

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 Federal government 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 around the delay and veto obstacles of the various stakeholders and 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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I. Introduction

In the United States, governments – federal, state and local – engage in a delicate 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.² In times of desperation, businesses can 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 violations³ and they can reorganize their business in a way that thwarts intricate regulatory designs.⁴ 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 a policy agenda that go beyond what a government can achieve outside of bankruptcy. The basic thrust of our

² See Tarek A. Hassan et al., *Firm-Level Political Risk: Measurement and Effects*, 134 Q. J. OF ECON. 2135.

³ 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 generally Ken W. Irvin and David E. Kronenberg, *Acquiring Bankrupt Energy Assets Clear of Compliance Obligations*, Power Mag: Gas (Feb. 22, 2018), <https://www.powermag.com/white-papers/acquiring-bankrupt-energy-assets-clear-of-compliance-obligations/>.

⁴ 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 generally PUC Files Opposition to PG&E Bankruptcy Reorganization Plan, CAL. PUB. UTIL. COMM’N (Nov. 27, 2011), https://docs.cpuc.ca.gov/published/News_release/11313.htm.

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 that litigation.⁵ 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 policy-making.⁶ 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, break 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

⁵ Jared A. Ellias, *The Law and Economics of Investing in Bankruptcy in the United States*, (Feb. 10, 2020), <https://ssrn.com/abstract=3578170>.

⁶ In a forthcoming and related article, Adam Feibelman discusses the government’s use of the bankruptcy process to further macro policy goals for the financial system as a whole, beyond the micro-objective of addressing the financial distress of the individual debtor. Adam Feibelman, *Bankruptcy and Financial Regulation*, Emory Bankr. Dev. J. (forthcoming).

public spending. This opportunity is particularly valuable when governments face log jams, vetoes and policy grid-lock in enacting the enabling legislation or regulation. Bankruptcy cases are resolved quickly, relative to the time needed for lawmaking and, in some cases, judicial review, under legislative and regulatory processes. Moreover, the bankruptcy system is populated by expert lawyers and financial advisors who may lack domain knowledge but have deep expertise in resolving disputes and forcing changes on reluctant stakeholders.

We conclude by discussing ways in which this policy-making 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 that lacks the bankruptcy system's procedures for forcing public borrowing disclosure. 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 or challenged with judicial review. Whether one sees this as a societal advantage - for overcoming grid-lock - or an undesirable end-run around democratic processes, might well depend on one's perspective on the policy in question.

We begin in Part II by reviewing how governments usually play defense in Chapter 11. In Part III, 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, “playing offense.” In Part IV, we describe two prominent examples of government policy execution through the bankruptcy system. In 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 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 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 V, we briefly outline the democratic, political, and economic concerns raised by governmental bankruptcy activism. Commentators, as well as creditors of 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 in this paper the question of whether the executive’s use of TARP funds in bankruptcy for these purposes was consistent with the enabling legislation and ask instead whether it was consistent with bankruptcy policy. In the past few months, members of the U.S. 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, 46 members of Congress stated that “[t]hese are questions of policy that must be resolved by Congress, not the courts.”⁷ Here again, we set aside for now the question of whether the settlement was a constitutionally valid use of the government’s enforcement power and focus instead 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.⁸ 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 was accordingly different, with Warren giving courts authority akin to courts of equity. Our focus here is not on the merits of distributive policies in bankruptcy law itself, as implemented by the 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.

⁷ Letter from Katherine Clark, Member of Congress, et al., to Hon. William Barr, Att’y Gen. U.S. (Nov. 10, 2020), 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.

⁸ See generally Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987); see also 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 (1997); KAREN GROSS, *FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM* 1424 (Yale Uni. Press, 1996); Elizabeth Warren & Jay Lawrence Westbrook, *Searching for Reorganization Realities*, 72 Wash. U. L. Q. 1257, 126586 (1994); Douglas G. Baird, *Bankruptcy’s Uncontested Axioms*, 103 YALE L. J. 573 (1998) [hereinafter “Baird, Uncontested Axioms”].

II. Defensive Government Action in Bankruptcy

In this Part, we review briefly the major challenges that a bankruptcy filing presents to governmental regulatory capacity. Bankruptcy law blocks governments from enforcing regulations and thereby undermines systems of regulation with three tools: (1) the automatic stay; (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 Bankruptcy Code §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, which allows a government to “enforce such governmental unit’s police and regulatory power, including the enforcement of a judgment other than a money judgment...”⁹ 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. 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.

⁹ See 11 U.S.C. § 362(b)(4).

¹⁰ See e.g., *Solis v. SCA Restaurant Corp.*, 9-CV-02212, Memorandum and Order, 463 B.R. 248 (Bankr. E.D.N.Y. 2011) (stating that litigation falls within the police and regulatory power exception of 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.”); *U.S. v. Nicolet*, 857 F.2d 202 (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)..

Second, under Bankruptcy Code §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 U.S. 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

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 Bankruptcy 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, governments 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

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

¹² Chapter 11 guarantees the objecting claimant only the liquidation payout of its claim (§1129(a)(7)) 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 (§1129(b)).

¹³ *But cf.*, *U.S. v. Apex Oil Co, Inc.*, 579 F.3d 734 (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).

regulatory actions that are subordinated to bankruptcy's goals and those that are not. In general, bankruptcy judges often seem to allow government regulators to act narrowly 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 tend fall by the wayside, even if they are deeply important to a governmental entity. For example, the International Trade Commission often argues that its public policy goal of protecting intellectual property rights is important and means that its enforcement capacity is not bound by the automatic stay, but it usually loses.¹⁷ 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.

