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From the Bankruptcy Courts: Limitations on the United States Trustee's Power to Appoint Committees: Lessons from PG&E

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Representative committees play an important role in large and complex chapter 11 cases.[1] Under section 1102 of the Bankruptcy Code, the United States trustee is required to appoint a committee of creditors holding unsecured claims against the debtor, and also has the discretion to appoint additional committees of creditors or equity security holders "as the United States trustee deems appropriate."[2] Thus, in the first instance, the U.S. trustee determines the number of committees in the case and selects the membership of each. On request of a party in interest, the court has the power to order the appointment of additional committees of creditors or equity security holders. However, upon entry of such an order, the Code gives the U.S. trustee, rather than the court, the exclusive task of selecting and appointing the committee members.[3]

A controversial issue that has been raised in a number of cases is whether, or to what extent, a bankruptcy court may review a decision of the U.S. trustee with respect to the appointment of committees. This question has been examined recently in a decision of the Bankruptcy Court for the Northern District of California in *In re Pacific Gas & Electric Company.*[4]

The Facts

On April 6, 2001, Pacific Gas & Electric Company (PG&E) filed a

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[1] *See* 11 USC § 1103 on the powers and duties of committees in chapter 11 cases.

[2] 11 USC § 1102(a)(1). However, the court may order that a creditors' committee not be appointed if the debtor is a small business. 11 USC § 1102(a)(3). *See* 11 USC § 101 for the definition of "small business."

[3] *See* 11 USC §1102(a)(2), which gives the court the authority, on request of a party in interest, to appoint additional committees of creditors or equity security holders if necessary to assure adequate representation, but states that the United States trustee shall appoint any such committee.

[4] Bankruptcy Case No. 01-30923DM, Memorandum Decision Regarding Motion for Order Vacating Appointment of Committee of Ratepayers, May 18, 2001 ("PG&E memorandum decision").

petition for relief under chapter 11 of the Bankruptcy Code in the Bankruptcy Court for the Northern District of California. PG&E is an electric and gas utility company that provides services to northern and central California. It is one of the largest companies to file for bankruptcy in U.S. history. The chapter 11 case of PG&E, including orders affecting utility rates entered during the case and the provisions of a reorganization plan, could have a significant impact on the customers who pay for utility services in California. In order to protect the interests of PG&E customers, as a group, the U.S. trustee appointed an Official Committee of Ratepayers to act as a representative body with a voice to participate in the chapter 11 case. The U.S. trustee also appointed the Official Committee of Unsecured Creditors.

Shortly after the U.S. trustee appointed the Ratepayers Committee, PG&E filed a motion for an order vacating the appointment. The U.S. trustee and certain ratepayers submitted opposition papers arguing that the court did not have the authority to review the U.S. trustee's discretionary appointment of the Ratepayers Committee under section 1102(a) of the Bankruptcy Code.

The Court's Role in Reviewing Appointments by the United States Trustee

The issue of whether a court is empowered to review the appointment of committees by the U.S. trustee has been complicated by the language, the legislative history, and the 1986 amendment of section 1102 of the Bankruptcy Code, which governs the appointment of committees. Section 1102(a) provides as follows:

> (1) Except as provided in paragraph (3), as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate.
> (2) On request of a party in interest, the court may order the appointment of additional committees of creditors or of equity security holders if necessary to assure adequate representation of creditors or of equity security holders. The United States trustee shall appoint any such committee.
> (3) On request of a party in interest in a case in which the debtor is a small business and for cause, the court may order that a committee of creditors not be appointed.

Before 1986, when Congress enacted legislation to make the U.S. trustee program nationwide,[5] section 1102(c) provided:

[5] Since 1986, every region has a United States trustee, except for the districts located

> On request of a party in interest and after notice and a hearing, the court may change the membership or the size of a committee appointed under subsection (a) of this section if the membership of such committee is not representative of the different kinds of claims or interests to be represented.[6]

The 1986 amendments to the Bankruptcy Code deleted this section in its entirety, which raises the question of the court's proper role, if any, in reviewing committee appointments made by the U.S. trustee.

