California State Senate

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INFORMATIONAL HEARING

Pacific Gas & Electric (PG&E) Chapter 11 Reorganization Bankruptcy:

Implications for California

State Capitol, Room 3191
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9:30 am

On January 29, 2019, Pacific Gas & Electric Corporation (PG&E Corp.), the holding company of the state's largest utility, voluntarily filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code. PG&E filed their case in the Northern California District Court San Francisco Division (Case No. 19-30088-DM). The case has been assigned to the same judge, Honorable Dennis Montali, who handled the utility's previous reorganization bankruptcy case in connection with the 2001 energy crisis. According to the company's first day filings, in a declaration filed by the company's Senior Vice President and Chief Financial Officer Jason Wells, PG&E's decision to seek relief under chapter 11 "were necessitated by a confluence of factors resulting from the catastrophic and tragic wildfires that occurred in Northern California in 2017 and 2018, and PG&E's potential liabilities arising therefrom." The declaration specifically cites the company's potential liability related to the fires could exceed $30 billion. The company's decision to voluntarily file for bankruptcy protection has raised numerous questions about the process entailed under a chapter 11 reorganization and the potential implications for the numerous stakeholders that could be affected, including wildfire victims, ratepayers, the utility workforce, energy and other suppliers, local governments, and many others. This hearing is an attempt to help answer many of these questions.

About PG&E. PG&E Corporation is an energy-based holding company, headquartered in San Francisco. PG&E Corporation is the parent company of PG&E Company, an investor-owned public utility providing gas and electric service to about two-thirds of California, from Bakersfield to the Oregon border. The utility serves about 16 million customers across a 70,000 square-mile service area in Northern and Central California. PG&E has a workforce of about 24,000 regular employees, 20 of whom are employed by PG&E Corp., 15,000 are covered by collective bargaining agreements with local chapters of three labor unions: the International Brotherhood of Electrical Workers (IBEW), the Engineers and Scientists of California, and the Service Employees International Union. According to the company's bankruptcy filing, as of September 30, 2018, the company had reported approximately $71.4 billion in assets and approximately $51.7 billion in liabilities, and $370 million of cash on hand for the PG&E Corporation and $240 million of cash on hand, net of $250 million of customer deposits, for PG&E Company (the utility). As noted above, this is the company's second Chapter 11 bankruptcy filing in less than twenty years. The previous bankruptcy was filed in 2001 as a reaction to the restructuring of the energy markets towards deregulated markets, authorized by the CPUC and the legislature in 1996, which resulted in an energy crisis involving market manipulation of participants such as Enron.

In PG&E's first day bankruptcy filings, the declaration of the Senior Vice President and CFO Jason Wells cites four principal objectives of the Chapter 11 filings:

- Establish a process for PG&E to fully address and resolve its liabilities resulting from the 2017 and 2018 Northern California wildfires and to provide compensation to those entitled to compensation fairly and expeditiously – more quickly and more equitably than those liabilities could be addressed and resolved in the state court system.
- Restore PG&E's financial stability and assure that PG&E has access to the capital and resources necessary to sustain and support its ongoing operations and to enable PG&E to continue investing in its systems infrastructure and critical safety and wildfire prevention initiatives.
- Work with State regulators and policy makers to address safety and operational and structural reforms, determine the most effective way for PG&E to provide safe and reliable electric and natural gas service to its customers and communities for the long term; and address the significant increase in wildfire risk.

- Enable PG&E to continue its extensive restoration and rebuilding efforts to assist the communities affected by the 2017 and 2018 Northern California wildfires.

Key events leading up to the bankruptcy filing:

Wildfires. As noted above, a number of deadly wildfires spread throughout the state in 2017 and 2018. Beginning on October 8, 2017, several wildfires ignited throughout Northern California and spread quickly largely due to high-speed winds. The affected counties include: Napa, Sonoma, Butte, Humboldt, Mendocino, Lake, Nevada, and Yuba Counties. The 2017 Northern California wildfires resulted in 44 deaths, the largest stemming from the Tubbs Fire, which spread across Sonoma and Napa Counties, inflicting some of the worst damage in communities in and around Santa Rosa. At the time, the Tubbs Fire was the most destructive in state history. CalFire has issued its determination on the causes of 18 of the 2017 Northern California wildfires, with 17 of those fires caused by utility infrastructure coming into contact with trees, or failure of power poles, or utility infrastructure coming into contact with another part of the infrastructure. The Tubbs Fire CalFire investigation found the fire was caused by a private electrical system adjacent to a residential structure not owned by the utility. Based on its first day bankruptcy filings, as of January 11, 2019, PG&E was aware of "approximately 700 complaints on behalf of at least 3,600 plaintiffs related to the Northern California wildfires, five of which seek to be certified as class actions."

On November 8, 2018, a wildfire began near the Town of Paradise in Butte County, which demolished most of the town. According to CalFire, the Camp Fire resulted in 86 fatalities and the destruction of 13,972 residences, 528 commercial structures and 4,293 other buildings. The cause of the Camp Fire remains under investigation. However, just last week, in a fourth quarter earnings report, PG&E acknowledged, based on current information, it believes it is probable its equipment ignited the fire. As a result, PG&E took a $10.5 billion charge related to the 2018 Camp Fire. Based on PG&E's first day filings, as of January 11, 2019, the utility is aware of "approximately 46 complaints on behalf of the at least 2,000 plaintiffs related to the Camp Fire, six of which seek to be certified as class actions." As stated in the first day filings, "the pending litigation for 2017 and 2018 fires against PG&E includes claims under multiple theories of liability, including inverse condemnation trespass, private nuisance and negligence." In addition to these cases, there are at least 41 subrogation complaints filed by insurance companies who have made payments to their insureds for property damage stemming from the 2017 fires.