¹⁴ See *E.E.O.C. v. Rath Packing Co.*, 787 F.2d 318, 321 (B.A.P. 8th Cir. 986) (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.").

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 (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.").

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 (B.A.P. 5th Cir. 2004); *In re Calpine Corp.*, 337 B.R. 27 (Bankr. S.D.N.Y. 2006); *In re FirstEnergy Solutions Corp. v. FERC*, 2018 WL 2315916 (Bankr. N.D. Ohio 2018).

¹⁹ See e.g., *United States', States', and Tribe's Objection to the Plan at 1, In re Peabody Energy Corp.*, No. 16-42529-399 (Bankr. E.D. Mo. 2017), ECF No. 2648 (EPA and DOI called Peabody's reorganization plan "obviously

III. Goals and Methods of Government Bankruptcy Activism

In this Part, we turn to 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 law, 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 policy goals through the rescue financing combined with the structure of the bankruptcy sale under 363(b) of the Code. In the PG&E case (Part IV.B), its 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.

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.*, No. 15-33896 (KRH) (Bankr. E.D. Va. 2015), ECF No. 542 (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.”).

The second set of levers are features of bankruptcy law. Specifically, bankruptcy gives the debtor a range of new powers that it would not have outside of bankruptcy. Activist investors have been known to exert control over those powers to enrich themselves.²⁰ 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 Bankruptcy Code §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.²¹ 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 and the 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 DIP loan, activist investors can

²⁰ See e.g., Jared A. Ellias, *The Law and Economics of Investing in Bankruptcy in the United States*, (Feb. 10, 2020), <https://ssrn.com/abstract=3578170>; Jared A. Ellias, *Do Activist Do Activist Investors Constrain Managerial Moral Hazard in Chapter 11?: Evidence from Junior Activist Investing*, 8 J. LEGAL ANALYSIS 493 (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 (2014); Wei Jiang, Kai Li & Wei Wang, *Hedge Funds and Chapter 11*, 67 J. FIN. 513, 556 (2012).

²¹ George G. Triantis, *A Theory of the Regulation of Debtor-in-Possession Financing*, 46 VAND. L. REV. 901, 901 (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* (Tuck Sch. of Bus. Working Paper, No. 3384389), <https://ssrn.com/abstract=3384389>.

gain enormous influence over the bankruptcy process and shape its outcome.²² 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.²³

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;²⁴ and (3) 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 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.

Bankruptcy Code §365 allows the debtor to assume or reject executory contracts and leases.²⁵ 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

²² See e.g., AM. BANKR. INST., COMMISSION TO STUDY THE REFORM OF CHAPTER 11: 2012-2014 FINAL REPORT AND RECOMMENDATIONS (2014), <http://commission.abi.org/full-report>; see also GEORGE TRIANTIS, DEBTOR-IN-POSSESSION FINANCING (B. Adler ed., Edward Elgar Pub., 2019).

²³ Kenneth Ayotte & Jared A. Elias, *Bankruptcy Process for Sale* (U.C. Hastings L., Research Paper No. 382, 2020), <https://ssrn.com/abstract=3611350> (noting how lenders benefit from making DIP loans).

²⁴ The debtor can also propose, for authorization by the court, the method of sale. This was an important power in the Chrysler sale (*infra*).

²⁵ See 11 U.S.C. § 365 (2020).

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 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.²⁶ 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 did Chrysler) notwithstanding restrictions in distributorship agreements, federal or state statutes²⁷ and the political hurdles that would impede such termination outside bankruptcy.²⁸

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.²⁹ The debtor must satisfy the burden of

²⁶ See generally Ken Ayotte, *Leases and Executory Contracts in Chapter 11*, 12 J. OF EMPIRICAL LEGAL STUD. 637 (2015).

²⁷ State statutes often require notice and/or cause before termination, cancellation, or non-renewal. See e.g., Michigan Vehicle Franchise Act, MICH. COMP. LAWS, § 7 (1981).

²⁸ Peter Valdes-Dapena, *Chrysler Closing 789 Dealerships*, MONEY & MAIN ST. (May 14, 2009, 10:39 AM), https://money.cnn.com/2009/05/14/autos/chrysler_dealer_closings/index.htm ("Chrysler LLC will close down 789 dealerships, or roughly 25% of the current number"). See *In re Old Carco LLC*, 406 B.R. 180, 212–13 (Bankr. S.D.N.Y. 2009).

²⁹ 11 U.S.C. § 1113 (2020). 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.

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 after having trouble competing because of spikes in jet fuel prices and relatively high labor costs. Northwest was able to force its flight attendants to take \$195 million in pay reductions after the bankruptcy judge permitted Northwest to reject their collective bargaining agreement.³⁰

One can speculate about the government's policy interest in the decision to assume or reject contracts. Environmental policy may dictate that it is in society's interests that a debtor 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 that employ local workers should not be rejected. 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.

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 Enterprises, Inc.*, 196 B.R. 734, 747 (Bankr. W.D. Pa. 1996) (destroying supermarket union workers union contracts).

³⁰ 11 U.S.C. § 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. *See, compare, In re Pinnacle Airlines Corp.*, 483 B.R. 381 (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).

