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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

In re) Case No. 01-30923 SFM
)
PACIFIC GAS AND ELECTRIC) Chapter 11
COMPANY, a California Corporation,)
)
Debtor.)
)
)
Federal I.D. No. 94-0742640)
_____)

ORDER AUTHORIZING ESTABLISHMENT OF
MANAGEMENT RETENTION PROGRAM

The Court has considered the motion of debtor Pacific Gas and Electric Company ("PG&E"), filed May 25, 2001, for an order authorizing establishment of a management retention program (the "Motion"), the opposition filed by the United States Trustee ("UST"), the response filed by the Official Committee of Unsecured Creditors ("OCC") in support of the Motion, the opposition filed by the City and County of San Francisco ("San Francisco"), the arguments of counsel presented at a hearing on June 18, 2001, the post-hearing declarations of Mark K. Gordon of Hewitt Associates and Russell M. Jackson filed by PG&E on June 25, 2001, the post-

1 hearing memorandum filed by San Francisco and the supplementary
2 objection of the UST, each filed on July 6, 2001, and rules as
3 follows.¹

4 In its initial opposition, San Francisco complained about the
5 lack of evidence to support the Motion, distinguished PG&E's cited
6 cases, and asked that the Motion be denied. Its post-hearing
7 memorandum argues that no deference is due to PG&E's "business
8 judgment" in favor of the management retention program and
9 conversely that deference is due to any contrary judgment by the
10 UST. San Francisco also argues that the management retention
11 program should be analyzed under the standards for incurring a
12 debt under Section 364(b),² that the program must constitute an
13 "actual, necessary" cost or expense of preserving the estate under
14 Section 503(b)(1)(A), and that because the officers and directors
15 who support the program are among its beneficiaries it must be
16 "fair" to the estate and its creditors under the "rigorous
17 scrutiny" of the court. San Francisco relies heavily upon Mark IV
18 Properties, Inc. v. Club Development & Management Corp. (In re
19 Club Development & Management Corp.), 27 B.R. 610 (9th Cir. BAP
20 1982) and In re Regensteiner Printing Co., 122 B.R. 323 (N.D. Ill.
21 1990).

22 On the evidence presented, San Francisco alleges that PG&E
23 has not established a sufficient factual basis for its fear of
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25 ¹ The following discussion constitutes the court's findings
26 of fact and conclusions of law. Fed. R. Bankr. P. 7052(a).

27 ² Unless otherwise indicated, all chapter and section
28 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and
all rule references are to the Federal Rules of Bankruptcy
Procedure.

1 attrition among those employees to be covered by the management
2 retention program nor the reasonableness of that program. San
3 Francisco claims that the analysis provided by Hewitt Associates
4 does not adequately describe how the other management retention
5 programs it considered are comparable.

6 The UST argues that the declarations of Messrs. Gordon and
7 Jackson "might have provided a basis for the relief requested" but
8 that the Motion should be denied because those declarations were
9 not submitted when the Motion was originally filed. It may be
10 that the UST no longer challenges the merits of the management
11 retention program as argued in its initial opposition, but only
12 the procedure by which it has been presented for approval.³

13 The court is not persuaded by these objections. Regardless
14 of the legal standard to be applied, the court does not believe
15 PG&E must show exact parity with other companies, nor does the
16 court view its role as second guessing PG&E's selection of which
17 of its six hundred eighty-two employees should be eligible for its
18 retention program and how much any particular employee should
19 receive. Nor should the court review each individual employee's
20 likelihood of leaving absent a retention bonus that is some
21 percentage greater or less than what Hewitt Associates recommended
22 and PG&E seeks to implement. That degree of scrutiny is uncalled
23 for under the Club Development and Regensteiner cases and would be

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25 ³ To the extent the UST does express any judgment on the
26 merits of the management retention program, the court disagrees
27 with San Francisco's view that such judgment is entitled to any
28 deference. The UST is acting as a litigant taking a position as
authorized by Section 307, rather than performing a regulatory or
supervisory function such as appointment of a committee under
Section 1102.

1 impracticable. In Club Development the estate was being
2 liquidated, the debtor had no ongoing business, it sought to pay
3 salaries to its owners who had never been employees and had never
4 received a salary, and it presented no evidence that the salaries
5 were necessary to accomplish anything for the benefit of its
6 creditors. In Regensteiner the debtor, a commercial printer, had
7 stopped accepting new orders and was only completing existing
8 orders and collecting accounts receivable. The official committee
9 of unsecured creditors in that case objected that the proposed
10 employment contracts only required two more weeks of work, far
11 short of what was needed to collect the accounts receivable. The
12 debtor in Regensteiner presented no evidence at all in support of
13 its program.

14 In contrast, PG&E has presented evidence of widespread
15 concern among managers that they will lose their jobs;⁴ other
16 companies hiring away a number of key managers;⁵ likely harm to the

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19 ⁴ As San Francisco pointed out, much of Mr. Jackson's
20 original declaration was "on information and belief" with no
21 explanation of the basis for his belief. That was insufficient
22 and the court was not prepared to grant PG&E's Motion based on the
23 papers it initially filed. Mr. Jackson's supplemental
24 declaration, however, stated both his personal knowledge (e.g.
25 through "face-to-face discussions, telephone calls and email
26 messages" with employees) and a basis for his knowledge due to his
27 position as Vice President of Human Resources and his regular
28 leadership and staff meetings.

⁵ PG&E presented evidence that in the last few years the
25 heads of four departments voluntarily resigned and accepted
26 executive positions with other companies. Moreover, PG&E has lost
27 a number of other key management employees, employee morale is
28 very low, and external search firms have been active in recruiting
PG&E employees. In the past legally-mandated restructuring has
resulted in job losses, more legally-mandated restructuring is
pending, and PG&E's bankruptcy itself has affected morale.

