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8 **UNITED STATES BANKRUPTCY COURT**  
9 **NORTHERN DISTRICT OF CALIFORNIA**

10  
11 In re ) No. 01-30923 DM  
12 PACIFIC GAS AND ELECTRIC ) Chapter 11  
13 COMPANY, )  
14 Debtor. ) Date: July 22, 2002  
Time: 1:30 p.m.  
15 ) Ctrm: Hon. Dennis Montali  
22<sup>nd</sup> Floor, 235 Pine Street,  
16 ) San Francisco

17 **UNITED STATES TRUSTEE'S**  
18 **OPPOSITION TO CALIFORNIA PUBLIC UTILITIES COMMISSION**  
19 **MOTION FOR AN ORDER REQUIRING THE DEBTOR TO PAY**  
**UBS WARBURG LLC**

20 William T. Neary, United States Trustee, respectfully submits this opposition to the  
21 Motion of the California Public Utilities Commission (the "CPUC") for an Order Requiring the  
22 Debtor to Pay UBS Warburg (the "UBS Warburg Motion"). The UBS Warburg Motion  
23 should not be approved because it seeks to impose as much as \$176 million in fees on the  
24 estate without any proof of benefit to the estate. The statutes the CPUC relies upon provide  
25 no authority for the requested relief. Even if the proposed retention were appropriate, terms  
26 calling for the indemnification of UBS Warburg by the estate or limiting the estate's right to  
27 sue the firm should be disapproved because they confer no benefit on the estate.

28 UNITED STATES TRUSTEE'S OBJECTION TO MOTION REQUIRING  
DEBTOR TO PAY UBS WARBURG

**FACTUAL BACKGROUND**

The CPUC moves the Court for an order requiring debtor to pay UBS Warburg to arrange the financing of the CPUC's chapter 11 plan. The CPUC maintains it does not have the ability to pay UBS Warburg. The cost of UBS Warburg's services is substantial. The United States Trustee estimates the cost ranges from a minimum of \$9.8 million to \$176 million, calculated as follows:<sup>1/</sup>

**Retainer Agreement --**

Due at Signing	\$3,000,000	
Due upon Delivery of Proposal	\$2,500,000	
Due After 45 Days or Acceptance of Proposal	\$2,500,000	
Total		<b>\$8,000,000</b>

<b>Monthly Fees (for 12 months)</b>	<b>\$1,800,000</b>
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**Commitment Payment**

	Fee %	Amount Expected to be financed per CPUC Plan	Fees to be Earned (see fn 1)	
Senior Debt (Exit Financing)	1%	\$1,900,000,000	\$19,000,000	
Subordinated Debt	2%	\$3,860,000,000	\$77,200,000	
Convertible Debt	2%			
Equity	4%	\$1,750,000,000	\$70,000,000	
				<b>\$166,200,000</b>

**Consummation Fee**

Maximum, less any amounts paid under Commitment Fees or Underwriting Fees	<b>\$60,000,000</b>
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<b>Range:</b>	<b>\$9,800,000</b> (Retainer + to Monthly fees)
	<b>\$176,000,000</b> (Retainer+ Monthly Fees +Commitment Payment)

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<sup>1/</sup> The fees to be earned were calculated using the CPUC's plan figures. The United States Trustee assumed for the purpose of this calculation that the \$3.86 billion to be issued would be subordinated because there was no category for debt that was equal in priority to the existing trade debt.

1 **I. THE MOTION TO EMPLOY UBS WARBURG SHOULD BE DENIED BECAUSE IT**  
2 **FAILS TO COMPLY WITH BANKRUPTCY CODE PROVISIONS FOR THE**  
3 **EMPLOYMENT OF PROFESSIONALS**

4 Although couched as a motion to “use estate property” under 11 U.S.C. § 363, the  
5 UBS Warburg Motion should be seen as an attempt by the CPUC to employ a professional  
6 for the estate because that is the substance of the relief being sought. If the retention is  
7 approved, an investment banker will bill the estate (not the CPUC) for its services. It is  
8 important to observe that approval of the UBS Warburg retention would result in less control  
9 over professional fees than the court would have for a professional employed under 11  
10 U.S.C. § 327(a). If approved, UBS Warburg would have no need to demonstrate that its  
11 fees were actual, necessary and beneficial to the estate as § 330(a) requires of other  
12 professionals.