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 security interests and successor liability.³¹ Companies commonly also use bankruptcy to shed underperforming assets and re-focus on their core business.³² 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 to pursue policy goals. Second, government can use its leverage to influence how assets are sold. In Chrysler, government determined the liabilities with respect to which the assets would be sold free and clear, and those that would be assumed by the purchaser.³³ 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 its affected creditors: notably, the majority voting rule within any given class of claimants³⁴ and the cramdown option when a court finds that a proposed plan is “fair and equitable.”³⁵ While each creditor is guaranteed the payout it would have received in a Chapter 7 liquidation,³⁶ the debtor has significant discretion in distributing the going concern surplus among its creditors. Government activism can prefer policy-favored claimants at

³¹ § 363(b), (f).

³² 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>.

³³ *Infra* note – and accompanying text.

³⁴ § 1129(a)(8); 1126(c).

³⁵ § 1129(b).

³⁶ § 1129(a)(7).

the expense of the others, if the dissenters can be outvoted or if the court finds that the reorganization is fair and equitable.

IV. 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 far harder to achieve 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 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 § 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 economic policy objective of ensuring that the manufacturers survived the financial crisis, along with their workers and communities.³⁷ The government was also able to leverage powers available only in bankruptcy

³⁷ 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>.

to achieve other political wins outside of, and arguably at odds with the bankruptcy goals, particularly that of maximizing the return to claimholders.³⁸ Our description will focus on Chrysler, but the approach was very similar in GM.

a. Chrysler's Distress and Bankruptcy Proceeding

In 2008, Chrysler and GM experienced severe financial distress—losses, illiquidity, and insolvency—that threatened their survival.³⁹ Their financial distress was largely due to the cost-structure of auto manufacturing in the U.S. and intense product market competition.⁴⁰ 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, U.S. 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 large quarterly losses and were burdened by enormous unfunded healthcare and retiree pension obligations.⁴¹

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.⁴² The outgoing Bush Administration drew from the financial rescue funds of the Troubled Asset Relief Program (“TARP”) and conditioned the loan extension on Chrysler and GM submitting viable

³⁸ In discussing the policy goals of preserving the health of the U.S. financial system as a whole, Adam Feibelman states that “while part of the government’s engagement in the Chrysler [bankruptcy] involved its own direct financial claim against the company, i.e., as a creditor, the underlying claim was one created in direct pursuit of the government’s regulatory goal.” Feibelman, *supra* note --, at --.

³⁹ SEPT. OVERSIGHT REP. 7–8, CONG. OVERSIGHT REP. (Sept. 9, 2009),

<http://online.wsj.com/public/resources/documents/tarpautoreport.pdf> [hereinafter “Oversight Report”].

⁴⁰ *Id.* at 7.

⁴¹ *Id.*

⁴² *Id.* at 8.

plans to restore solvency and profitability.⁴³ 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.⁴⁴

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 30⁴⁵ and General Motors on June 1.⁴⁶ 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.⁴⁷ The government decided that Chrysler should be reorganized in bankruptcy under a §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 in cash.⁴⁸ Fiat S.p.A. would provide New Chrysler

⁴³ *Id.* at 8–10.

⁴⁴ *Id.* at 10–12; *see also* Jesse Lee, *GM & Chrysler*, WHITE HOUSE: PRES. BARACK OBAMA (Mar. 30, 2009, 12:53 PM), *archives*, <https://obamawhitehouse.archives.gov/blog/2009/03/30/gm-chrysler> (last visited Mar. 10, 2021).

⁴⁵ *See* Oversight Report, *supra* note 40, at 13.

⁴⁶ *Id.* at 19.

⁴⁷ 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 id.* at 21.

⁴⁸ Mark J. Roe & David Skeel, *Assessing Chrysler Bankruptcy*, 108 MICH. L.R. 727, 748 (2010). This chart summarizes the treatment of the various unsecured claims. *Id.* at 754.

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 standards.⁴⁹ Most of the rest of the stock ownership (55%) went to the trust that had been set up to pay health benefits to Chrysler employees and retirees (VEBA).⁵⁰ The U.S. government received a much smaller stake of 8%.

b. The Obama Administration’s Policy Objectives

Clearly, one of the 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

Old Chrysler		New Chrysler	
Secured Debt		Secured Debt	
First Lien	\$6.9 B		
Second Lien (prior shareholders)	\$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%

⁴⁹See *In re Chrysler LLC*, 576 F.3d 108 (B.A.P. 2d Cir. 2009); see also Todd J. Zywicki, *The Chrysler and General Motors Bankruptcies* 308 (George Mason U. L. & Econ., Research Paper No. 18-21, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3252104. 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. *Id.* at 12–13, n.37. The Task Force claimed that Fiat was the only option available at that time. *Id.* at 12 n.37.

⁵⁰ See Oversight Report, *supra* note 40, at 14–15. The restructuring of GM had a similar design as a §363(b) sale from “Old GM” to “New GM”. *Id.* 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%. *Id.* at 19–20. In GM’s bankruptcy, the government focused more on protecting labor interests rather than any environmental goals. *Id.* at 23.

(UAW)⁵¹ and (2) promoting climate goals by building Chrysler's ability to manufacture and sell smaller, more fuel-efficient cars in the United States.⁵²

First, as unfunded obligations of Chrysler and of GM, pensions and health benefits would be obliterated if the company liquidated. At the time of the bankruptcy filing, Chrysler owed \$10 billion to VEBA and had \$3.5 billion in unfunded pension obligations.⁵³ 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 stock of New Chrysler.⁵⁴ 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 U.S. The Obama Administration entered office with ambitious environmental objectives related to vehicle emissions.⁵⁵ 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 US vehicle fleet.⁵⁶ During Chrysler and GM's period

⁵¹ See Zywicki, *supra* note 50, at 305.

