

CHAPTER 11 REORGANIZATION OF UTILITY COMPANIES

*Ralph R. Mabey**

*Patrick S. Malone***

I. INTRODUCTION

On April 6, 2001, Pacific Gas and Electric (PG&E), the utility unit of PG&E Corporation, filed for reorganization under Chapter 11 of the United States Bankruptcy Code after months of intense media coverage of the "California Energy Crisis." PG&E filed for Chapter 11 after spending \$9 billion in excess of revenues to purchase electricity to supply its customers, exhausting its ability to borrow, while consumer rates remained frozen by the California Public Utilities Commission (CPUC) at a level far below prices at which PG&E could buy power on the wholesale market. According to PG&E Chairman Robert D. Glynn, Jr., PG&E

chose to file for Chapter 11 reorganization affirmatively because we expect the court will provide the venue needed to reach a solution, which thus far the State and the State's regulators have been unable to achieve The regulatory and political processes have failed us, and now we are turning to the court.

Similar problems face Southern California Edison (SCE) that might drive it toward bankruptcy as well.

Although PG&E is the latest, and perhaps largest, utility to file for bankruptcy, it is only the most recent in a series of utility bankruptcies, mostly involving electric power utilities, which began in the late 1980s. As deregulation and other forces have come to bear on the natural gas and electric power industries over the last decade, several utilities have turned to Chapter 11 in an effort to save their troubled companies.

Because of the historical role of regulation in the utility sector, such

* Mr. Mabey is a partner at LeBoeuf, Lamb, Greene & MacRae, L.L.P. where he heads the international insolvency and reorganization practice. He has, inter alia, served as Chapter 11 Trustee of Cajun Electric Power Cooperative and as a United States Bankruptcy Judge from 1979 to 1983.

** Mr. Malone is an associate in the Salt Lake City, Utah office of LeBoeuf, Lamb, Greene & MacRae.

1. PACIFIC GAS AND ELEC. CO., News Release, *Pacific Gas and Electric Company Files for Chapter 11 Reorganization*, (April 6, 2001), available at http://www.pge.com/006a_news_rel/01405.shtml.

2. *Id.*

bankruptcies often present legal and policy issues not found in more typical bankruptcies. This article will discuss four recent major utility bankruptcies and some of the practical lessons learned from these bankruptcies, primarily focusing on such fundamental issues facing troubled utilities as the interplay between the regulatory agencies charged with overseeing such companies and the bankruptcy courts. It will then conclude with a discussion of some of the issues which are likely to be important in the pending PG&E, and possible SCE, bankruptcy proceedings. To begin, however, this article will review the basic legal concepts applicable to any Chapter 11 reorganization.

II. OVERVIEW OF CHAPTER 11 BANKRUPTCY

Chapter 11 provides a process whereby a business may attempt to reorganize itself by restructuring its debt, business, and assets or by liquidating its assets in an orderly fashion. This process involves a number of key concepts and procedural protections that are fundamental to any Chapter 11 proceeding. The remainder of this section will briefly review a few of the most important of these concepts and protections.³

A. *The Bankruptcy Estate*

When a voluntary bankruptcy petition is filed, an estate comprised of the debtor's property and interests is created as a matter of law.⁴ With a few limited exceptions, the estate consists of all legal and equitable interests of the debtor in property at the time of filing. The estates of individuals include exempt property, even though an unsecured creditor or some involuntary secured creditors may not be able to participate in the value of such exempt property.

Generally, in a Chapter 11 reorganization, the bankruptcy estate and debtor's business are operated either as the "debtor-in-possession" or by a court-appointed trustee.⁵ The debtor-in-possession is ordinarily operated by the same management as was the debtor company before bankruptcy. Once a company enters bankruptcy, however, the duty of the debtor-in-possession (or trustee) is no longer to maximize profits for shareholders, but rather to maximize the value of the bankruptcy estate primarily for the benefit of the debtor's unsecured creditors. Thus, the dynamics of operating a company in bankruptcy will be substantially different from those of operating a company outside of bankruptcy.

3. At the time of this article, both the House and Senate have passed bills amending the Bankruptcy Code. Differences between the bills have not yet been resolved in conference and, therefore, neither has been signed into law by the President. Consequently, the new amendments will not be discussed in this article. At any rate, most (but not all) of the major proposed amendments to the Bankruptcy Code in the House and Senate bills relate to Chapter 7 consumer bankruptcies, not to large Chapter 11 corporate reorganizations.

4. 11 U.S.C. § 541 (2000).

5. 11 U.S.C. §§ 1107-1108 (2000).

B. The Automatic Stay

Filing for bankruptcy triggers the so-called "automatic stay."⁶ The automatic stay is an important procedural protection implemented to preserve the bankruptcy estate. It is very broad, automatic, and generally stays, with certain restricted but important exceptions, all actions against the debtor to recover on its financial obligations or to make recovery against property of the estate. In many jurisdictions, actions taken in violation of the automatic stay are deemed void.

One notable exception to the automatic stay is that "the commencement or continuation of an action or proceeding by a governmental unit . . . to enforce such governmental unit's police or regulatory power . . ." is not subject to the automatic stay.⁷ This provision reflects the general requirement in bankruptcy that a debtor continue to conduct its affairs according to laws generally applicable to similar businesses. In recent bankruptcies involving electric utilities, this exception has been particularly important, as will be more fully discussed below.

Generally, a creditor may petition the bankruptcy court to lift the automatic stay, allowing the creditor to proceed against the bankruptcy estate, only when: (1) the property at issue is not necessary for an effective reorganization, and the debtor has no equity in the property; or (2) there is other "cause," including a lack of "adequate protection" such as when a secured creditor's collateral is rapidly depreciating in value.⁸

Section 366 of the Bankruptcy Code provides protection to a debtor from its utility service providers in a manner similar to the automatic stay. In effect, section 366 prohibits a "utility" from altering, refusing, or discontinuing service to a debtor solely on the basis of the debtor's filing for bankruptcy unless the debtor fails to furnish adequate assurance of payment, in the form of a deposit or other security, for future service.⁹ Although "utility" is not defined, the courts have interpreted the term broadly to include any provider of services with a monopoly.¹⁰ Thus, in some cases, section 366 may provide a debtor utility with some protection from its own utility service providers. For example, an electric utility may, in some circumstances, be entitled to section 366 protection from the company that supplies natural gas for the utility's turbines. Likewise, it is also possible that a utility would be afforded some measure of section 366 protection from transmission or generation companies that supply the debtor utility with electricity or natural gas which the utility then distributes to its customers.

6. 11 U.S.C. § 362(a) (2000).

7. 11 U.S.C. § 362(b)(4) (2000).

8. 11 U.S.C. § 362(d) (2000).

9. 11 U.S.C. § 366 (2000).

