's crowded policy agenda, forcing State leaders to spend more time considering the future of power provision in California and perhaps bringing

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149 Mayor London Breed of San Francisco informed PG&E early in the bankruptcy that the city might offer money to buy the company's San Francisco assets. J.D. Morris, *San Francisco Mayor to PG&E: We May Make You an Offer*, S.F. CHRON. (Mar. 16, 2019), https://www.sfchronicle.com/business/article/San-Francisco-mayor-to-PG-E-We-may-make-you-an-13692954.php. The City later made a $2.5 billion dollar offer. Sonja Hutson, *San Francisco Offers to Buy PG&E Electric Grid in the City for $2.5 Billion*, KQED (Sept. 8, 2019), https://www.kqed.org/news/11773007/san-francisco-offers-to-buy-pge-electric-grid-in-the-city-for-2-5-billion#:~:text=California,San%20Francisco%20Offers%20to%20Buy%20PG%26E%20Electric,the%20City%20for%20%242.5%20Billion&text=San%20Francisco%20city%20officials%20are,and%20City%20Attorney%20Dennis%20Herrera. This was rejected by PG&E. Michelle Wiley, *PG&E Rejects San Francisco's Offer to Buy the City's Electric Grid*, KQED (Oct. 12, 2019), https://www.kqed.org/news/11779780/pge-rejects-san-franciscos-offer-to-buy-the-citys-electric-grid. Mayor of San Jose teamed up with other elected officials to promote a plan to make PG&E a "customer-owned utility." Nadia Lopez, *San Jose Mayor's Plan for Ratepayer Takeover of PG&E Won't Be Easy*, SAN JOSE SPOTLIGHT (Nov. 22, 2019), https://sanjosespotlight.com/san-jose-mayors-plan-for-ratepayer-takeover-of-pge-wont-be-easy/.

150 Senator Scott Wiener of San Francisco led the effort in the State Legislature to make PG&E a state entity. *See* J.D. Morris, *State Sen. Scott Wiener Gets Serious About Plan for Public Takeover of PG&E*, S.F. CHRON. (Feb. 3, 2020, 4:10 PM), https://www.sfchronicle.com/business/article/Sen-Scott-Wiener-gets-serious-about-plan-for-15026478.php. Interestingly, PG&E's bankruptcy briefly became a 2020 election primary issue after Senator Bernie Sanders released an ad promoting a state takeover of PG&E. *See* J.D. Morris, *Bernie Sanders Goes After PG&E in New California Campaign Video*, S.F. CHRON. (Feb. 13, 2020, 4:01 PM), https://www.sfchronicle.com/politics/article/Bernie-Sanders-goes-after-PG-E-in-new-California-15051924.php. PG&E's main employee union lambasted this effort, condemning Senator Sanders for what amounted to a "betrayal." *Id.*; *see also* Tom Dalzell, *California Wants to Take Over PG&E? Learn From Long Island's Mistake*, S.F. CHRON. (Feb. 19, 2020, 4:00 AM), https://www.sfchronicle.com/opinion/openforum/article/California-wants-to-take-over-PG-E-Learn-from-15066131.php (opining that California should not publicly takeover the utility company).

Governor Newsom deeper into the fray as an advocate for fire survivors and for the State's climate agenda.

More practically, bankruptcy law provided PG&E with helpful tools that likely hastened its resolution of financial distress. The company faced tens of thousands of lawsuits from fire survivors, and bankruptcy law's automatic stay reduced the cash burn associated with that litigation and allowed PG&E to settle the lawsuits through a bankruptcy process in front of a judge instead of Northern California juries. Bankruptcy law also appointed an official committee of fire survivors, providing PG&E with one bargaining counterparty instead of a dispersed group of plaintiff's law firms representing claimants with disparate facts and circumstances. Moreover, and perhaps most importantly, bankruptcy law gave Judge Montali the power to impose a settlement on all parties, including fire survivors, over their objections. Bankruptcy law often asks a judge to weigh the rights of creditors against the need to rehabilitate the debtor company, putting pressure on bankruptcy judges to issue orders that advance reorganization so long as they impose a reasonable outcome on creditors.[151] This likely lubricated bargaining and hastened a global settlement as everyone had to weigh the risk that Judge Montali would impose a settlement that could advantage some creditors at the expense of others.