In *PG&E*, the U.S. trustee relied on *In re Wheeler Technology, Inc.*[7] when arguing in favor of the proposition that courts lack jurisdiction to review her discretionary appointment of the Ratepayers Committees under section 1102(a). In deciding whether the district court had the power to remove a creditor from a committee as a sanction for violating the automatic stay, the appellate panel in *Wheeler Technology* found that, by deleting section 1102(c), Congress explicitly took away from the courts the power to delete a member from a committee appointed by a U.S. trustee. The appellate panel also reasoned that section 105(a)—which grants the court the power "to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code] . . . or to prevent an abuse of process"[8]—can not be used to circumvent the clear intent of Congress to exclusively place the committee-appointing power with the U.S. trustee. In response, PG&E relied on *In re Pierce*[9] for the proposition that section 105(a) allows courts to review the U.S. trustee's appointment under an abuse of discretion standard. According to *Pierce*, such a review may be justified under section 105(a) because it may be necessary or appropriate to carry out the provisions of the Bankruptcy Code or to prevent an abuse of process. In essence, the provisions of chapter 11 cannot be carried out if the U.S. trustee abuses the discretion afforded her under that chapter.

The bankruptcy court found that neither *Wheeler Technology* nor *Pierce* applied directly to *PG&E* because they did not involve a request to disband a committee in its entirety as not being authorized by law.[10]

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in North Carolina and Alabama, where administrative tasks are performed by bankruptcy administrators.

[6] 11 USC § 1102(c).

[7] 139 B.R. 235 (9th Cir. BAP 1992).

[8] 11 USC §105(a).

[9] 237 B.R. 748 (Bankr. E.D. Cal. 1999).

[10] The Court noted that there was one case, *In re* New Life Fellowship, Inc., 202 B.R. 994 (Bankr. W.D. Okla.) which addressed the court's authority to review the U.S. trustee's appointment of a committee in the context of a request to disband the committee. In *New Life Fellowship*, the court held that it lacked authority to review the decision of the U.S. trustee to appoint a bondholders' committee because the Bankruptcy Code is absolute on its terms that the U.S. trustee shall appoint committees. The court in *PG&E* refused to follow *New Life Fellowship* because the reasoning of *Pierce* and the majority of other cases was more persuasive. Also, the *PG&E* court noted that that case involved the appointment of a committee specifically authorized by law as op-

However, the court agreed with the *Pierce* analysis, which represents the majority view, in finding that it had the power under section 105(a) to review the U.S. trustee's appointment of the Ratepayers Committee under an abuse of discretion standard. In *Pierce*, the court noted that the U.S. trustee performed administrative functions and was not a judicial officer, thereby rendering it inappropriate for the U.S. trustee to resolve disputes regarding the propriety of her own actions. Thus, by deleting section 1102(c), Congress could not have intended to give the U.S. trustee unfettered and unreviewable discretion in appointing committee members. The appointments by the U.S. trustee must logically be reviewable in some manner by some forum. The court in *PG&E*, relying on several other cases as well, stated that bankruptcy courts must have the inherent power to review acts of the U.S. trustee, or "there would be no means for judicial review of the UST's actions, even if the UST exceeded her authority and acted contrary to law."[11]

The Standard of Review

Upon its finding that it had the authority to review the U.S. trustee's appointment of the Ratepayers Committee under section 105(a), the bankruptcy court then focused on the appropriate standard of review. The court, consistent with prevailing authority regarding judicial review of a U.S. trustee's acts, held that the standard is the "arbitrary and capricious" or "abuse of discretion" standard, rather than a *de novo* review standard. The court observed that these prevailing standards have been drawn from appellate practice. Though it does not sit as an appellate court reviewing a judicial decision, the standard of review is the same. "Applying these appellate standards, this court cannot simply substitute its judgment for that of the UST, but it can overturn a UST's decision that is based on an erroneous interpretation of law."[12] Therefore, the court had to decide whether the U.S. trustee, in exercising her discretion, disregarded controlling law.