⁵² Professor Zywicki argues, "Contrary to standard bankruptcy analysis, these interventions and others like them—i.e., protecting the UAW from significant wage reductions, protecting inefficient dealers from downsizing, and providing incentives to manufacture unprofitable small cars—did *not* aid GM and Chrysler in reorganizing to become more viable as competitors." See *id.* at 305.

⁵³ See Oversight Report, *supra* note 40, at 14 n.49.

⁵⁴ *Id.* at 15.

⁵⁵ The Administration addressed energy more broadly in its second term; it committed the United State 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. BARAK OBAMA, <https://obamawhitehouse.archives.gov/president-obama-climate-action-plan> (last visited Mar. 10, 2010).

⁵⁶ Its new regulations doubled the fuel efficiency standards for cars. See Press Release, Obama Administration Finalizes Historic 54.5 MPG Fuel Efficiency Standards, White House: President Barak Obama (Aug. 28, 2012),

of financial distress, President Obama also promoted the Car Allowance Rebate System (“CARS” or commonly known as “Cash for Clunkers”).⁵⁷ This program provided incentives for Americans to trade in “gas-guzzling” vehicles for more fuel-efficient alternatives.⁵⁸ The program would hopefully boost car sales in the struggling economy and promote the purchase of greener cars.⁵⁹

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?”⁶⁰ Historically, American companies manufactured larger vehicles like pickup trucks and SUVs because their prices could cover the high union labor costs in the United States.⁶¹ 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,

archive, <https://obamawhitehouse.archives.gov/the-press-office/2012/08/28/obama-administration-finalizes-historic-545-MPG-fuel-efficiency-standard>.

⁵⁷ 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.”).

⁵⁸ *Id.*

⁵⁹ *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.”).

⁶⁰ *See* Todd J. Zywicki, *The Corporatist Legacy of the Auto Bailouts*, LIBERTY L. (Jan. 13, 2014), <http://www.libertylawsite.org/2014/01/13/the-corporatist-legacy-of-the-auto-bailouts/>; *see generally*, Todd J. Zywicki, *The Auto Bailout and the Rule of Law*, 7 NAT’L AFFAIRS 66 (Spring 2011), <https://www.nationalaffairs.com/publications/detail/the-auto-bailout-and-the-rule-of-law> (highlighting Obama Administration’s frustration with GM and Chrysler).

⁶¹ *See* Todd J. Zywicki, *The Corporatist Legacy of the Auto Bailouts*, LIBERTY L. (Jan. 13, 2014), <http://www.libertylawsite.org/2014/01/13/the-corporatist-legacy-of-the-auto-bailouts/>.

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, to promote these policy goals.⁶²

c. 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 decided to restructure the auto manufacturers through a 363(b) sale.⁶³ Although the debtors must obtain judicial approval of the 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

⁶² While the federal government succeeded in privileging UAW worker benefits, it was less successful in promoting fuel-efficient auto manufacturing through the Chrysler sale. Looking at car manufacturing in the United States today, international manufacturers still dominate the small market and American autos have pivoted back to their expertise in pickup trucks. This move was a political tactic wrapped into the bankruptcy reorganization procedure. To be fair, it is not clear whether the policy goal would have been any more achieved through the more conventional avenues outside of bankruptcy. See Zywicki, *supra* note 50, at 308.

⁶³ See also Oversight Report, *supra* note 40, at 21 (highlighting how the government’s investment put it in the driver seat, steer the restructuring).

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

⁶⁵ *Id.* at 127. The Second Circuit’s judgment was vacated by the U.S. Supreme Court on grounds of mootness. See *In re Chrysler*, 592 F.3d 370 (B.A.P. 2d Cir. 2010) (holding that the judgement be vacated and remanded “with instructions to dismiss the appeal as moot.”).

subsequently not oppose the proposed 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 entire company as a whole, rather than a piecemeal sale.⁶⁷ 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.⁶⁸ This would ensure that the 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 and thereby 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.⁶⁹

d. Who Bore the Cost of Policy Goals?

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 46, *In re Chrysler*, No. 09-50002, 405 B.R. 84 (Bankr. S.D.N.Y. 2009) [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* at 4 (Univ. of Chi. Law & Econs., 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 Zywicki, *supra* note 50, at 312.

⁶⁸ 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.").

⁶⁹ *Id.* 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. *Id.* at 747.

Several pension and retirement funds – including 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 subordinated their first liens to those unsecured claims. Chrysler argued that workers would receive value in return for concessions made in a new agreement with the UAW that included, for example, a commitment not to strike for six years. 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, the threat of strikes was less likely than advertised.⁷⁰ The secured claimholders 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 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 the first-lien holders had voted, consistent with majority required under their loan and collateral agreements with Chrysler, 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 had become beholden to the U.S. government’s bank bailouts earlier in the financial crisis. The four banks had together received \$90 billion from the

⁷⁰ [cite]

⁷¹ *In re Chrysler*, 576 F.3d 108, 119–120 (B.A.P. 2d Cir. 2009). 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.

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 state bore the risk 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.

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 108, 118–19 (B.A.P. 2d Cir. 2009); see, compare, Brief of Appellants Indiana State Police Pension Trust et al. at 15–19, *In re Chrysler*, 576 F.3d 108, No. 09-2311-bk (B.A.P. 2d Cir. 2009) ["Brief of Indiana State Police Pension Trust"]; see also Andy Hoffman, *Chrysler Revises Stance on Liability*, N.Y. TIMES, Aug. 28, 2009, at B2.