10. COLLIER ON BANKRUPTCY § 366.05 (Lawrence P. King ed., 15th ed. 2001).

C. *Priority of Claims Against the Estate*

Because the automatic stay prevents creditors from taking actions to recover on the debtor's obligations, either creditors holding rights to the debtor's pre-petition obligations must file claims with the bankruptcy court seeking compensation for such claims or the Chapter 11 debtor must have scheduled the claims as uncontested. According to the Bankruptcy Code, the term "claim" is broadly defined to include rights to payment, whether or not those rights are liquidated, matured, contingent, disputed, legal, equitable, secured or unsecured. A right to an equitable remedy for breach of performance is also considered a claim if that breach gives rise to a right of payment.¹¹

Unsecured debt and equity interests are paid from the bankruptcy estate in accordance with a priority scheme governed by title 11 of the U.S.C., section 507.¹² Unless agreed otherwise, higher priority claims are entitled to complete satisfaction before lower priority claims are entitled to any recovery from the bankruptcy estate. Secured claims are normally paid first, at least to the extent that they are secured. Priority among secured creditors is governed by the relative priority of security interests in collateral according to applicable non-bankruptcy law. To the extent that the value of collateral securing a creditor's claim is insufficient to cover the full amount of the claim, that creditor's claim is considered secured only up to the value of the collateral. The unsecured portion is treated as general unsecured debt under the section 507 priority scheme.

Administrative expenses necessary to keep the debtor operational, including the professional fees of the debtor's bankruptcy counsel, are normally treated as the highest priority unsecured claims. General unsecured claims come next, and the equity interests of shareholders come last. In some cases, a court will grant a particular creditor a super-priority for post-petition financing or some other pressing need. The court may also subordinate some claims that might otherwise be entitled to a higher priority.

D. *Post-Petition Interest*

Filing for bankruptcy protection also places a moratorium on the accrual of post-petition interest on pre-petition obligations during the pendency of the bankruptcy, subject to two important exceptions. First, post-petition interest may be allowed in the case of "over-secured" creditors, when a creditor holds rights to collateral worth more than the amount of the creditor's claim.¹³ Second, post-petition interest may also be allowed in cases where the bankruptcy estate has sufficient asset value to pay pre-petition claims in full. In those bankruptcy cases involving large amounts of unsecured debt, this moratorium on interest, together with the debtor's right to suspend principal payments, can be a significant boon to a debtor-

11. 11 U.S.C. §101(5) (2000).

12. For Chapter 7 liquidation cases, order of payment is set out in 11 U.S.C. § 726 (2000).

13. 11 U.S.C. § 506(b) (2000).

in-possession/trustee, by freeing large amounts of money normally dedicated to debt service.

E. Avoiding Powers

Bankruptcy trustees and debtors-in-possession are endowed with the power to avoid certain payments or transfers of property, as well as to reject burdensome executory contracts. For example, Section 547(b) of the Bankruptcy Code allows the trustee/debtor-in-possession to avoid "preferences" when all of the following elements are found to be satisfied: (1) the debtor transfers, (2) property of the debtor, (3) to or for the benefit of creditors, (4) on account of antecedent debt, (5) made while the debtor was insolvent, (6) within ninety days of the debtor filing for bankruptcy (increased to one year when the preference beneficiary is an insider), (7) that enables the creditor to receive more than it would under Chapter 7.¹⁴ Because of the significant imposition that preference liability can be for an entity doing business with a financially distressed company, there are a number of effective defenses to a preference action under Section 547(c), including the following:

- *Ordinary course.* If a transfer was incurred and paid in the ordinary course of business and in line with terms utilized in the industry, the transfer may not be avoided as a preference.
- *Contemporaneous exchange.* If the parties contemplated that they would make a substantially contemporaneous exchange and if, in fact, the transaction involved a substantially contemporaneous exchange, the transfer may not be avoided as a preference.
- *New value.* If, after receiving a transfer that would be a preference, the creditor advances new value to the debtor, its preference liability is reduced by the extent of the new value.¹⁵

Under sections 548 and 544(b), the Bankruptcy Code also authorizes the trustee or debtor-in-possession to recover transfers of property that were "fraudulently transferred." In general, transfers are "fraudulent" in one of two situations. First, if the debtor engaged in the transaction with intent to hinder, delay, or defraud its creditors, the transaction is deemed to be actually fraudulent. Second, a transaction is deemed constructively fraudulent if the debtor received less than "reasonably equivalent" consideration and was insolvent at the time of transfer, was rendered insolvent as

14. 11 U.S.C. § 547(b) (2000).

15. 11 U.S.C. § 547(e) (2000).

a result of the transfer, or was left with "unreasonably small capital" following the transfer.¹⁶ Fraudulent transfers may also be set aside under state law.¹⁷

Bankruptcy trustees and debtors-in-possession are also given the power to assume and reinstate pre-petition leases and contracts or reject burdensome pre-petition executory contracts and leases.¹⁸ Creditors' breach of contract claims resulting from such rejections are treated as pre-petition, unsecured debt. Sections 502(b)(6) and 502(b)(7) also limit the damages recoverable for such rejection in the case of certain leases and employment contracts. This rejection power can thus be a potent tool in the hands of the debtor-in-possession/trustee, allowing the debtor to take advantage of any favorable changes that may have occurred in the markets and thereby increasing the debtor's chances of successfully reorganizing.

F. Plan of Reorganization

The ultimate goal of any Chapter 11 process is for the bankruptcy court to confirm a plan of reorganization that classifies all of the creditor's claims or interests in the bankruptcy estate and discharges those claims or interests pursuant to its terms. A proposed plan is described in a disclosure statement and is voted upon by "impaired" classes of creditors and shareholders. In order to be confirmed, each impaired class must accept the plan by the requisite majority set out in the Bankruptcy Code unless that class is "crammed down." In order to be confirmed, a plan must also satisfy certain statutory requirements, such as the "best interest of creditors" test. The best interest of creditors test requires that, in order for a plan to be confirmable, a dissenting creditor must receive as much under the Chapter 11 plan as it would under a Chapter 7 liquidation.

Under section 1129(b)(1), the bankruptcy court may confirm a plan of reorganization even though one or more classes of creditors votes against the plan, provided that the plan "does not discriminate unfairly and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan" so long as a least one class of impaired creditors votes for the plan. This process is referred to as "cram down" in bankruptcy vernacular.¹⁹

The phrase "fair and equitable" in the cram down requirements has been interpreted to mean, among other things, that the plan must satisfy the "absolute priorities rule." The absolute priorities rule demands that equity come last. Thus, if a plan is crammed down over the dissent of a class of unsecured creditors, shareholders of the debtor entity normally cannot retain or receive anything until all of the creditors in the dissenting class have been paid in full.

16. 11 U.S.C. § 548(a)(1)(B) (2000).

17. 11 U.S.C. § 544(b) (2000).

18. 11 U.S.C. § 365 (2000).

19. 11 U.S.C. § 1129(b)(1) (2000).

Once a plan is confirmed, the debtor's pre-confirmation obligations are discharged according to the terms of the plan, and the debtor is positioned to emerge from bankruptcy after the plan becomes effective. The confirmed plan of reorganization becomes binding on all parties in interest.