United States Trustee's Lack of Authority to Appoint Ratepayers Committee

Upon its review of the provisions of the Bankruptcy Code that grant the U.S. trustee the power to appoint committees, the Court found that the U.S. trustee lacked authority to create the Ratepayers Committee and, therefore, such appointment was an abuse of discretion. Several reasons were mentioned for this conclusion.

First, as the bankruptcy court explained, section 1102(a)(1) authorized the U.S. trustee to appoint a committee of *creditors holding unsecured claims*. It also authorizes the

posed to the Ratepayers Committee in *PG&E*.

[11] PG&E memorandum decision at 3.

[12] PG&E memorandum decision at 4.

U.S. trustee to appoint, in her discretion, additional committees of *creditors*. Section 1102(a)(2) authorizes the appointment of additional committees upon the request of a party in interest if the appointment of such additional committees is necessary to assure adequate representation of *creditors*. Similarly, sections 1102(b) directs that a committee of creditors appointed under section 1102(a) shall ordinarily consist of the holders of the seven largest *claims* against the debtor of the kinds represented on such committee.[13]

The court further explained that section 101(10) defines "creditor" as an entity that has a ". . . claim against the debtor that arose at the time of or before the order for relief."[14] The court noted that Congress intended that creditor committees in chapter 11 cases could consist only of holders of prepetition claims, rather than postpetition claims. Applying this rationale, the *PG&E* court analyzed the interests of the ratepayers represented by the Ratepayers Committee in order to determine if they were prepetition "creditors." If so, the appointment of a committee representing their interests would have been authorized under section 1102(a) of the Bankruptcy Code.

The court found no articulation of a particular claim of any ratepayer *qua* ratepayer that existed on the petition date that could justify the creation of the Ratepayers Committee as a committee of "creditors." Specifically, the court found that although blackouts may have caused damages to certain ratepayers before the filing of PG&E's bankruptcy petition, claims arising therefrom would be the same for non-ratepayers. Accordingly, both ratepayers and non-ratepayers would be protected by the Official Committee of Unsecured Creditors as prepetition holders of unsecured claims. Moreover, unchallenged authority was presented by PG&E's general counsel that PG&E, as a regulated utility, would be insulated from liability based on problems encountered by ratepayers as a result of rolling blackouts. The court could not find any events that occurred before bankruptcy that would give any ratepayer a "right to payment" pursuant to section 101(5), or establish that PG&E owed a "debt" to any ratepayer such that ratepayers, as a group, could be considered creditors for the purpose of creating a separate committee to represent their interests.

The court also pointed out that any recoveries coming from the use of the avoiding powers of the Bankruptcy Code as applied to PG&E's affiliates will "redound to the benefit of the estate generally, and not to a separate class of ratepayers."[15] In addition, any proceedings resulting in benefits ordered by regulatory

[13] Section 1102(a) also authorizes the appointment of a committee of equity security holders. In addition, section 1114 authorizes the appointment of committees of retirees in appropriate cases.

[14] *See* 11 USC § 101(10).

[15] PG&E memorandum decision at 7.

agencies such as the California Public Utilities Commission ("CPUC") would take place before such agencies with the right to be heard governed by nonbankruptcy law, and any refunds ordered by the CPUC would take the form of future rate adjustments.