⁷⁴ See Hoffman, *supra* note 77, at B2 (reporting 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.”).

B. Pacific Gas & Electric (PG&E)

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 Pacific Gas & Electric Company ("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 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 did not have any problems that could not have been solved by the state legislature's powers to regulate and appropriate, had they chosen to do so. But, by using the bankruptcy process as a vehicle for PG&E's restructuring, the State was able to resolve, at least for now, a thorny problem, with the aid of private sector capital and protect important public policies. Importantly, the outcome of the bankruptcy may be different than what would have happened if it were a purely private sector bankruptcy, as the firm would have been tempted to use Chapter 11 to reduce its debt load, which would have necessarily meant not paying fire survivors in full.

⁷⁵ See *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. 25, 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 38 homes. See 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>.

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

a. 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 households of Californians against the risks of wildfires, which have greatly increased over the past decade due to climate change. We discuss each in turn.

⁷⁷ See PAC. GAS & ELECTRIC CO., 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 (whitepaper 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/#:~:text=The%20shut%2Doff%20plan%20comes,covered%20by%20Newsom's%20environmental%20waiver> (describing statewide fire prevention projects and priorities).

⁷⁸ See Nicholas Lovino, *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 20-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), <https://www.sfchronicle.com/business/article/Sometimes-things-just-break-PG-E-CEO-15084426.php>.

First, the State of California had been using PG&E as a catalyst for California's 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 constrained 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

⁷⁹ Dale Kasler, *California Seeks 100% Clean Energy. Why PG&E's Bankruptcy Could Imperil That Plan*, SACRAMENTO BEE (June 11, 2019), <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 also AMANDA SINGH, 2018 CALIFORNIA RENEWABLES PORTFOLIO STANDARD ANNUAL REPORT at 2 (2018), https://www.cpuc.ca.gov/uploadedFiles/CPUC_Public_Website/Content/Utilities_and_Industries/Energy_-_Electricity_and_Natural_Gas/Renewables%20Portfolio%20Standard%20Annual%20Report%202018.pdf (describing successive laws that have expanded California's renewable purchase mandates).

⁸¹ Christine Cordner, *Sempre, Con Edison Development Partner on Renewable Energy Development*, SNL ENERGY POWER DAILY (May 22, 2013), <https://search-proquest-com.uchastings.idm.oclc.org/docview/1355587748/CF13EB5C404D04PQ/1?accountid=33497> (describing the sale of two photovoltaic plants which were developed under a Power Purchase Agreements ("PPA") with PG&E); see also *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 Pac. Gas & Elec. Co., Comments to Commission on Catastrophic Wildfire Cost and Recovery at 3 (Apr. 22, 2019), https://opr.ca.gov/wildfire/docs/comments/20190424-wildfire_comments_04-22-2019_Pacific_Gas_and_Electric.pdf (last visited Mar. 12, 2021) ("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.").

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 in 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

b. Background to the Bankruptcy Filing.

PG&E's Chapter 11 filing was driven by its inability to reduce significantly the dangers that running power 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 potentially liability.⁹⁰ The company could not eliminate the risk that wind posed to its equipment

⁸⁴ Russel 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>.

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”); see also Van Alstyne, *Inverse Condemnation: Unintended Physical Damage*, 20 HASTINGS L. J. 431 (1969).

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

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 <https://www.nytimes.com/2019/02/13/business/energy-environment/pge-wildfire-bankruptcy-control.html>

⁹⁰ See Wells Aff., *supra* note 91, at 21–22 (describing passage of S.B. 901 fire relief bill, estimating PG&E's liability for damages at \$15 billion); see also Jeff St. John, *California Lawmakers Pass PG&E Wildfire Relief Bill, Let Grid Regionalization Expire*, GREEN TECH MEDIA (Sept. 4, 2018), <https://www.greentechmedia.com/articles/read/california-passes-pge-wildfire-relief-bill-but-grid-regionalization-fails>.

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 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 people⁹⁵ and causing more than \$16.5

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/pg-e-puts-cost-of-judges-wildfire-plan-at-up-to-150-billion-idUSKCN1PI00P>.

⁹² PG&E only had \$800 million insurance for the entire 2017 fire season. See Nicole Friedman, *Disaster Losses Close in on Record*, N.Y. TIMES, Dec. 13, 2017, at B1. For the 2018 fire season, PG&E was able to obtain \$1.4 billion in insurance. See Wells Aff., *supra* note 91, 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.*, No. 17-11-033 (Cal. Pu. 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 A.B. 901, (Cal. 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. 1, 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/pg-e-camp-fire-california-victim-impact-statements/index.html>.

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 the need to pay as much as \$30 billion in damages.⁹⁸ The weight of tort litigation took a continuing toll 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

c. 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

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 Matier & 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>.

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*, No. 19-30088, 603 B.R. 471 (Bankr. N.D. Cal. 2019).

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

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 could have hurt California. First, PG&E could have sought to confirm a plan that did not pay fire survivors—owed some \$30 billion¹⁰⁵—in full. 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 power to exit to force contractual counterparties to renegotiate deals. PG&E could

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 also Russell Gold et al., *PG&E Prepares for Bankruptcy Amid Wildfire Fallout*, WALL ST. J. BUS. (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.