III. RECENT MAJOR UTILITY BANKRUPTCY CASES

Prior to PG&E's filing earlier this year, there had been at least three major electric utilities²⁰ and at least one major natural gas utility holding company that filed for protection under Chapter 11 of the Bankruptcy Code since the end of the Depression era: Public Service Company of New Hampshire (PSNH), El Paso Electric Company (EPEC), Cajun Electric Power Cooperative, Inc. (Cajun), and Columbia Gas Systems, Inc. (Columbia).

A. *In re Public Service Company of New Hampshire*

PSNH is New Hampshire's largest electric utility, providing service to more than 400,000 homes and businesses. It currently has over 1,110 megawatts of generating capacity, with three fossil fuel-fired generating plants and nine hydroelectric facilities.²¹ At the time it filed for bankruptcy, PSNH also held an approximately 36% stake in the Seabrook Station nuclear power facility. Because of construction delays and problems in obtaining regulatory approval from the Nuclear Regulatory Commission, construction costs continued to rise, and eventually PSNH had invested some \$2.9 billion dollars in the Seabrook plant, much of this amount borrowed. At the same time, New Hampshire law prevented PSNH from recovering costs of incomplete construction work in progress in its rate base. Consequently, PSNH found itself unable to service the debt it had incurred and filed for bankruptcy on January 28, 1988.

PSNH initially proposed a plan whereby PSNH would be reorganized as a holding company owning two separate subsidiaries: one operating PSNH's generation and transmission assets and the other operating its distribution assets. Because this disaggregation would result in a partial shift of ratemaking jurisdiction from the New Hampshire Public Utility Commission (NHPUC) to the FERC, this plan was vigorously opposed by the State of New Hampshire. The advantage of the new structure would have

20. There have also been several smaller electric utilities which have filed for bankruptcy in recent years, including: Big Rivers Electric Corporation, Colorado-Ute Electric Association, Inc., Eastern Maine Electric Cooperative, Inc., and Wabash Valley Power Association. It is also noted that an involuntary Chapter 11 petition was filed against Tucson Power Company by certain creditors, but the involuntary petition was eventually dismissed. TUCSON ELEC. POWER CO., Form 8K (filed S.E.C. Jan. 6, 1992). Tucson Power was later able to consummate an out-of-court restructuring plan, restructuring its debts to key creditors as equity, avoiding the need for a later Chapter 11 voluntary filing. See generally TUCSON ELEC. POWER CO., 1992 ANNUAL REPORT (1993). For purposes of this article, discussion is limited to the four major bankruptcies discussed above.

21. See generally PUBLIC SERV. CO. OF N.H., *About PSNH*, available at <http://www.psnh.com/about/index.shtml> (last visited Sept. 28, 2001).

been that the partial shift of ratemaking jurisdiction to the FERC would have reduced the financial impact of New Hampshire law that forbade inclusion of construction work in-progress in the rate base.²² Eventually, PSNH abandoned this plan in favor of one which opened the door for Northeast Utilities (NU) to acquire PSNH.

On January 11, 1989, the NHPUC issued an Order of Notice, pursuant to which it commenced an investigation into the rates charged by PSNH, alleging that PSNH was earning amounts in excess of its authorized rate of return. PSNH responded by seeking and obtaining an injunction against the NHPUC and the State of New Hampshire that enjoined either from proceeding with or otherwise continuing the rate investigation or any other proceeding relating to that rate case.

Ultimately, in order to resolve the bankruptcy, the value of PSNH had to be determined and allocated among the numerous classes of creditors and equity holders. The value of the regulated utility, however, depended almost entirely on the rates that it could charge its customers. Under New Hampshire law, these rates were in turn dependent on the investment prudently devoted by the company to providing service.²³ Eventually, all of the parties, including the State, agreed on a capitalization of approximately \$2.3 billion for PSNH. This valuation almost quadrupled PSNH's pre-bankruptcy rate base although it in effect disallowed several hundred million dollars of PSNH's investment in Seabrook.²⁴

After the parties came to an agreement on PSNH's valuation, the Bankruptcy Court approved PSNH's plan of reorganization, which included a rate agreement between PSNH and the Governor and Attorney General of New Hampshire that allowed PSNH to raise retail customer rates by 5.5% in each of seven successive years to account for this increased rate base.²⁵ The New Hampshire Public Utility Commission approved the rate agreement and, with the new rates in place, PSNH emerged from bankruptcy on May 16, 1991.²⁶

Approximately one year later, PSNH was acquired by NU for \$2.3 billion as provided for in PSNH's plan of reorganization. PSNH currently remains a wholly-owned subsidiary of NU; however, North Atlantic Energy Corporation, another NU subsidiary, currently owns PSNH's former share in the Seabrook Station.

B. *In re El Paso Electric Company*

El Paso Electric Company was, at the time it filed for Chapter 11, in the business of generation, transmission and distribution of electricity to approximately 271,000 customers in West Texas and Southern New Mex-

22. *In re PSNH*, Update (Oct. 6, 1989).

23. *In re Public Serv. Co. of N.H. v. Patch*, 136 F.3d 197, 201 (1st Cir. 1998).

24. *Id.*

25. *In re Public Serv. Co. of N.H.*, 963 F.2d 469 (1st Cir. 1992).

26. *In re Public Serv. Co. of N.H.*, 136 F.3d 197.

EPEC also sold power to wholesale customers in Southern California, Mexico, New Mexico, and Texas. Like PSNH, EPEC had incurred significant debt related to construction of a large nuclear power plant, in this case the Palo Verde Nuclear Generating Station near Phoenix, Arizona.

Prior to filing its petition for reorganization, EPEC attempted to negotiate financial restructuring with its primary lenders, which was initially to be completed by the end of November 1991. That financial restructuring contemplated: (1) the extension of the maturities of certain existing obligations through 1993; (2) the extension of approximately \$83 million of additional secured financing; and (3) renewals or replacements of existing letters of credit issued to certain owned interests in certain units of the Palo Verde facility that were leased back to EPEC. All necessary regulatory approval for this restructuring had been obtained; however, in November of 1991, the Public Utility Commission of Texas (PUCT) unexpectedly authorized only \$47 million of an approximately \$131.3 million rate increase EPEC had requested. This rate decision ultimately frustrated EPEC's attempts to restructure its debt. EPEC was unable to meet its obligations as they came due, and EPEC filed for Chapter 11 protection on January 8, 1992.

EPEC emerged from bankruptcy as a free-standing company after the PUCT approved a rate agreement between EPEC and the City of El Paso whereby EPEC was allowed an approximately \$25 million base rate increase, and EPEC's base rates were thereafter frozen for ten years, providing EPEC with the means to restructure its debts in such a way that it could meet its obligations.²⁷ Under the terms of the plan of reorganization, secured creditors were paid 100% of their secured claims and unsecured creditors were compensated for up to 85% of their claims in the form of the company's reissued stock. Compensation for unsecured claims accounted for 85% of the reissued stock; the remaining 15% of EPEC's new stock was distributed among its previous stockholders. Pre-petition holders of EPEC preferred stock received twelve percent of the new preferred stock, and pre-petition holders of EPEC common stock received three percent of the new common stock. Holders of both preferred and common stock also received rights to the first \$20 million of any recovery by EPEC in certain pending litigation.