Finally, it is not clear whether the State could have received some of the same concessions from PG&E outside of bankruptcy. For example, the State was able to influence the composition of the post-bankruptcy board, preserve and advance climate goals, and reshape PG&E's internal governance. PG&E's shareholders accepted a regulatory process that could allow the State to seize their assets if PG&E fails to meet safety goals, which is a regulatory remedy to which no other public utility in the United States is subject. The large privately owned public utilities that serve San Diego and Los Angeles were able to obtain access to the same wildfire insurance regime without having to give the State anything approaching the same level of influence over their operations as PG&E provided in bankruptcy to Governor Newsom and CPUC.

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[151] *See generally* Jared A. Ellias & Robert Stark, *Bankruptcy Hardball,* 108 CAL. L. REV. 745, 750–51 (2020) ("bankruptcy judges balance creditor interests against other policy goals, such as the need for the firm to finance itself post-petition, to reorganize, and to protect the jobs of current and future employees."); Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862 (2014) (noting that a bankruptcy judge must weigh interests of a speedy reorganization process and diminished value for creditors and going-concern of the company); Adam J. Levitin, *Purdue's Poison Pill and the Rule of Two: The Breakdown of Chapter 11 Checks and Balances*, 100 TEX. L. REV. (forthcoming 2021).

C. The Potential Hazards of Government Activism in Bankruptcy

In the American system, governments have immense powers they exercise through well-defined processes of legislation and administrative regulation (whether through rulemaking or adjudication) that, ideally, provide the checks and balances that come from transparency and accountability. These processes are absent in the bankruptcy process. While government policy is intended to improve social welfare, it also inevitably distributes benefits and costs of policy measures. Taxpayers and regulated parties typically bear the cost of policy in regulation or legislation. As such, procedural safeguards exist in the legislative and rulemaking processes that give voice to the interests of affected parties and these stakeholders have significant opportunities to delay or veto new regulation. In contrast, government is subject to different constraints when executing policy in bankruptcy: notice and hearings before the bankruptcy judiciary and, in the case of the plan, majority voting by class of claims. These safeguards are intended to protect the financial interests of claims and interests. However, they may not be well enough suited to deal with policy-driven actions in bankruptcy. One reason is that bankruptcy is not well understood by the sort of interest groups that normally have a voice in the policy process. Perhaps a more significant reason is that the urgency caused by the debtor's financial distress calls for much quicker and abbreviated processes than under administrative law (either rulemaking or adjudication), let alone the process of legislative enactment.

Moreover, bankruptcy judges are generally not experienced in being arbiters of complex policy debates. To be sure, judges in business bankruptcies often weigh important societal issues such as the saving of jobs and of communities. At times, for example, they may deny relief from the stay at a cost to a claimholder to preserve a going concern or jobs. Bankruptcy judges have less experience, however, with a wide range of other types of regulatory issues. Judge Montali, for example, had no special expertise to critically evaluate the impact of PG&E's proposed plan of reorganization on wildfire risk mitigation.

Whether such policy making is the job of bankruptcy courts has been the subject of some debate, at least since the exchange between Elizabeth Warren and Douglas Baird in 1987. Professor (now Senator) Warren argued that a central function of business bankruptcy is to distribute the debtor's losses in a way that promotes multiple goals, including the protection of vulnerable interests such as workers, retirees, and communities.[152] In her view, such distribution was a policy goal *of* bankruptcy. Citing Congressional comments in the debates leading to the enactment of the Code, she further recognized that "Congress—whether out of a crass concern about reelection or a superior view of the deeper social implications of business failure in a highly integrated society—accepted the idea that bankruptcy serves to protect interests that have no other protection."[153] Several other scholars have developed the view that judges do and should promote public welfare goals in adjudicating among the economic and noneconomic interests in the debtor.[154]

Professor Baird has responded that distributional policies are and should be pursued by non-bankruptcy ("state") law and that bankruptcy policy should be focused on value creation through its collective process.[155] His primary concern is that having two different distributional systems—outside and inside bankruptcy—would distort incentives to file (or resist filing) for bankruptcy. Among his arguments, Baird suggested that promoting distributional goals is beyond the competence of bankruptcy courts.[156]