13 The UBS Warburg Motion’s attempt to employ a professional for the estate does not  
14 comply with the Bankruptcy Code. Section 327(a) authorizes applications to employ  
15 professionals to be submitted by the “trustee” (a trustee appointed under § 1104(a) or the  
16 debtor in possession under § 1107(a)) or by a committee constituted under § 1102(a). The  
17 CPUC does not have the authority to impose its choice of an investment banker on the  
18 estate under this statutory scheme because it is not the trustee, debtor or an official  
19 committee of creditors.

20 Even if the CPUC were authorized to employ professionals like UBS Warburg, the  
21 proposed employment is not permissible. Estate professionals must demonstrate they are  
22 qualified to serve under 11 U.S.C. § 327(a) and submit detailed disclosure of their  
23  
24  
25  
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1 connections to the estate under Federal Rule of Bankruptcy Procedure 2014(a). UBS  
2 Warburg makes no attempt to comply with these sections.

3 **II. BANKRUPTCY CODE §§ 363 AND 1107 DO NOT PROVIDE A BASIS FOR**  
4 **EMPLOYMENT OF UBS WARBURG TO REPRESENT THE CPUC IN PG&E'S**  
5 **BANKRUPTCY CASE**

6 The CPUC's attempt to employ UBS Warburg LLC should be denied because it is not  
7 authorized by any provision of the Bankruptcy Code. The CPUC largely relies on 11  
8 U.S.C. §§ 363(b) and 1107 to support this effort. Neither of those sections authorizes the  
9 result the CPUC seeks. Section 363(b) authorizes only the debtor or a trustee to use estate  
10 property outside the ordinary course: "the trustee, after notice and a hearing, may use, sell,  
11 or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. §  
12 363(b). The CPUC does not have standing under the easily understood terms of the statute  
13 to request payment of UBS Warburg's fees. Congress gave trustees and debtors in  
14 possession the broad power to deal with property of the estate. *In re Canyon Partnership*,  
15 55 B.R. 520, 524 (Bankr. S.D. Cal. 1985). It did not confer those powers on third parties  
16 like the CPUC.

17 Section 1107 does not extend the power to deal with estate property to the CPUC  
18 either. That section only provides that the debtor in possession has the powers of a trustee  
19 under the Bankruptcy Code, providing "a debtor in possession shall have all the rights ...  
20 and powers, and shall perform all the functions and duties ... of a trustee serving in a case  
21 under this chapter." 11 U.S.C. § 1107.

22 **III. SECTION 503(b) DOES NOT AUTHORIZE PRE-APPROVAL OF ADMINISTRATIVE**  
23 **EXPENSES LIKE THE EMPLOYMENT OF UBS WARBURG**

24 The CPUC describes in detail the benefits it has conferred on the estate by the  
25 prosecution of its competing chapter 11 plan. Even assuming for the sake of argument the  
26 CPUC is correct that its competing plan has had a salutary effect on the progress of this  
27 chapter 11 case, it is premature to consider whether this benefit merits payment by the  
28 estate to UBS Warburg because that company's efforts have no proven worth yet. Neither

1 the CPUC nor UBS Warburg has proven UBS Warburg will make a substantial contribution  
2 to the estate. Case law suggests such determinations must be premised on history rather  
3 than speculation: "A creditor's application under § 503(b) should be allowed only if the  
4 creditor demonstrates by a preponderance of the evidence that the expenses were incurred  
5 in an endeavor that "provide[d] tangible benefits to the bankruptcy estate and the other  
6 unsecured creditors." *In re Catalina Spa & R.V. Resort, Ltd.*, 97 B.R. 13, 17  
7 (Bankr.S.D.Cal.1989). A determination about the value of such services is necessarily  
8 subjective. As the Fifth Circuit stated, "The development of a more concrete standard of  
9 substantial contribution is best left on a case-by-case basis. At a minimum, however, the  
10 court should weigh the cost of the claimed fees and expenses against the benefits  
11 conferred upon the estate which flow directly from those actions. Benefits flowing to only a  
12 portion of the estate or to limited classes of creditors are necessarily diminished in weight."  
13 *In re DP Partners Ltd. Partnership*, 106 F.3d 667 (5<sup>th</sup> Cir. 1997). The UBS Motion must be  
14 denied because there is no proof of any benefit from UBS Warburg's work yet.

15 **IV. THE TERMS OF THE PROPOSED EMPLOYMENT SHOULD NOT BE APPROVED**  
16 **BECAUSE THEY PROVIDE NO DEMONSTRABLE BENEFIT TO THE ESTATE**  
17 **AND DO NOT COMPORT WITH THE OBLIGATIONS OF PROFESSIONAL**  
18 **PERSONS**

19 The Engagement Letter attached to the UBS Warburg Motion contains numerous  
20 objectionable terms like indemnification, choice of forum and jury trial waivers the Court  
21 should not approve.