¹⁰⁵ Ivan Penn, *PG&E Says Wildfire Victims Back Settlement in Bankruptcy*, N.Y. TIMES (May 18, 2020, updated 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: BUS. (July 5, 2019 12:11 PM, updated July 5, 2019), <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*, GREEN TECH. MEDIA (June 10, 2019), <https://www.greentechmedia.com/articles/read/pge-bankruptcy-judge-leaves-door-open-to-severing-renewable-energy-contract>.

have saved more somewhere between \$1 billion¹⁰⁸ and \$2.5 billion¹⁰⁹ a year by tearing up clean energy contracts.¹¹⁰

As such, 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 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

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

¹⁰⁹ See John, *supra* note 111.

¹¹⁰ Jeff Manning & Steven Wilamowsky, *Will PG&E be Forced to Turn to PPAs to Get a Bankruptcy Exit Plan Confirmed*, UTILITY DIVE: OPINION (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*, GREEN TECH. MEDIA (Feb. 12, 2019), <https://www.greentechmedia.com/articles/read/newsom-pge-strike-team-60-days>; see generally, WILDFIRES AND CLIMATE CHANGE: CALIFORNIA’S ENERGY FUTURE, REPORT FROM GOVERNOR NEWSOM’S STRIKE FORCE (2019), <https://www.courthousenews.com/wp-content/uploads/2019/04/CalifWildfireReport2019.pdf> [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 115, 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, *Mixed Reaction to Newsom’s ‘Strike Force’ Report on California Wildfires*, SAN DIEGO UNION-TRIB. (Apr. 12, 2019), <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 115, at 38.

¹¹⁴ *Id.* at 46.

As the bankruptcy began to move forward, Governor Newsom filed a pleading in the bankruptcy court noting that PG&E would need to 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 a new regulatory framework if PG&E demonstrated, among other things: (a) an improvement in their safety culture to reduce the risk of fires; and (b) significant contributions from PG&E's shareholders towards fixing the company. 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."¹¹⁶ 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.¹¹⁷

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

Subsequently, the State Legislature unveiled a law 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.¹¹⁸ The law, Assembly Bill 1054 ("AB1054"), proposed a trade of sorts, where California protected its own interests in several ways. As this is the first state law that we

¹¹⁵ See generally, 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, No. 19-30088 (Bankr. N.D. Cal. 2019) [hereinafter "Newsom Objection"].

¹¹⁶ See Newsom Objection, *supra* note 119, at 6.

¹¹⁷ See Newsom Objection, *supra* note 119, at 4.

¹¹⁸ Chron. Ed. Board, *Editorial: AB1054 Will Change the way California Deals with Wildfires, so the Legislature Needs to get it Right*, S.F. CHRON. (July, 9, 2019), <https://www.sfchronicle.com/opinion/editorials/article/Editorial-AB1054-will-change-the-way-California-14083760.php> (noting that "AB1054).

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.¹¹⁹ 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.”¹²⁰ Politically, AB1054 required PG&E to propose a “rate neutral” plan, which would guard against the inevitable outrage that would have accompanied PG&E appearing to pay for wildfire damages by passing the costs onto customers.¹²¹ Importantly, all pre-bankruptcy fire victims would need to be paid in full.¹²² Taken together these provisions would force PG&E to implement a solvent debtor plan, pay all fire survivors in full and reorganize very quickly with a board of directors and management team that met the State's approval. The requirement that fire survivors be paid in full also meant that the bondholders, whose unsecured claims had equal priority to fire victims, would also need to be paid in full, helping to protect 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 need to guarantee the pay and benefits of its workforce for three years. This helped to lock-in the deal structure that the State envisioned.¹²³

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

¹¹⁹ A.B. 1054; A.B. 3291(b).

¹²⁰ A.B. 1054, § 16, ¶ 3291(b)(1)(C).

¹²¹ A.B. 1054, § 16, ¶ 3291(b)(1)(E).

¹²² A.B. 1054; § 16, ¶ 3291(b)(1)(B).

¹²³ A.B. 1054, § 12 (amending § 854.2 of Cal. Pub. Util. Code).

that was consistent with the state’s climate goals.¹²⁴ 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.¹²⁵ The State also increased its oversight of PG&E by establishing a new Wildfire Safety Advisory Board¹²⁶ and bolstering the CPUC with a new Wildfire Safety Division.¹²⁷

In exchange for these new burdens, PG&E’s shareholders were given significant protection from future fire liability through changes to the “cost recovery” process that tilted the process in favor of PG&E and other privately-owned public utilities. In general, utilities like PG&E can only pass costs from wildfires onto ratepayers as “rate increases” if CPUC finds the increase justified; CPUC became much less willing to allow PG&E to pass fire costs onto customers in 2017, effectively rendering the company insolvent.¹²⁸ 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 reasonably¹²⁹ and, if PG&E went through a regulatory process to obtain a safety

¹²⁴ A.B. 1054; § 16, ¶ 3291(b)(1)(D).

¹²⁵ Jeff St. John, *California Assembly Passes \$21B Wildfire Fund for Utilities*, GREEN TECH. 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*, GREEN TECH. MEDIA (Aug. 9, 2019), <https://www.greentechmedia.com/articles/read/pge-pledges-to-keep-all-power-purchase-agreements-but-some-already-took-a-h>.

¹²⁶ A.B. 1054, §§ 4, 5.

¹²⁷ A.B. 1054, § 18.