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[152] Warren, *supra* note 7, at 777 ("I see bankruptcy as an attempt to reckon with a debtor's multiple defaults and to distribute the consequences among a number of different actors. Bankruptcy encompasses a number of competing—and sometimes conflicting—values in this distribution."). The interests Warren had in mind were:

> many who are not technically 'creditors' but who have an interest in a business' continued existence. Older employees who could not have been retrained for other jobs, customers who would have to resort to less attractive, alternative suppliers of goods and services, suppliers who would have lost current customers, nearby property owners who would have suffered declining property values, and states or municipalities that would have faced shrinking tax bases benefit from the reorganization's success.

Warren, *supra* note 7, at 787–88. As Congress gave bankruptcy judges substantial policymaking power, judges have substantial flexibility to reshape the administration of bankruptcy law. *See* Rafael I. Pardo & Kathryn A. Watts, *The Structural Exceptionalism of Bankruptcy Administration*, 60 UCLA L. REV. 384 (2012) (examining the uniqueness of bankruptcy law and bankruptcy judges administering the Code); *see also* Melissa B. Jacoby, *Corporate Bankruptcy Hybridity*, 166 U. PA. L. REV. 1715 (2018) (arguing that the bankruptcy system is a model of "public private partnership.").

[153] Warren, *supra* note 7, at 788.

[154] *See, e.g.*, Korobkin, *supra* note 7, at 762 (describing the diverse moral, political, social and economic values that the bankruptcy process should take into account instead of focusing exclusively on collective wealth maximizing); Baird, *Uncontested Axioms*, *supra* note 7, at 576 (analyzing the contrast between the two bankruptcy views which he labels as traditionalist and proceduralists); *see* GROSS, *supra* note 7, at 1424 (discussing the significant spillovers from the dissolution of a debtor that should lead bankruptcy to prefer rehabilitation and continuation).

[155] *See* Baird, *Forum Shopping*, *supra* note 7, at 833–34; *accord* Baird, *Uncontested Axioms*, *supra* note 7, at 580.

[156] *See* Baird, *Forum Shopping*, *supra* note 7, at 51; *see also* Baird, *Uncontested Axioms*, *supra* note 7, at 596 (writing that proceduralists believe "judges are poor social planners.").

The phenomenon we describe in this Article broadens the debate over policymaking in bankruptcy significantly. Warren and Baird were debating the distributional policy *of* bankruptcy: whether the protection of vulnerable parties is a bankruptcy goal intended by Congress and whether the bankruptcy courts are equipped to implement that goal. The important shift since then is that government executive branches have seized the opportunity to actively use the bankruptcy process to promote a much broader range of policy objectives beyond the allocation of losses from the debtor's financial distress. In this respect, an important difference exists between a court taking into account policy arguments advanced by private claimholders in bankruptcy, and the active role of the government executive in promoting its policy (or political) goals. In advancing the view of bankruptcy as a forum for broader policymaking, Professor Donald Korobkin noted that, in the case of the asbestos miner and product manufacturer Johns-Manville, the claimants of property damage (those who had installed harmful asbestos products that now needed to be removed) voluntarily agreed to subordinate their claims to the asbestos health victims, recognizing that this was the moral and politically wise things to do.[157] In contrast, we have noted the auto workers' benefit trust received a much larger payout in Chrysler than the product liability claims of purchasers because of *political* forces that motivate activism by the Democratic federal executive.[158] The cause of saving the planet from climate change—again at a cost to creditors––is a much more complicated and politically sensitive matter than the distributional goals Warren had in mind. Nevertheless, the general framing of the Warren-Baird debate applies: is bankruptcy the appropriate forum for regulation by activist government executives? As we note in this Article's Introduction,[159] there are related questions as to whether activism of the executive branch in bankruptcy is consistent with the enabling legislation and administrative law, and whether it is consistent with bankruptcy policy. We confine our discussion here to the latter question and leave the former for future research.[160]

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[157] Korobkin, *supra* note 7, at 759 ("Recognizing compelling moral and political grounds to do so, the property claimants subordinated their unsecured claims to the unsecured claims of asbestos health victims"). The property damage claimants thereby agreed to a 99% dilution of their claims. Korobkin, *supra* note 6, at 759.