22 A. The Indemnity Provision Should Be Disapproved Because It Is Unjustified and  
23 Inappropriate for a Chapter 11 Professional

24 The Engagement Letter contains an "indemnity" provision that is, in fact, a release of  
25 liability by the estate for most types of misconduct by UBS Warburg. The provision purports  
26 to limit the estate's right to recovery damages resulting from intentional acts or gross  
27 negligence by UBS Warburg and, apparently, any third party's right to recover from that firm,  
28 to a complex contribution formula based almost exclusively on the compensation the firm  
receives from debtor and limited by equitable factors the firm and debtor agree upon in

1 advance of litigation<sup>2</sup>. These provisions should not be approved because they are  
2 unjustified. The terms are not in the best interests of the estate because they provide  
3 nothing of value to the estate.

4 The great weight of authority rejects indemnity and other liability protections as  
5 inappropriate and unacceptable terms of employment for a professional employed by a  
6 bankruptcy estate. *In re Metricom, Inc.*, 275 B.R. 364, 369 (Bankr. N.D. Cal. 2002); *In re*  
7 *Gillett Holdings, Inc.*, 137 B.R. 452, 458 (Bankr. D. Colo. 1991) (entirely improper and  
8 unacceptable); *In re Drexel Burnham Lambert Group*, 133 B.R. 13, 27 (Bankr. S.D.N.Y.  
9 1991) (“[s]imply stated, indemnification agreements are inappropriate”); *In re Mortgage &*  
10 *Realty Trust*, 123 B.R. 626, 631 (Bankr. C.D. Cal. 1991) (“[i]ndemnification is not consistent  
11 with professionalism”); *In re Allegheny Int’l, Inc.*, 100 B.R. 244, 247 (Bankr. W.D. Pa. 1989)  
12 (“holding a fiduciary harmless for its own negligence is shockingly inconsistent with the strict  
13 standard of conduct for fiduciaries”); *In re United Companies Financial Corp.*, 241 B.R. 521,  
14 524 (Bankr. D. Del. 1999) (disapproving financial advisors’ use of indemnification provision  
15 and damages cap).

16 Indeed, in this case the Court declined to approve an indemnity agreement sought by  
17 an investment banker. In its *Tentative Decision on Debtor’s Application to Employ Dresdner*  
18 *Kleinwort Wasserstein, Inc.*, dated July 6, 2001, the Bankruptcy Court disapproved an  
19 indemnity agreement for an investment banker (Dresdner Kleinwort Wasserstein, Inc.)  
20 debtor sought to employ, stating:

21 This court is of the view that the cases cited by the UST that disapprove of indemnity  
22 agreements for investment bankers are well reasoned, both from a point of view of a  
23 legal analysis and also from the point of view of fundamental bankruptcy policy.  
24 Indemnity is inappropriate for professionals employed by representatives of  
25 bankruptcy estates. The court would rather presume that DrKW possesses sufficient  
26 expertise and sophistication that it will not be negligent in the performance of its  
27 duties . . .

28 Dresdner later withdrew its employment application.

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<sup>2</sup> Under the terms of the indemnity, the debtor is the party who is obliged to indemnify UBS Warburg even though the firm will work for the CPUC.

1 Neither UBS Warburg nor the CPUC has proven that the services UBS Warburg will  
2 provide to the CPUC are unavailable without the proposed indemnity. Although the CPUC  
3 avers that indemnities are “usual and customary” for underwriters, the evidence it offers in  
4 support of that allegation is skimpy at best. Mr. Victor, a principal of Chanin Capital  
5 Partners, LLC, who is an investment advisor, not an investment banker, opines indemnities  
6 are “typical” and that investment bankers “would typically refuse to work” absent an  
7 indemnity. *Declaration of Skip Victor* in support of UBS Warburg Motion 3:6-14. It is telling  
8 no one from UBS Warburg was willing to make the same representation, as it is UBS  
9 Warburg’s argument to make.<sup>3</sup>

10 Similarly, UBS Warburg submits no authority for the proposition that its liability can be  
11 limited by the fees it is paid or by a damage measure based on that provision. California  
12 has a complex statutory scheme for contribution, indemnity and related matters. Cal. Code  
13 Civ. Proc. §§ 875 *et seq.*; Cal. Civ. Code §§ 2772 *et seq.* At a minimum, debtor or UBS  
14 Warburg should explain whether the provisions they want the Bankruptcy Court to approve  
15 are consistent with California law.