Ratepayers Have Other Options

The court emphasized that depriving ratepayers of an official committee to represent their interests does not mean that they are without other avenues for effective representation. In fact, the court found that the creation of a Ratepayers Committee was not necessary to protect their interests. First, the court recognized that the Attorney General of the State of California has access to the bankruptcy court under Rule 2018(b) of the Federal Rules of Bankruptcy Procedure, which provides that "the Attorney General of a State may appear and be heard on behalf of consumer creditors if the court determines the appearance is in the public interest. . . ."[16]

Second, the ratepayers, or an individual ratepayer, may be able to appear before the court under section 1109(b), which gives a party in interest the right to appear and be heard on any issue in the case. The court noted that "party in interest" is not defined in the Bankruptcy Code, but it appears some 46 times within the Bankruptcy Code and Bankruptcy Rules. "Congress certainly knew the difference between 'parties in interest' and 'creditors' when it empowered the latter to organize as a committee and participate in bankruptcy cases at the expense of the estate. It did not extend that right to parties in interest."[17] The court stressed that when a particular ratepayer wished to be heard on any matter, the court will decide at that time whether, and to what extent, that ratepayer may be considered a party in interest and be heard. In addition, the court was careful to note that nothing in the court's order was intended to affect the rights of ratepayers to be heard in a forum other than the bankruptcy court, and that if the bankruptcy court is ever required to exercise

[16] The court noted, however, that the Attorney General of the State of California has decided not to accept the invitation to appear, "apparently fearing that sovereign immunity protection will be lost if the State of California takes advantage of this right. The court expresses no opinion on whether that will occur or whether it makes sense for the Attorney General to explore the possibility of a stipulation that would preserve the sovereign immunity defense for other matters." PG&E memorandum decision at 8. In that regard, the court mentioned that PG&E and the Official Committee of Unsecured Creditors have already agreed on record to that possibility. They also agreed that they are willing to stipulate that the Attorney General can represent all ratepayers, notwithstanding Rule 2018's possible limitation that the Attorney General can represent only "consumer creditors." PG&E memorandum decision at n.6. Finally, the court commented that "[i]f the ratepayers of PG&E believe they are entitled to the assistance of the Attorney General they should resort to the political arena to seek relief. The court cannot help them because Congress has not provided a means for it to do so." PG&E memorandum decision at n.6.

[17] PG&E memorandum decision at 8.

power traditionally vested in a regulatory agency, then the appropriateness of a committee consisting of ratepayers may be revisited.

Finally, the court agreed with the U.S. trustee's assertion that ratepayers are greatly interested in the outcome of the case and the financial affairs of PG&E, but emphasized that having such an interest in the results of the case does not rise to the level of having a claim as defined in the Bankruptcy Code that could warrant the creation of their own committee.[18]

Section 105(a) Cannot Save the Ratepayers Committee

The court then focused on the use, or misuse, of section 105(a) in the context of the Ratepayers Committee. First, it acknowledged that one might "reasonably argue" that, since the court is using section 105(a) powers to review the U.S. trustee's appointment of the Ratepayers Committee, it would be consistent to use the same section to serve the public interest by creating such a committee, notwithstanding the limitations in section 1102(a) regarding committee appointments. But the court found no inconsistency in its decision. The court explained that the Bankruptcy Code is silent as to whether courts can review the U.S. trustee's decisions and actions and, therefore, using section 105(a) as a basis for such judicial review does not conflict with any provision of the Bankruptcy Code. However, section 1102(a) preempts the subject of committee creation in that it describes only two categories of entities that may be organized as official committees, creditors and equity security holders. Relying on section 105(a) to allow the Ratepayers Committee to continue as an official committee, despite the fact that it does not consist of creditors or equity security holders, would cause the court to "override the clear limitations of the statute," which "would itself be an abuse of discretion."[19]

Motion for Reconsideration

The bankruptcy court denied motions for reconsideration filed by the U.S. trustee and the former Ratepayers' Committee.[20] Again, the court emphasized that the fundamental question is "whether a ratepayer is a creditor solely because that person is a ratepayer, as distinguished from the fact that any particular ratepayer might be a creditor holding a claim as defined in Bankruptcy Code

[18] The *PG&E* court cited the court in the *Public Service of New Hampshire* case. "Although clearly interested in the outcome of the Utility's organization [sic] proceedings, ratepayers arguably lack a strong enough investment in a utility to warrant an independent and unfettered voice in the reorganization." *In re* Public Service Co. of New Hampshire, 88 B.R. 546, 553, *quoting* Flaschen & Reilly, *Bankruptcy Analysis of a Financially-Troubled Utility*, 22 HOUS. L.REV. 965, 971-73 (1985).