¹²⁸ 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., *Re Southern California Edison Company*, D.87-06-021, 24 Cal.P.U.2d 476 (1987).

¹²⁹ “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.

certificate,¹³⁰ 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.¹³¹

e. 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.¹³² 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.¹³³

The wildfire survivors then 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—and by PG&E, really their shareholders'—offer of \$8.4 billion and settling instead with bondholders for \$13.5 billion.¹³⁴ Judge Montali then gave the bondholders and fire survivors permission to sponsor their own rival plan of reorganization.¹³⁵ 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.¹³⁶

¹³⁰ Cal. Pub. Util. Code § 451.1.

¹³¹ Cal. Pub. Util. Code § 8389.

¹³² 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.”).

¹³³ J.D. Morris, *Why Hedge Funds are Fighting for Control of PG&E*, S.F. CHRON. (July 23, 2019), <https://www.sfchronicle.com/business/article/Why-hedge-funds-are-fighting-for-control-of-PG-E-14115025.php>.

¹³⁴ 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.

¹³⁵ 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>.

¹³⁶ Objection of the Ad Hoc Committee of Senior Unsecured Noteholders to Debtors' Motion to Enter into Restructuring Support Agreement with the Consenting Subrogation Claimholders, *In re PG&E*, No. 19-30088 (Bankr. N.D. Cal. 2019).

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.¹³⁷

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 not fund the plan with higher rates for ratepayers.¹³⁸ 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.¹³⁹

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 setting the terms of the bankruptcy.¹⁴⁰ Both

¹³⁷ 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 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, No. 19-30088 (Bankr. N.D. Cal. 2019) [hereinafter "Newsom Rejection"].

¹³⁸ See Newsom Rejection, *supra* note 141, at 3.

¹³⁹ *Id.* at 4.

¹⁴⁰ Letter from Gavin Newsom, Governor of the State of California, to Hon. Dennis Montali, United States Bankruptcy Court, Northern District of California (Nov. 1, 2019), <https://restructuring.primeclerk.com/page/Home-DownloadPDF?id1=MzA0OTAw&id2=0>.

PG&E and its bondholders appeared to recognize this, as they collectively spent millions lobbying the legislature to curry favor in Sacramento.¹⁴¹

Following the Governor's intervention, PG&E reached a deal with wildfire victims to pay them the same \$13.5 billion that 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 concessions.¹⁴² The week after PG&E reached a deal with fire survivors, Governor Newsom wrote a five page public letter detailing his problems with the amended plan that incorporated the fire survivor settlement.¹⁴³ 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 caused significant fires after bankruptcy.¹⁴⁴ Governor Newsom also continued to use the bankruptcy process to acquire bargaining leveraging, informing Judge Montali that he was concerned that the plan was not yet acceptable to the State of California.¹⁴⁵

In the weeks to follow, Newsom would make repeated public threats to take the company over if they 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 2020.¹⁴⁶ This plan of reorganization

¹⁴¹ Lee Fang, *PG&E Spent Millions on Lobbying Following Bankruptcy, Wining and Dining Lawmakers who Sponsored Bailout*, INTERCEPT (Nov. 4, 2019, 11:56 AM), <https://theintercept.com/2019/11/04/pg-e-bailout-bankruptcy-lobbying/>; *see also* @ColbyBermal, TWITTER (Feb. 3, 2020, 11:44 AM), <https://twitter.com/ColbyBermal/status/1224418507154059264?s=20>.

¹⁴² Dale Kasler, *PG&E Makes Deal to pay California Wildfire Victims. What is Means for Utility's Future*, SACRAMENTO BEE (Dec. 6, 2019, 11:02 AM), <https://www.sacbee.com/news/california/fires/article238138009.html>.

¹⁴³ *See generally* Letter from Gavin Newsom, Governor of the State of California, to William D. Johnson, Chief Executive Officer, PG&E Corporation (Dec. 13, 2019), <https://www.courthousenews.com/wp-content/uploads/2019/12/PGECh11-NewsomRejection.pdf> (hereinafter "Newsom December Rejection Letter").

¹⁴⁴ *Id.*

¹⁴⁵ 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, *In re* PG&E, No. 19-30088 (Bankr. N.D. Cal. 2020).

¹⁴⁶ @ColbyBermal, TWITTER (Jan. 29, 2020, 3:48 PM),

<https://twitter.com/ColbyBermal/status/1222667766093582336>; *see also* News Release, PG&E, PG&E Achieves

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 protecting the credit-worthiness of California. Importantly, the State also protected its long-term ability to control PG&E with new oversight powers and a process for dismantling the company in the event of additional destructive wildfires.¹⁴⁷ 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 mayors to seize portions of their assets¹⁴⁸ and by some members of the California legislature to make the company a public entity or a customer-owned cooperative.¹⁴⁹

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.

¹⁴⁷ @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.”).

¹⁴⁸ 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. See 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. See 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. See 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.” See 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/>.

¹⁴⁹ 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 Rhode 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>.

f. Bankruptcy Law as 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, creating a 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 that made it possible 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 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 those claims 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 reorganize the company, putting pressure on bankruptcy judges to issue orders that advance reorganization so long as they impose a reasonable outcome

on creditors.¹⁵⁰ 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 regime that no other public utility in the United States has to endure. 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 to Governor Newsom and CPUC.

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

¹⁵⁰ See generally Jared A. Ellias and Robert Stark, *Bankruptcy Hardball*, 108 CALIF. L. REV. 745 (June 2020); Adam J. Levitin, *Purdue's Poison Pill and the Rule of Two: The Breakdown of Chapter 11 Checks and Balances*, 100 TEX. L. REV. ____ (2021); Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L. J. 862 (2014).