C. *In re Cajun Electric Power Cooperative, Inc.*

Cajun was one of the largest generation-and-transmission electric cooperatives in the nation, serving eleven member cooperatives, that in turn provided electricity to more than 1,000,000 Louisiana customers in sixty parishes. At the time it filed for Chapter 11 protection, Cajun owned a 30% stake in the River Bend Nuclear Station (the remainder was owned by Entergy Gulf States, Inc.). Cajun also owned and operated approxi-

27. See generally, Juan B. Elizondo, Jr., *Federal Judge Approves Reorganization Plan for El Paso Electric*, THE ASSOCIATED PRESS, Jan. 9, 1996.

mately 1,710 MW of coal and natural-gas-fired generation units in New Roads, Louisiana. Cajun ran one of the longest continuous fuel chains in the world in order to operate its coal-fired boilers. Some 6.5 million tons of Powder River Basin, Wyoming, coal was transported by railcar to Saint Louis, Missouri and from there on barges down the Mississippi River to Cajun's plant in New Roads, Louisiana. Cajun also received an allocation of hydroelectric power from the Southwest Power Administration. Although Cajun owned almost all of its generation assets, it owned very little of its transmission facilities, relying on the transmission systems of investor owned utilities. Cajun was also a member of the Southeastern Electric Reliability Council, and through interconnection agreements delivered power in a twelve state area.

At the time it filed for Chapter 11 protection, Cajun owed approximately \$4.2 billion to the Rural Utilities Service (RUS), \$1.6 billion of which (plus interest) was borrowed to finance its portion of the River Bend facility. Cajun also owed approximately \$7 million to about 750 unsecured trade creditors and had contingent exposure for over a billion dollars of possible rejection damages on fuel and transportation contracts.

The immediate cause of Cajun's bankruptcy was a dispute between the Louisiana Public Service Commission (LPSC) and the RUS over the authority to regulate Cajun's rates and the determination by the LPSC that Cajun's 30% investment in River Bend was not "used and useful." On December 19, 1994, the LPSC had ordered a reduction in Cajun's annual revenues by about \$30 million and ordered it to reduce member rates from an average of 54.5 mills/kWh to 48.8 mills. On the next day, the RUS renewed its asserted authority over Cajun to regulate its rates, and ordered Cajun to maintain its rates at 54.5 mills. On December 21, 1994, Cajun complied with the LPSC order, which caused a breach in its lending agreements with the RUS. Cajun immediately filed its Chapter 11 petition, and sought a declaratory judgment requesting the Court to determine which regulator had authority over Cajun's rates.

In early 1995, various parties filed a motion to appoint a trustee for Cajun, alleging that the Board of Directors of Cajun (which was composed of representatives of Cajun's members) had conflicts of interests. The principal conflict was the desire of members for low rates versus the fiduciary duty of the directors to maximize creditor recovery and comply with its RUS obligations. After extensive briefing and a hearing, the District Court appointed a Chapter 11 trustee (the "Trustee").

Shortly thereafter, the Trustee was ordered by the District Court to file a plan of reorganization. The Trustee sought and obtained authority to conduct a bidding procedure for Cajun's non-nuclear assets. Bids were solicited through an investment banking house from major utility companies throughout the country. The highest and best offer, according to the Trustee, was submitted by Louisiana Generating Co. (LaGen), which was at that time a partnership of NRG (an affiliate of Northern States Power Co.) and Zeigler Coal Holdings. The Trustee filed a plan incorporating the bid of LaGen, and competing plans were then filed by an affiliate of Enron

Corp. (Enron), Southern Energy, Inc. (SEI) (an affiliate of Southern Companies), and an affiliate of Central and Southwest Power Company (SWEPCO). These other plans proposed varying purchase prices, rate structures, and power supply provisions.

After reviewing his options, the Trustee in Cajun determined that the sale of Cajun's non-nuclear generating assets as opposed to a stand-alone plan would maximize the value of Cajun's estate and provide an optimal solution for reorganizing Cajun. Under this approach, Cajun's interest in River Bend would be transferred to Entergy Gulf States (formerly Gulf States Utilities), which already owned a majority interest in River Bend, and Cajun's other assets would be sold to LaGen. The Trustee's original plan proposed that LaGen would purchase Cajun's non-nuclear assets for about \$1.1 billion, and that the "all requirement contracts" between Cajun and its members would be assumed by Reorganized Cajun, an entity that would purchase its power from LaGen. Eventually, LaGen, along with the Unsecured Creditors Committee and three of the member co-ops, became the proponents of the Trustee's Plan, which was renamed the Creditors' Plan.

In August of 1999, District Judge Frank J. Polozola convened a settlement conference in an effort to end the Cajun bankruptcy case. The session was attended by all of the major parties to the case, including Cajun's distribution member cooperatives and representatives of the LPSC. By the conclusion of the session, the Creditors' Plan had become a consensus plan. In addition, a separate LPSC/RUS/Trustee settlement was achieved. In that settlement, the LPSC, RUS, and the Trustee settled all outstanding matters relating to regulatory issues, rates, fuel review, and contract review pending at that time. Current rate reviews of Cajun were suspended pending the effective date. The LPSC thereafter instituted a review of certain aspects of the plan and ultimately gave its regulatory approval. The FERC was also required to review other aspects of the plan, and gave its approval as well.

The final purchase price, before adjustments, paid by LaGen was about \$1.026 billion. Under the Creditors' Plan, creditors (except the RUS) were paid in full with interest, the fuel chain received a satisfactory distribution, and ratepayers realized a substantial decrease in wholesale power costs. As part of the plan, the RUS agreed to forgive over \$3 billion in debt, principally incurred as a result of Cajun's unsuccessful investment in the River Bend nuclear plant. Cajun's member cooperatives were given a variety of choices for their power options, including long-term and short-term contracts, as well as market-based options, which the LPSC found to be reasonable and priced at or below market.

D. In re Columbia Gas Systems, Inc.

At the time it filed for Chapter 11, Columbia and its subsidiaries

"comprise[d] one of the largest natural gas systems in the United States,"²⁸ Several of these subsidiaries included gas utility companies. Columbia filed for Chapter 11 largely in order to reject certain long-term "take-or-pay" contracts that required Columbia to purchase natural gas at above-market prices.