1 estate if PG&E loses more key employees;⁶ use of an outside
2 consultant to structure a program targeted at key managers across
3 four tiers;⁷ delayed vesting of the retention amounts and
4 incentives tying those potential amounts to benefits for the
5 estate;⁸ retention payments that are consistent with other
6 companies in difficult transitions;⁹ significant shortfalls in
7 managers' targeted compensation last year of 36% and 45% in the
8 top two tiers, respectively;¹⁰ and, for employees in the top tier,
9 initial payments that might roughly compensate for this shortfall,

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12 ⁶ As San Francisco has pointed out, PG&E has not presented
13 evidence that it has already experienced widespread attrition. As
14 PG&E points out, however, it is no good shutting the barn door
15 after the horses have left.

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17 ⁷ PG&E hired Hewitt Associates, and PG&E's evidence is that
18 only about 1/3 of the management employees are eligible: 226 out
19 of 682 management employees.

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21 ⁸ Employees are terminated from the management retention
22 program if they are fired ("termination of employment and
23 ineligible for rehire") or if they retire or voluntarily leave.
24 Top employees in Tier I, at least three of whom can be expected to
25 be heavily involved in a plan of reorganization for PG&E's
26 bankruptcy estate (the "Plan"), forfeit the first 1/3 of their
27 payment if PG&E fails to file a Plan by January 1, 2002, and they
28 will not receive the remaining 2/3 until the court confirms a
Plan. All other managers will not receive the first 1/2 of their
payment until the earlier of either April 8, 2002, or when PG&E
files a Plan (employees with less than two years of credited
service will receive only 1/3 at this time), and they will not
receive the remainder until the earlier of either April 7, 2003,
or when a Plan is confirmed.

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30 ⁹ Hewitt Associates analyzed the retention programs of other
31 companies that were either in Chapter 11 or experiencing periods
32 of significant financial distress. The OCC agreed that the
33 program is typical of those customarily adopted in other complex
34 Chapter 11 cases. The court agrees.

35

36 ¹⁰ PG&E provided evidence that top management employees did
37 not receive a substantial portion of their targeted compensation
38 because inter alia, the employees' stock options are currently
worth nothing in the wake of PG&E's Chapter 11 filing.

1 but that will be forfeited if PG&E does not meet its goal of
2 filing a plan of reorganization by January 1, 2002.¹¹

3 Moreover, evidence submitted by San Francisco reveals that
4 the management retention program was structured and recommended by
5 a committee composed entirely of individuals who are neither
6 current nor former officers or employees of PG&E or its parent,
7 nor consultants to PG&E or its parent. In fact, although Club
8 Development suggests a higher level of scrutiny when a proposed
9 payment will benefit an "officer, director or stockholder," it
10 appears that two hundred twenty of the two hundred twenty-six
11 potential recipients of PG&E's management retention payments are
12 below the level of Senior Vice President, there is no evidence
13 that any eligible participant is a director of PG&E, and there is
14 evidence that all the stock beneficially owned by all directors
15 and executive officers of PG&E and its parent as a group
16 constitutes less than one percent of the outstanding shares.¹² In
17 addition, PG&E sought and obtained approval to award bonuses to
18 key non-management employees, which further reinforces its claim
19 that it has targeted its requested relief to what will actually
20 protect the estate and its creditors.

21 In sum, the court is persuaded that PG&E has taken reasonable
22 steps to structure a program that is necessary to avoid

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24 ¹¹ The court has compared the first installment for
25 individuals in Tier I B i.e., 1/3 of the retention incentive
26 listed in Exhibit 1 to Mr. Jackson's supplemental declaration B
27 with the compensation listed for Tier I employees on page 31 of
28 Exhibit A to the declaration of Irving Sulmeyer in support of San
29 Francisco's objection to the Motion.

¹² See Mr. Jackson's supplemental declaration, Exhibit 1,
and Mr. Sulmeyer's declaration, Exhibit A, page 10.

1 potentially serious harm to the estate from attrition of key
2 management employees. In addition, PG&E has represented on the
3 record and in Mr. Jackson's supplemental declaration that it will
4 not seek reimbursement for the cost of the bonuses through future
5 rate increases. If PG&E ever seeks to do so, the court is
6 confident that parties in interest will point out PG&E's promise.
7 PG&E has met its initial burden.

8 Neither San Francisco, nor the UST, nor any other party in
9 interest has presented any evidence to overcome PG&E's showing or
10 even suggest that PG&E's employees are over-compensated compared
11 to companies in comparable circumstances. Thus, whether looked at
12 solely as a matter of business judgment, or as a "necessary"
13 expense, PG&E has met its burden. In addition, the court notes
14 and rejects an implication underlying some opposition to the
15 Motion: that the employees who will receive bonuses are
16 responsible for California's energy woes and therefore should not
17 receive typical bonuses. That notion is unsupported by any
18 evidence whatsoever. No party has even suggested any facts
19 implicating individual or collective wrongdoing by any PG&E
20 employees. To the contrary, the record contains no evidence that
21 the individuals are deficient in work skills or dedication. The
22 record does establish that they may have legitimate concerns about
23 their jobs, and might, absent the retention program, find more
24 secure and rewarding employment with a company that is not going
25 through difficult times, adverse publicity and bankruptcy. Again,
26 there is simply no evidence to rebut PG&E's showing in favor of
27 its management retention program.

28 For the foregoing reasons, PG&E's Motion is granted and its

1 management retention program is approved.

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3 Dated: July 13, 2001

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DENNIS MONTALI
5 UNITED STATES BANKRUPTCY JUDGE
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