[158] *Supra* note 51 and accompanying text.

[159] *Supra* note 7 and accompanying text.

[160] For an argument that bankruptcy judges should focus on bankruptcy policy goals, *see* Anthony J. Casey & Joshua C. Macey, *The Hertz Maneuver (and the Limits of Bankruptcy Law)*, 2020 U. CHI. L. REV. ONLINE *1 (2020); Anthony J. Casey, *Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy*, 120 COLUM. L. REV. 1709 (2020)

The Indiana State Police Pension Trust, the Indiana State Teachers Retirement Fund, and other pension fund investors in Chrysler's first-lien bonds did not think that the bankruptcy court adequately protected their investments from government policy action in favor of workers or fuel efficiency. The judicially approved section 363(b) sale allowed the retiree health benefits unsecured claim to recover 44% of its amount while the first-lien claims only received 29%. They were forced to compromise because they were outvoted by institutional investors in the same first-lien debt whom they felt had been coopted by the federal government. Moreover, bankruptcy may have facilitated partisan—rather than benign—policymaking. The Democratic Party has traditionally aligned itself with labor unions, supporting political causes like minimum wage standards and mandatory healthcare benefits. The UAW is one of the largest labor unions in the United States and has long-standing ties with the Democratic Party. In fact, the UAW had refused to negotiate with the Bush Administration for this very reason, betting that the more labor-friendly incoming Obama Administration would offer better terms.[161]

In the PG&E case, the sheer number of policy proposals that the State sought to protect in bankruptcy crowded out a policy that bankruptcy law cares a lot about, which is ensuring that the reorganized firm is unlikely to file for another Chapter 11 case. Traditionally, companies exit bankruptcy with less debt than they had coming in to ensure the firm is able to handle future financial shocks and invest in its business. Instead, PG&E left bankruptcy essentially having transformed its pre-bankruptcy tort liability into post-bankruptcy contract debt, as it borrowed money to pay fire survivors, leaving the firm with roughly twice as much contract debt as it had going in.[162] That could leave the company vulnerable if future fires turn out to exhaust the wildfire insurance fund. It also means that the company did not gain access to incremental financial capacity which it could use to invest in, for example, hardening its grid to reduce the risk of future fires. While a robust debate in Sacramento over PG&E's future may very well have resulted in the same outcome, it is likely that putting the question squarely before the State government, instead of indirectly through AB1054, might have led California to reach a different outcome.

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[161] STEVEN RATTNER, OVERHAUL: AN INSIDER'S ACCOUNT OF THE OBAMA ADMINISTRATION'S EMERGENCY RESCUE OF THE AUTO INDUSTRY 38 (First Mariners Books, 2010).

[162] Jeff St. John, *4 Things PG&E Must Do to Survive and Thrive as It Exits Bankruptcy*, GREENTECH MEDIA (July 2, 2020), https://www.greentechmedia.com/articles/read/four-hurdles-pge-must-clear-to-survive-post-bankruptcy#:~:text=PG%26E%20will%20exit%20bankruptcy%20with,to%20cover%20its%20capital%20needs.

Finally, we note that the current Chapter 11 bankruptcy case of Purdue Pharma provides another interesting instance of state activism where the federal government is using another lever: the settlement by the Department of Justice of criminal and civil liability in the bankruptcy forum.[163] Notably, the bankruptcy judge approved the settlement.[164] A key condition of the settlement is that the company would emerge from bankruptcy in the form of a public benefit corporation, a corporate trust that would be run for the public benefit.[165] This agreement bears similarity to deferred prosecution and non-prosecution agreements that have emerged over the past couple of decades, under which prosecutors grant amnesty in exchange for defendant's agreement to pay fines and implement corporate reforms.[166] The Purdue settlement was opposed by two dozen states who argued that it improperly blocked the potential sale of the business.[167] In a letter to the Attorney General, forty-six members of Congress also objected the potential for, or at the least the appearance of, a conflict of interest between a state's ownership interest in the public trust and its law enforcement obligations.[168] The members of Congress also noted forcefully that that the provision determining the structure of the post-bankruptcy entity bypassed the authority of Congress:

> Never in American history have federal courts used the bankruptcy process to achieve this outcome. That is why there is so much

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[163] Press Release, Dep't of Just., Off. of Pub. Aff., Justice Department Announces Global Resolution of Criminal and Civil Investigations with Opioid Manufacturer Purdue Pharma and Civil Settlement with Members of the Sackler Family (Oct. 21, 2020), https://www.justice.gov/opa/pr/justice-department-announces-global-resolution-criminal-and-civil-investigations-opioid [hereinafter Purdue Pharma Settlement]; *see* Jonathan Randles, *Purdue Gets Chapter 11 Approval of Justice Department Opioid Settlement*, WALL ST. J. (Nov. 17, 2020, 7:28 PM), https://www.wsj.com/articles/purdue-gets-chapter-11-approval-of-justice-department-opioid-settlement-11605655666.

[164] *See* Randles, *supra* note 163.

[165] *See* Purdue Pharma Settlement, *supra* note 163.

[166] Over the past couple of decades, governments have also implemented policies through "deferred prosecution agreements" ("DPAs") that force firms to make governance changes. Governance requirements have included the appointment of monitors, board compliance committees, or independent directors. *See* F. Joseph Warin et al., *2019 Year-End Update on Corporate Non-Prosecution Agreements and Deferred Prosecution Agreements*, GIBSON DUNN 1, 29 (Jan. 8, 2020), https://www.gibsondunn.com/wp-content/uploads/2020/01/2019-year-end-npa-dpa-update.pdf (noting that DPAs increased from two in 2000 to 102 in 2015).

[167] Jan Hoffman, *Purdue Pharma Tentatively Settles Thousands of Opioid Cases*, N.Y. TIMES (Nov. 24, 2020), https://www.nytimes.com/2019/09/11/health/purdue-pharma-opioids-settlement.html.

[168] The letter added that "[m]oreover, entangling government with this company may also create conflicts and doubts regarding the government's ability to regulate other companies in the industry that are its suppliers, customers, and competitors. This apparent conflict will undermine the public's faith in state enforcement activity". Letter from Katherine Clark, Member of Congress, et al., to Hon. William Bar, U.S. Att'y Gen. (Nov. 10, 2020) (available at https://katherineclark.house.gov/_cache/files/2/d/2dcd9718-3c10-4b98-ad40-782844eff102/1EF22593BD913787CB832BF8A3339A47.11.10.20-letter-to-ag-barr-on-sweetheart-provision-in-purdue-settlement-final.pdf).

> confusion and uncertainty about how this public benefit corporation will operate. No one knows the answers to simple questions like: Who would sit on the board of directors? Who would receive the profits from the sale of OxyContin? How would profits be distributed? These are questions of policy that must be resolved by Congress, not the courts. But Congress has never addressed these issues because state ownership of private business has never been considered an appropriate outcome of bankruptcy proceedings. To force the court to create this new bankruptcy outcome would set a dangerous precedent.[169]

CONCLUSION

Bankruptcy law effects a very significant change in the rules impacting the finance, governance, and operations of firms who file. The debtor enjoys powers that are unavailable outside of bankruptcy that are consequential both during bankruptcy and after the debtor exits as a reorganized entity. In the couple of decades following the enactment of the Code, scholars have focused on concerns about the forum-shopping incentives created by those powers available uniquely in bankruptcy and their abuse by debtors in bankruptcy. Over the past quarter century, in contrast, investors have become increasingly sophisticated in harnessing those powers for their private benefit through strategies that have been termed bankruptcy activism. Therefore, it is not surprising that governments have moved from a defensive to activist posture in bankruptcy, to exploit analogous opportunities to pursue their policy and political objectives. The question of the appropriate scope of bankruptcy policy has been debated by scholars for some time, at least since the Warren-Baird debate. The activism by government executive branches extends this debate and calls for further examination of bankruptcy law in a new context: when is the executive's use of the bankruptcy process a desirable tool for policymaking and when does it effect an end-run around the constitutional and democratic safeguards in legislative and regulatory lawmaking.

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169 *Id.*