In 1985, a class action lawsuit was filed against Columbia Gas Transmission Corporation (Columbia Gas), a Columbia subsidiary that transported and sold Columbia gas to thirteen Northeastern, Mid-Atlantic, Midwest, and Southern states and the District of Columbia. The action arose out of Columbia Gas's alleged underpayment on some 852 of the above-market gas purchase contracts. In the early part of 1991, Columbia Gas and the class members entered into a Settlement Agreement that, upon approval by the District Court, extinguished the class members' claims against Columbia Gas.²⁹ The Settlement Agreement required Columbia Gas to deposit \$30 million into an escrow account: \$15 million in March of 1991 and \$15 million in March of 1992. Class members were entitled to receive their share of the escrow monies once they executed a release of claims and a supplemental contract. Columbia Gas paid the first \$15 million into escrow on time, but on July 31, 1991, less than two weeks after the Settlement Agreement became final, Columbia and Columbia Gas filed for bankruptcy.³⁰

Columbia Gas's original intent was to treat its obligations under the Settlement Agreement as an executory contract under section 365 of the Bankruptcy Code. Columbia Gas sought court approval to assume its obligation to pay the remaining \$15 million installment as an administrative expense; however, the Third Circuit held that the Settlement Agreement was not an executory interest, since the class members' claims had already been extinguished by the approval of the Agreement by the District Court.³¹

More important, bankruptcy allowed Columbia Gas to reject its remaining long-term take-or-pay gas purchase contracts under section 365 of the Bankruptcy Code, which resulted in rejection of damage claims in excess of \$13 billion against Columbia Gas. However these claims were eventually settled for about one tenth of their face amount, and Columbia successfully emerged from bankruptcy in November of 1995.

IV. LESSONS LEARNED FROM THE PRINCIPLE CASES

These four principal cases provide at least some answers to the question of how a utility that has filed for Chapter 11 protection can expect to interact with state regulatory agencies responsible for setting rates. A related, mostly unanswered question is how these principles will transfer to

28. *In re Columbia Gas System, Inc.*, 146 B.R. 106 (Bankr. Dcl. 1992).

29. *In re Columbia Gas Systems, Inc.*, 50 F.3d 233, 242 (3rd Cir. 1995).

30. *Id.* at 236-237.

31. *In re Columbia Gas*, 50 F.3d at 244.

the modern landscape, where utilities are increasingly buying power and natural gas from wholesalers, thereby expanding the role which the FERC may play in future utility bankruptcies.

A. Will the State Regulatory Agency Be Considered a "Party in Interest" to the Bankruptcy under Section 1109(b) of the Bankruptcy Code?

In *Public Service Co of New Hampshire*, the bankruptcy court expressly held that the State of New Hampshire "will be granted full party in interest status under § 1109(b) of the Bankruptcy Code and will be granted general intervenor rights under Rule 2018(a) of the Bankruptcy Rules."³² The court stated that "rather than burdening the reorganization process of a regulated electric utility, the granting of such status and rights to the State of New Hampshire should expedite the progress of this reorganization proceeding."³³

In *Cajun*, the LPSC also took a very active role and was a frequent litigant in the bankruptcy proceedings. Likewise, in *Columbia*, several state regulatory agencies were allowed to participate in the proceedings. Consequently, it is very likely that state and federal regulatory agencies will be given the same right to be heard in future utility bankruptcies.

B. Who Will Set Rates During the Pendency of the Bankruptcy Case, the Regulatory Agency or the Bankruptcy Court?

Generally, regulatory agencies can be expected to continue "normal ratemaking activities" involving the utility, even after the utility has filed for Chapter 11 protection. The bankruptcy automatic stay does not generally stay regulatory actions. Thus, filing for bankruptcy may not prevent a regulatory agency from increasing or decreasing the debtor utility's rates based on the effects of external forces.³⁴ There is also precedent, however, to suggest that a bankruptcy court will not allow the regulatory agency to change rates during the pendency of the bankruptcy based solely on the filing of bankruptcy itself.³⁵ On the other hand, there is countervailing precedent in *Cajun* to suggest that a regulatory agency may in fact be able to change rates, as a result of the utility's changed circumstances caused by bankruptcy, while the utility remains in bankruptcy.

In *Cajun*, this issue played out in the context of an attempt by the LPSC to lower *Cajun*'s rates to reflect the fact that *Cajun* would not be required to pay post-petition interest on pre-petition debt during the pendency of the bankruptcy and, assuming that a plan of reorganization could be confirmed, *Cajun* would likely be completely discharged from this duty altogether. In response, *Cajun* sought an injunction to prevent the LPSC from seeking to change its rates on this basis. The Bankruptcy Court

32. *In re Public Serv. Co. of N.H.*, 88 B.R. 521, 557 (Bankr. D.N.H. 1988).

33. *Id.*

34. *In re Public Serv. Co. of N.H.*, 98 B.R. 120 (Bankr. D.N.H. 1989).

35. *Id.* at 126. See also 11 U.S.C. § 525 (2000).

granted Cajun's motion and ordered, pursuant to its powers under title 11 of the U.S.C., section 105(a), that "the LPSC is enjoined from considering, any argument that Cajun's wholesale rate to its members should be lowered during [the pendency of the bankruptcy case] based solely upon the suspension of debt service occasioned by the filing of [Cajun's bankruptcy petition]."³⁶ Although this injunction was later reversed by the Fifth Circuit on appeal, the Fifth Circuit did not determine whether the Bankruptcy Court had authority under section 105(a) to enjoin a ratemaking agency from pursuing rate cases. Rather, the Fifth Circuit held that, even assuming such authority, issuing such an injunction, given the particular facts of *Cajun*, would be an abuse of discretion since Cajun's claimed injury would be prevented by implementing the LPSC's plan that the post-petition interest component of Cajun's rates be placed in escrow subject to refund if, as was almost a certainty, Cajun ultimately was discharged from post-petition interest. The Fifth Circuit went on to state that

[a]lthough the effect of suspending debt service may be to make it possible for the debtor to use income to pay its current operating expenses and the administrative expenses of the proceeding, we find no support for appellees' claim that § 502(b)(2) is intended to provide the debtor, a regulated public utility, an unfettered right, vis-a-vis *Louisiana consumers*, to build up money to give to its undersecured and unsecured creditors.³⁷

The Fifth Circuit further determined that the "automatic stay" provided by filing for bankruptcy would not bar a regulatory agency from seeking to change the utility's rates. The Fifth Circuit said, "Congress created a specific exception from automatic stay of proceedings against the debtor that occurs upon the debtor's bankruptcy filing for actions or proceedings by governmental units to enforce their police and regulatory power."³⁸

The possibility of enjoining rate regulation also raises important issues of sovereign immunity under the Eleventh Amendment of the United States Constitution. Because Congress normally does not have power to abrogate a State's Eleventh Amendment sovereign immunity in federal court, a bankruptcy court may not have the authority to enjoin a state regulatory agency directly.³⁹ The bankruptcy court may, however, have authority to enjoin individual officials of the regulatory agency from seeking to change rates under the doctrine of *ex parte Young*.⁴⁰ It is noted that Southern California Edison's recent attempts to enjoin the California Public Utilities Commission (CPUC) were brought against the individual

36. *In re Cajun*, 185 F.3d 446, 450 (5th Cir. 1999).

37. *Id.* at 457.

38. *In re Cajun*, 185 F.3d at 453, citing 11 U.S.C. § 362(b)(4).