[19] PG&E memorandum decision at 10.

[20] *In re* Pacific Gas & Electric Co., Case No. 01-30923-DM, Transcript of Proceedings, July 10, 2001 (hereinafter referred to as "Transcript").

Section 101(5)."[21] Employing the "fair contemplation test" adopted by the Ninth Circuit,[22] the court held that ratepayers do not have claims—as ratepayers—because they do not have a right to damages based on the debtor's prepetition conduct coupled with a fair contemplation of the existence of a claim caused by that conduct. In particular, the mere possibility that the California Public Utilities Commission may someday order refunds to ratepayers does not rise to the level of a "contingent claim" under the Code. There were no pending refund orders of the Commission and, in any event, any adjustments to rates based on prepetition conduct could be made by the Commission in the form of prospective rate adjustments, rather than refunds to ratepayers. "In summary, there is no theory on which the Court can conclude that a future rate adjustment applicable to then-existing ratepayers translates to a claim as of the petition date for bankruptcy purposes."[23]

The bankruptcy court also rejected the argument made in the motions for reconsideration that ratepayers have claims for interruption in service based on intercompany transfers. "Not only are there no facts to support any of these theories, there is nothing to suggest that as of the petition date, there is even the remotest fair contemplation that some intercompany transfers from PG&E to its parent alerts prospective ratepayer claimants that they may have claims based upon interruption of service."[24]

The court again noted that ratepayers, who were not entitled to have their own official committee, are not without remedies. "Nothing stands in the way of the ratepayers in forming an informal committee, retaining counsel at their own expense, and seeking to be heard on matters that pertain to their rights as ratepayers, if and when those matters come before the Court."[25] The court also emphasized that, by its decision, it was not disallowing ratepayers' claims. Rather, all ratepayers who also hold claims may assert their claims in a timely manner. Moreover, consistent with its finding that ratepayers do not have "claims" for rate refunds, the court ordered public notice "to the effect that customers of PG&E are not required to file proofs of claim by the claims deadline in order to ensure their entitlement to future rate refunds that may be ordered by the Pubic Utilities Commission."[26]

Conclusion

Undoubtedly, there are many lessons to be learned from the *PG&E* case. Its complexity and unique role in the history of utility insolvencies will present many novel and chal-

[21] Transcript at 9-10.

[22] *In re* Jensen, 995 F.2d 925 (9th Cir. 1993).

[23] Transcript at 14.

[24] Transcript at 19.

[25] Transcript at 11.

[26] Transcript at 23.

lenging legal issues that will require resolution during the course of the chapter 11 case. Early in the case, the court reminded us that bankruptcy courts, when asked, will judicially review the propriety of U.S. trustees' appointments of committees under section 1102(a). When doing so, it will employ an "abuse of discretion" standard to ensure that they have not acted contrary to the Bankruptcy Code. The court also confirmed that the statutory limitations on the power to create committees are real limitations that cannot be disregarded through the court's use of its section 105(a) powers. The court concluded in its decision that the U.S. trustee, while acting with good intentions and in the best interest of the ratepayers, did not have the power to create a Ratepayers Committee that does not consist of creditors or equity security holders.

Perhaps the most important lesson of the court's decision—which may indicate how it will entertain, or refrain from entertaining, issues yet to be resolved—is found in its conclusion. The bankruptcy court reminds the parties that the Bankruptcy Code and the bankruptcy court were designed to resolve debtor-creditor problems. In contrast, state agencies handle such regulatory issues as rates for electricity. "In its wisdom, Congress was correct: the estate should pay for dealing with those debtor-creditor issues in bankruptcy. It should not be burdened with matters likely to be resolved elsewhere."[27]

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[27] PG&E memorandum decision at 10.