16 B. The Indemnity Exceeds the Scope of What Is Necessary to Protect Against  
17 the Harm UBS Warburg Foresees

18 The harm UBS Warburg foresees is much narrower than the scope of the indemnity  
19 requested. Although UBS Warburg does not say why it needs the indemnity, Mr. Victor  
20 proposes at least one plausible basis for the provision. According to Mr. Victor, UBS  
21 Warburg needs to rely on information supplied by debtor when acting as investment banker.  
22 The indemnity apparently protects the firm in that situation. *Declaration of Skip Victor* in  
23 support of UBS Warburg Motion 3:6-14. Yet the indemnity as it is drafted is far too broad to  
24 protect against only the potential for misstatements by PG&E. If UBS Warburg’s concern is  
25 that financial information it takes from PG&E may be faulty, it is reasonable to believe an  
26 appropriate provision could be drafted to eliminate the problem.

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27 <sup>3</sup> The *Declaration of Kenneth S. Crews* in support of the motion refers to UBS Warburg’s need for PG&E’s  
28 financial information but does not refer to the indemnity. See Crews Declaration § 11.

1 C. The Application Includes A Waiver of Jury Trial Rights, Choice of Law  
2 Provisions and Venue Provisions, All Of Which Are Inconsistent With The  
3 Bankruptcy Court's Supervision of the Estate

4 The Engagement Letter contains a "choice of law provision" (New York) and a  
5 provision requiring the use of New York courts. In addition, UBS Warburg requests the  
6 estate waive any right to a jury trial in connection with any dispute over UBS Warburg's  
7 professional services. The Bankruptcy Court should reject UBS Warburg's attempt to  
8 impose these terms on the estate.

9 Professionals employed under the authority of the Bankruptcy Court must rely on  
10 federal law and the Bankruptcy Court for protection in the first instance. Choice of law terms  
11 are inconsistent with Bankruptcy Code §§ 327 - 330, which give this court exclusive control  
12 of employment terms and fees in bankruptcy cases. See *In re Shirley*, 134 B.R. 940, 943-  
13 44 (Bankr. 9th Cir. 1992), ("Bankruptcy Code and Federal Rules of Bankruptcy Procedure  
14 operate to preclude fee awards for services performed on behalf of a bankruptcy estate  
15 based on state law theories not provided for by the Code"). Accord, *In re Atkins*, 69 F.3d  
16 970, 973 (9th Cir. 1995); and *In re Weibel*, 176 B.R. 209, 211 (Bankr. 9th Cir. 1994).

17 In a recent case pending before the San Jose division, *In re Komag, Inc.*, Judge  
18 Grube rejected debtor's attempt to employ an accounting firm which sought specific venue  
19 provisions, jury trial waivers and a binding arbitration provision. 268 B.R. 566, 568 (Bankr.  
20 N.D.Cal 2001). Judge Grube wrote:

21 The rights that Komag has agreed to waive are substantial. The right to trial by  
22 jury is viewed as being so fundamental to our system of jurisprudence that it is  
23 part of the Bill of Rights, the Seventh Amendment to the United States  
24 Constitution. Binding arbitration not only eliminates a trial by jury but any trial at  
25 all. The venue provisions, while not as obviously detrimental, certainly limit the  
26 right of a potential plaintiff to choose its forum from those legally available.

27 *Id.*

28 Like the accounting firm in Komag, UBS Warburg has not demonstrated its  
Engagement Letter is appropriate under the facts of the case and current state of the law.



1 The United States Trustee anticipates UBS Warburg and the CPUC will argue the  
2 terms calling for use of New York Courts and related provisions are intended to bind only the  
3 CPUC and UBS Warburg. Unfortunately, the structure of the indemnity suggests otherwise.  
4 The indemnity broadly refers to a "dispute of any kind or nature whatsoever arising out of or  
5 in any way relating to this agreement." The United States Trustee is concerned this  
6 provision would extend to disputes involving parties beyond the CPUC and UBS Warburg.

7 **V. CONCLUSION**

8 The United States Trustee objects to the proposed employment for the foregoing  
9 reasons and requests no order issue approving the UBS Warburg Motion.

10 Dated: July 11, 2002

Respectfully submitted,  
Patricia A. Cutler  
Assistant U.S. Trustee

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