39. See generally *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996).

40. *Ex parte Young*, 209 U.S. 123 (1908).

commissioners in their official capacities, not against the CPUC itself.⁴¹

C. Who Will Make Other Business Decisions During the Pendency of the Bankruptcy?

As a general principle of bankruptcy law, title 28 of the U.S.C., section 959(b) and Title 11, section 363 have been interpreted to provide the trustee or debtor-in-possession of a corporation which has filed for bankruptcy protection authority to make the "ordinary course of business" operational decisions for that corporation with broad deference from the bankruptcy court. For example, in the seminal *In re Curlew Valley Associates* decision, the bankruptcy court held that the court should defer to decisions by the trustee that "involved a business judgment made in good faith, upon a reasonable basis, and within the scope of his [Chapter 11 trustee's] authority under the Code."⁴²

The Bankruptcy Code involves the court in proposed actions which are not in the ordinary course of business.⁴³ Thus, in *PSNH*, the bankruptcy court refused to defer to the debtor-in-possession's operational decisions that were out of the ordinary course of a reorganization debtor's business. In this case, the debtor-in-possession had proposed to transfer management and operational control of the Seabrook nuclear plant to a separate corporation. The court held that such a decision was not entitled to the deference of the bankruptcy court and was subject to more searching review by the court.⁴⁴

D. What Regulatory Approval Is Required for the Debtor-in-Possession or Trustee to Exercise Powers Granted under the Bankruptcy Code?

In *Cajun*, an open administrative docket was sought by the LPSC to consider whether the Trustee had prudently exercised his contract rejection right (one of the Trustee's core bankruptcy powers) in refusing, for the time being, to reject Cajun's fuel supply and fuel transportation contracts. In response, the bankruptcy court ruled that the LPSC was enjoined from making such an inquiry. The approval of the bankruptcy court would be required before the Trustee could exercise such a right; however, the approval of the regulatory agency would not be required.⁴⁵

41. Recent Supreme Court precedent has put the continuing legitimacy of *ex parte Young* in question. In the PG&E case, however, the Bankruptcy Court has held that the *ex parte Young* exception to CPUC's sovereign immunity defense is available to PG&E. *Idaho v. Coeur d'Alene Tribe*, 117 S. Ct. 2028 (1997); see also *ex parte Young: Relativity in Practice*, 72 AM. BANKR. L.J. 455 (1998).

42. *In re Curlew Valley Associates*, 14 B.R. 506, 513-514 (Bankr. D. Utah 1981).

43. 11 U.S.C. § 363(b) (2000).

44. *In re Public Serv. Co. of N.H.*, 90 B.R. 575, 581 (Bankr. D.N.H. 1988).

45. 11 U.S.C. § 365(a) (2000).

E. Is Regulatory Approval Required to Confirm the Plan of Reorganization?

Confirmation and consummation of a plan of reorganization are the principal objectives of a Chapter 11 reorganization case. A plan of reorganization sets forth the means for satisfying claims against, and interests in, a debtor. Confirmation of a plan of reorganization by the bankruptcy court makes the plan binding on the debtor, any issuer of securities under the plan, any person acquiring property under the plan, and any creditor or shareholder holding a debt or interest that arose prior to the date of confirmation of the plan and substitutes therefor the obligations specified under the confirmed plan. For this reason, a requirement of regulatory approval of portions of the plan gives substantial power over the debtor utility's future to the regulatory agency.

Under section 1129(a)(6) of the Bankruptcy Code, regulatory approval is required for any rate changes that are part of the Plan of Reorganization.⁴⁶ Thus, federal bankruptcy law will not preempt the state regulatory agency's authority, or for that matter applicable FERC authority, over this vital issue. On the other hand, the *PSNH* court found authority under section 1123(a)(5) of the Bankruptcy Code⁴⁷ to preempt state law which required regulatory approval of changes in corporate structure and transfers of assets, as the plan of reorganization would necessarily require.⁴⁸ LPSC approval ultimately was required in order to confirm the Cajun Plan of Reorganization because the Trustee's proposed plan was expressly conditioned on LaGen efforts to qualify as an exempt wholesale generator. Under the Public Utility Holding Company Act of 1935 (PUHCA), in order for LaGen to obtain such status, the LPSC was required to make a "specific determination that allowing such a facility to be an eligible facility (1) will benefit consumers, (2) is in the public interest, and (3) does not violate State law. . . ."⁴⁹ Thus, even though federal bankruptcy law may have preempted the state law requirement of state regulatory approval in *Cajun*, federal law also required state regulatory approval in this specific case. Furthermore, when Cajun sought approval of the sale of Cajun's nuclear assets, it was made subject to the approval of the Nuclear Regulatory Commission (NRC) because of the strong non-bankruptcy federal interest involved.

Prior precedent therefore suggests that, although regulatory agencies will be allowed to be heard and participate in the bankruptcy process, their actual authority to approve or disapprove a particular plan will normally be limited to the issue of rates set as part of the plan and will not extend to other core bankruptcy decisions regarding reorganization, non-bankruptcy law on the issue notwithstanding.

46. *In re Public Serv. Co. of N.H.*, 108 B.R. 854, 892 (Bankr. D.N.H. 1989).

47. 11 U.S.C. § 1123(a)(5) provides that a plan of reorganization shall contain "adequate means for the plan's implementation."

48. *In re Public Serv. Co.*, 108 B.R. 854, 892 (Bankr. D.N.H. 1989).

49. *In re Cajun*, 230 B.R. 715, 749 (5th Cir. 1999) (quoting 15 U.S.C. § 79z-5a).

IV. PG&E AND SCE

A. *Likely Impact of Bankruptcy on the PG&E and SCE Cases*

The power crisis in California has brought national attention to the issue of utility bankruptcies. However, bankruptcy may be able to address only some of the problems facing the beleaguered California utilities. This leads some to believe that the ultimate solution to many of the problems facing these utilities will likely be political rather than legal.⁵⁰

On the other hand, political attempts to save SCE from impending bankruptcy have, to this point, not gone well. As recently as September 19, 2001, John Burton, President Pro Temp of the Senate, has stated "This bill is d-e-a-d dead. . . . There is nothing more that can or will be done by this Senate for this company."⁵¹

1. Background on the PG&E Bankruptcy

Although opinions may vary, some regard the PG&E bankruptcy as the direct result of California's attempt at deregulating its electric power utilities. For example, in 1996 when the California Assembly passed Assembly Bill 1890, the law implementing deregulation of the California electric utilities, the legislature presumed that deregulation would result in lower overall electricity prices.⁵² In order to allow electrical utilities to recover their "transition costs" from deregulation, A.B. 1890 froze retail rates during the period 1998 to 2002. When in fact inadequate supply resulted in the dramatic rise of electric power prices on the open market, PG&E's operating costs exceeded revenue from the frozen rates and the company began hemorrhaging billions of dollars in operating costs.⁵³ After its repeated attempts to obtain rate relief were rejected, PG&E eventually filed Chapter 11.