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 interest groups who are active in the conventional policy processes often lack the required expertise in bankruptcy. 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 or judicial review.

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.¹⁵¹ In her view, such distribution

¹⁵¹ Warren wrote that: "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." See Warren, *supra* note 9, at 777. The interests Warren had in

was a policy goal *of* bankruptcy. Citing Congressional comments in the debates leading to the enactment of the Bankruptcy 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.”¹⁵² 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.¹⁵³

Professor Baird has responded that distributional policies are and should be pursued by nonbankruptcy (“state”) law and that bankruptcy policy should be focused on value creation through its collective process.¹⁵⁴ 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.¹⁵⁵

The phenomenon we describe in this Article broadens the debate over policy making in bankruptcy significantly. Warren and Baird were debating the distributional policy *of* bankruptcy:

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.” *Id.* As Congress gave bankruptcy judges substantial policymaking power, judges have substantial flexibility to reshape the administration of bankruptcy law. See Rafael I. Pardo and Kathyn A. Watts, *The Structural Exceptionalism of Bankruptcy Administration*, 60 *UCLA L. REV.* 384 (2012). See also Melissa Jacoby, *Corporate Bankruptcy Hybridity*, 166 *U. PA. L. REV.* 1715 (2018) (arguing that the bankruptcy system is a model of “public private partnership.”).

¹⁵² *Id.* at 788.

¹⁵³ See e.g., Korobkin, *supra* note 9 (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); see Gross, *supra* note 9, at 14–24 (discussing the significant spillovers from the dissolution of a debtor that should lead bankruptcy to prefer rehabilitation and continuation); see e.g., Baird, *Uncontested Axioms*, *supra* note 9 (analyzing the contrast between the two bankruptcy views which he labels as traditionalist and proceduralists).

¹⁵⁴ See Baird, *Forum Shopping*, *supra* note 9, at 833–34; see e.g., Baird, *Uncontested Axioms*, *supra* note 9.

¹⁵⁵ See Baird, *Forum Shopping*, *supra* note 9, at 51; see also Baird, *Uncontested Axioms*, *supra* note 9, at 596 (writing that proceduralists believe “judges are poor social planners.”).

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 policy making, 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.¹⁵⁶ 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.¹⁵⁷ 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 paper's Introduction,¹⁵⁸ 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

¹⁵⁶ “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 ninety-nine percent dilution of their claims. See Korobkin, *supra* note 9, at 759.

¹⁵⁷ Text accompanying *supra* note --.

¹⁵⁸ *Supra* text accompanying note --.

consistent with bankruptcy policy. We confine our discussion here to the latter question and leave the former for future research.¹⁵⁹

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 §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 -- policy making. 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.¹⁶⁰

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 shocks and invest in its business. Instead, PG&E left bankruptcy essentially having transformed its pre-

¹⁵⁹ For an argument that bankruptcy judges should focus on bankruptcy policy goals, *see* Anthony J. Casey and Joshua Macey, *The Hertz Maneuver (and the Limits of Bankruptcy Law)*, *University of Chicago Law Review Online* (2020).

¹⁶⁰ STEVEN RATTNER, *OVERHAUL: AN INSIDER'S ACCOUNT OF THE OBAMA ADMINISTRATION'S EMERGENCY RESCUE OF THE AUTO INDUSTRY* 38 (First Mariners Books ed. 2011).

bankruptcy tort debt into post-bankruptcy contract debt, as it borrowed money to pay to fire survivors, leaving the firm with roughly twice as much contract debt as it had going in.¹⁶¹ 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 very possible that putting the question squarely before the State government, instead of indirectly through AB1054, might have led California to reach a different outcome.

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.¹⁶² The bankruptcy judge approved of the settlement.¹⁶³ One of its provisions 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.¹⁶⁴ 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.¹⁶⁵

¹⁶¹ Jeff St. John, *4 Things PG&E Must do to Survive and Thrive as it Exits Bankruptcy*, GREEN TECH. 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>.

¹⁶² 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 also 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>.

¹⁶³ See Randles, *supra* note 161.

¹⁶⁴ See Purdue Pharma Settlement, *supra* note 161.

¹⁶⁵ 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

The Purdue settlement was opposed by two dozen states who argued that it improperly blocked the potential sale of the business.¹⁶⁶ 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.¹⁶⁷ 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 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.¹⁶⁸

D. 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 Bankruptcy Code, scholars have focused on concerns about the forum-shopping incentives created by those powers

Year-End Update on Corporate Non-Prosecution Agreements and Deferred Prosecution Agreements, GIBSON DUNN 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 2 in 2000 to 102 in 2015).

¹⁶⁶ Jan Hoffman, *Purdue Pharma Tentatively Settles Thousands of Opioid Cases*, N.Y. TIMES (Sept. 11, 2019, updated Nov. 24, 2020), <https://www.nytimes.com/2019/09/11/health/purdue-pharma-opioids-settlement.html>.

¹⁶⁷ The letter added that "Moreover, 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". See Letter from Katherine Clark, Mem. of Cong., et al., to Hon. William Barr, Att'y Gen. of U.S., U.S. Dep't of Just. (Nov. 10, 2020), 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.

¹⁶⁸ *Id.*

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 policy making and when does it effect an end-run around the constitutional and democratic safeguards in legislative and regulatory lawmaking?