2. Likely Benefits to PG&E

Obviously, bankruptcy provides a process by which a utility company could, for instance, discharge its existing debts to creditors by granting them equity in the reorganized entity. Filing for bankruptcy may also allow the utility to avoid servicing pre-existing debt, freeing assets for other

50. See, e.g., Laura M. Holson, *Bankruptcy Filing of California Utility Tests Limits of Court*, N.Y. TIMES, Apr. 9, 2001 (quoting David Wiggs, former chairman of El Paso Electric, as stating "It is going to be expensive, and, in the end, you have to find a political solution anyway.").

51. Stacy L. Bradford, *Against the Odds, Edison Keeps Faith in California Lawmakers*, The Daily Bankr. Rev., Sept. 19, 2001.

52. *In re Public Serv. Co. of N.H.*, 90 B.R. 575 (Bankr. D.N.H. 1988).

53. *Id.*

purposes. If the utility were insolvent, post-petition interest on unsecured debt would also stop. Furthermore, filing for bankruptcy would allow the company immediately to be deemed more credit-worthy than before; in fact, the Bankruptcy Code specifically provides powerful means for debtors to obtain post-petition financing.⁵⁴ Finally, the bankruptcy court would provide a forum wherein all of the concerned parties could come together to find a common solution. For example, in the *Columbia Gas* bankruptcy case, the bankruptcy court was able to resolve, through negotiation and compromise, over 4,000 claims against the debtor for the breach of natural gas take-or-pay contracts totaling over \$13 billion.

Filing for bankruptcy may also give PG&E a stronger bargaining position if a political battle is indeed unavoidable. PG&E's bankruptcy filing places significant pressure on the State of California, which was worried about its own status as a possible creditor of PG&E in light of AB1X, the state legislation that authorized the State of California to purchase power for PG&E's customers, and about the impact that may occur if PG&E is allowed to reject its contracts to buy electricity from the state's so-called qualifying facilities (QFs). For example, California State Senator Debra Bowen, chair of the California Senate Energy Committee, was concerned early in the process that the state could go bankrupt if PG&E rejected its QF contracts. If PG&E rejected these contracts, Senator Bowen argued that the state may have been forced to buy the power that was subject to such QF contracts to make up the shortfall and "[T]hat, more than anything, has the ability to bankrupt the state."⁵⁵

This doomsday scenario has, not unexpectedly, been damped. The CPUC has allowed QFs to elect to sell power to PG&E in the future for a fixed price, a benefit over the previous variable pricing. PG&E has agreed to assume many QF power contracts if the QFs: (1) in fact do offer a fixed price; (2) allow PG&E to defer paying the past arrearages until the effective date of its plan of reorganization; and (3) waive other pecuniary damage claims. The Bankruptcy Court has approved the assumption of QF power contracts on these terms.

3. Likely Limitations

A bankruptcy court may not, however, be able to resolve the fundamental problem facing the California utilities. As a case in point, PG&E's revenues generated by present rate levels may not be sufficient to meet its costs. Bankruptcy may allow PG&E to restructure its pre-petition debt, but unless it is allowed to raise rates to meet the costs of buying wholesale energy (or unless it finds some way to obtain cheaper power), PG&E may not be capable of emerging from Chapter 11 as a viable, independent company. Fortunately, under FERC order, the wholesale cost of power has

54. 11 U.S.C. § 364 (2000).

55. *California Concerned PG&E Unit May List State as Creditor*, THE DAILY BANKR. REV., Apr. 10, 2001, at 2.

declined below crisis levels.

Whereas previous utility bankruptcies have allowed the debtor utilities to reject unprofitable long-term contracts and divest themselves of liabilities, resulting in more healthy companies or attractive targets for acquisition, the problems facing the California utilities were derived largely from their *lack* of long-term power contracts that would protect them against spikes in the market price of wholesale power, coupled with legislative caps on the rates that they may charge their customers. Prior precedent suggests that the bankruptcy courts cannot preempt state law on the issue of ratemaking and the bankruptcy court would not be able to force wholesale power suppliers to enter into favorable, long-term contracts with the California utilities. Thus, the bankruptcy court will probably be unable to provide a permanent solution to this critical problem.

B. Noteworthy Early Rulings in the PG&E Bankruptcy

Although the PG&E bankruptcy is, at the time of this article, just getting underway, Judge Montali, the bankruptcy judge presiding over the PG&E case, has already issued at least two notable rulings.

On May 18, 2001, Judge Montali disbanded the official Ratepayers' Committee appointed in the case by the United States Trustee, ruling that there was no basis in the Bankruptcy Code for a ratepayers' committee and that its appointment was an abuse of discretion.⁵⁶ Judge Montali noted that section 1102 of the Bankruptcy Code authorizes the appointment of one creditors' committee and additional creditors' committees "if necessary to assure adequate representation of creditors," (*i.e.*, holders of pre-petition claims).⁵⁷ Since "no one is able to articulate a particular claim of any ratepayer *qua* ratepayer, that existed on the petition date," Judge Montali ruled that the adequate representation of creditors did not require the formation of a ratepayer committee.⁵⁸ The court noted that "ratepayers have other means and other fora to protect their interests," such as the Official Committee of Unsecured Creditors and the Attorney General's office.⁵⁹

On June 1, 2001, Judge Montali issued a second noteworthy opinion in which he denied PG&E's motion seeking to prevent the CPUC from implementing an accounting order, issued March 27, 2001, that required PG&E to reclassify its accounting of certain transition costs, or "stranded" costs that arose out of deregulation. The original intent of the rate freeze was to allow the electric utilities to recover their stranded costs. It was assumed that the freeze would hold power rates at a level exceeding PG&E's production costs, thereby allowing the utility the "headroom" to recover its

56. *In re Pacific Gas & Electric Co.*, Case No. 01-30923, Memorandum Decision Regarding Motion for Order Vacating Appointment by U. S. Trustee of Official Comm. of Ratepayers (Bankr. N.D. Cal. May 18, 2001)[hereinafter *PG&E Motion to Vacate Appointment*].

57. *Id.* at 5.

58. *PG&E Motion to Vacate Appointment*, *supra* note 56, at 6.

59. *Id.* at 2.

stranded costs. The continuation of the rate freeze depended in part on whether the utility had recovered its stranded costs. This, in turn, largely depended on whether PG&E was required to transfer certain negative balances into the account that tracks its stranded costs.

The CPUC's March 27 order reversed its earlier position that the utilities should not transfer such negative balances. This reversal substantially undermined PG&E's position that the stranded costs had been recovered. Therefore, the rate freeze should have ended in mid-2000 and the CPUC's refusal to end it was illegal.⁶⁰

Judge Montali first held that the accounting order was not blocked by the automatic stay since the order fell squarely under the section 362(b)(4) "police and regulatory" exception to the automatic stay.⁶¹ Judge Montali then went on to deny PG&E's motion for preliminary injunction brought under section 105 of the Bankruptcy Code because the CPUC's actions did not violate federal law.⁶² "The fact that PG&E will suffer significant losses if the Accounting Decision is enforced does not constitute a violation of federal law."⁶³

"Moreover," Judge Montali wrote, to excise from the CPUC's fifty-nine page ratemaking decision the two (of twelve) ordering paragraphs from which PG&E sought relief "would create jurisdictional chaos. The public interest is better served by deference to the regulatory scheme and leaving the entire regulatory function to the regulator, rather than selectively enjoining the specific aspects of one regulatory decision that PG&E disputes."⁶⁴

C. PG&E's Proposed Plan of Reorganization

On September 20, 2001, PG&E filed its first proposed plan of reorganization, projecting the plan would become effective in 2003. The proposed plan has the advantages of being supported by the official creditors' committee and not raising retail rates from current levels.⁶⁵ However, critics have already labeled the proposed plan as "robbery" because the proposed plan would transfer some of the utility's most lucrative assets to PG&E Corporation, arguably at below market value.⁶⁶ In light of these criticisms, the plan will likely be changed more than once before it can be

60. *In re Public Serv. Co. of N.H.*, 90 B.R. 575, 581 (Bankr. D.N.H. 1988).

61. *PG&E Motion to Vacate Appointment*, *supra* note 61, (discussing 11 U.S.C. § 362(b)(4) (2000)).

62. *Id.* at 25.

63. *PG&E Motion to Vacate Appointment*, *supra* note 61, citing *Baker v. Drake, Inc. v. Public Serv. Comm'n of Nev.*, 35 F.3d 1348, 1354 (9th Cir. 1994).

64. *PG&E Motion to Vacate Appointment*, *supra* note 61, at 29.

65. PACIFIC GAS AND ELEC. CO., *Pacific Gas and Electric Company and PG&E Corporation File Plan of Reorganization*, (Sept. 20, 2001), available at http://www.pge.com/006_news/006a_news_rel/010920.shtml.

66. Jason Leopold, *Power Points: PG&E Reorganization Rests on "Robbery,"* THE DAILY BANKR. REV., Sept. 24, 2001, at 3.

confirmed.

The proposed plan spins off the regulated utility into a separate entity no longer affiliated with PG&E Corporation. As part of the reorganization, PG&E Corporation would purchase the electric generation, electric transmission, and natural gas transmission systems currently owned and operated by the utility. The sales of these assets would generate cash that would be used, in combination with the issuance of long-term notes, for the full payment of all "valid creditor claims."⁶⁷ The utility would continue to own and operate the retail electric and natural gas distribution system.

A bankruptcy reorganization sells assets and restructures companies, which is just what this plan proposes. The proposed actions in the PG&E plan would draw upon some of the bankruptcy courts' core powers such as the power under section 1123(a)(5) of the Bankruptcy Code to transfer or sell "all or any part of the property of the estate to one or more entities."⁶⁸ On the other hand, the proposed asset sales would violate provisions of the California public utilities code. The corporate restructuring would, in effect, leave the state with much less to regulate. Many of the utility's present assets would be owned by unregulated entities.

On balance, it is likely that, if push comes to shove, the powers of the bankruptcy court would prevail over state law on the issues of selling assets and restructuring entities. But the state is not powerless to bring its own pressure on the process through rate reviews and challenging the supremacy of the bankruptcy provisions. In addition, the sales of assets may be for less than fair values, which would be prohibited by section 549 of the Bankruptcy Code.⁶⁹

Because of these potential sticking points, it is likely that either the CPUC will attempt to take a more active role in the reorganization or that ratepayers will find another way to be heard, notwithstanding Judge Montali's previous ruling that the ratepayers cannot be represented by an official committee. In fact, the proposed PG&E plan is somewhat similar to PSNH's first proposed plan.⁷⁰ As in the proposed PG&E plan, the initial PSNH plan would have resulted in the shift of ratemaking jurisdiction over large portions of PSNH's operations from the state regulatory agency to the FERC. That plan, like this one, showed the steel fist of the bankruptcy process; in the end, however, state interests were preserved in a largely consensual, substantially different, plan of reorganization.

D. Other Issues in the PG&E Bankruptcy

It remains to be seen whether PG&E will continue to dispute the billions of dollars it owes to the California Independent System Operator and the California Power Exchange, the latter which, incidently, also filed for

67. *Id.*

68. 11 U.S.C. § 1123(a)(5)(B) (2001).

69. 11 U.S.C. § 549 (2000).

70. Discussed in more detail in Section III.A. above.

bankruptcy in early March. PG&E disputed these claims, arising out of PG&E's power purchases and grid fees, purportedly on the basis that the California market failure and unexpected power shortages constitute a force majeure for which PG&E should not be held responsible.

Another remaining issue in the pending PG&E bankruptcy, and in subsequent cases, will be the disposition of forward contracts (contracts which provide the ability to buy or sell commodities in the market on a forward basis) entered into by PG&E. Prior precedent suggests that settlement payments on such forward contracts made prior to filing may not be avoidable as preferences under section 546(e) of the Bankruptcy Code, unless such payments qualify as fraudulent transfers under section 548(a)(1)(A) of the Bankruptcy Code.⁷¹ Moreover, the Bankruptcy Code expressly allows the closing out of forward contracts.⁷²

It is also noteworthy that the California Attorney General has asked the Securities and Exchange Commission (SEC) to investigate billions of dollars that were transferred from PG&E to its parent company, PG&E Corporation, between 1997 and 1999. The SEC has a right to make such an investigation in certain circumstances under the Public Utility Holding Company Act (PUHCA). It has been reported that PG&E Corporation claims it is an intrastate entity that is exempt from PUHCA.⁷³ If improper, these cash transfers might be voidable as fraudulent transfers.

Finally, it is important to note that Chapter 11 is a very public fishbowl. No doubt, as this article is being written, there are a number of felines hungrily eyeing PG&E as it swims in circles.

V. CONCLUSION

Chapter 11 bankruptcy can be a tremendously effective means of resolving a troubled company's financial problems. The Bankruptcy Code provides a debtor company with many useful means of restructuring pre-existing debt and disposing of other financial liabilities. Indeed, Chapter 11 has proven successful at some level in every recent utility bankruptcy. Chapter 11, however, is not a panacea for all economic ills. There are some problems that simply may not be resolvable under Chapter 11 alone. The current California energy crisis is one such situation not easily resolved under the Bankruptcy Code. The ultimate resolution of the crisis will likely require a difficult political resolution.

Fortunately, not every utility bankruptcy involves the same intractable problems facing the California utilities. Chapter 11 has proven itself a very effective process for restoring electric utilities to viability and will likely continue to be useful in future utility bankruptcies. In fact, the PG&E bankruptcy may increase the likelihood of success in future utility bank-

71. *In re Olympic Natural Gas Co.*, 258 B.R. 161 (Bankr. S.D. Tex. 2001) (interpreting 11 U.S.C. § 546(e) (2000)).

72. 11 U.S.C. § 556 (2000).

73. Jessica Berthold, *California Attorney General Asks SEC to Probe PG&E Cash Transfer*, THE DAILY BANKR. REV., July 9, 2001.

ruptcies. Presumably, other state legislatures and regulatory agencies are learning hard economic realities from PG&E about keeping utility companies viable. If these lessons are taken to heart, future troubled utility companies may find the path to resolving their economic difficulties much easier because PG&E has gone before them.