In its filing, PG&E noted its belief that its potential liability is "exacerbated by the unique doctrine of 'inverse condemnation,' which imposes strict liability on PG&E regardless of whether it was negligent, and by the continuing uncertainty surrounding PG&E's ability to recover costs associated with inverse condemnation." The utility further states that the legislation enacted last year, SB 901 (Dodd, Chapter 626, Statutes of 2018) to address a portion of the liabilities associated with the 2017 wildfires through the issuance of rate recovery bonds does not address the wildfires occurring in 2018. The SB 901 methodology to determine the amount of PG&E's cost recovery related to the 2017 Northern California wildfires would "not occur, if at all," until the utility has paid claims, submitted an application for cost recovery to the CPUC, and the CPUC has made a determination that such costs are just and reasonable or in excess of the disallowance threshold established through the methodology. As such, "PG&E does not expect that it would be permitted to securitize costs relating to the 2017 Northern California wildfires on an expedited or emergency basis."

Credit Ratings Downgraded. With some exceptions, regulated utilities, those who are provided the opportunity to earn a rate of return through rates regulated by the CPUC, generally enjoy high investment grade credit ratings. The investment grade credit ratings allow the utility to access less expensive capital in the market than might otherwise be the case. However, PG&E and other California regulated utilities have seen their credit ratings decline. The utilities began to experience these reduced credits ratings after the 2017 California wildfires. The fires occurred just before a November 2017 CPUC decision to disallow cost recovery in an application filed by San Diego Gas & Electric stemming from costs of damages from three wildfires in 2007 which were ignited by utility infrastructure – the Rice, Guejito, and Witch Fires. Earlier this year, PG&E's credit ratings was further downgraded by the credit ratings agencies to a point characterized as "junk status." Such a downgrade would greatly diminish the utility's ability to access capital, a bedrock of the regulated utility business model. As such, nearly a week after the downgrade, PG&E notified its workforce that it intended to file for Chapter 11 bankruptcy protection on or around January 29, 2019. The notice by the company was in compliance with a provision of SB 901, which required a minimum 15-day notice to the utility workforce of any such action.

San Bruno PG&E Pipeline Explosion. There is continued fallout from the 2010 PG&E San Bruno natural gas pipeline explosion that eviscerated a neighborhood, injured over 50 individuals, and killed eight residents. A National Transportation Safety Board (NTSB) investigation found that PG&E's inadequate maintenance and flawed record keeping led to the disaster in San Bruno. As a result, in April 2015, the CPUC imposed a $1.6 billion penalty on PG&E for causing the explosion, characterized as the largest such punishment ever levied on an American public utility. Additionally, a federal jury convicted PG&E on five charges of violating federal pipeline safety regulations and one charge of obstructing an official NTSB investigation. The federal sentencing issued in January 2017 requires the company to pay a $3 million fine, ordered the company to submit to court-ordered supervision of its natural gas pipelines, and instituted five years of criminal probation. Under the terms of the probation, PG&E must not commit another federal, state, or local crime. The federal case is now under the supervision of federal Judge William Alsup of the United States District Court for the Northern District of California who has taken the utility to task for not doing enough to reduce wildfire risk of its operations. Judge Alsup has also ruled that PG&E violated the terms of its probation by not reporting a potential district attorney's investigation in a timely manner into one of the 2017 Northern California fires ignited by the utility's equipment (Docket Number 0971 3:14CR00175-001 WHA). Judge Alsup has also proposed an order to require the utility to inspect all of its electric lines by June 21, 2019. As of the timing of this hearing, the proposed order is still pending a decision.

CPUC on PG&E Safety Culture. As part of the post-San Bruno pipeline explosion, the CPUC's Safety and Enforcement Division evaluated PG&E's and PG&E Corp.'s organizational culture, governance, policies, practices, and accountability metrics in relation to PG&E's record of operations, including its record of safety incidents. The Safety and Enforcement Division produced a report on the issues with the assistance of an independent consultant, NorthStar Consulting Group. The recommendations that PG&E is ordered to implement include: development of a comprehensive safety strategy, with associated timelines/deliverables, resource requirements and budgets, personnel qualifications, clear delineation of roles and responsibilities; action plans, assignment of responsibility for initiatives; and associated metrics to assess effectiveness. Additionally, the CPUC opened a new phase of the proceeding requiring the safety review of PG&E. CPUC President Picker announced he would open an Order Instituting Rulemaking (OIR) to "examine the corporate governance, structure, and operation of PG&E to determine the best path forward for Northern California to receive safe electrical and natural gas service." The OIR is soliciting comments from the public and stakeholders about changes to PG&E to address the safety culture. As of the timing of this hearing, the OIR remains open.

CPUC Alleges Gas Safety Violations. In December 2018, the California Public Utilities Commission opened a formal investigation into PG&E alleging that the utility may have violated safety standards and falsified gas records. State law requires that utilities must mark underground gas infrastructure before excavators begin digging. The CPUC Safety and Enforcement Division issued a report that claims PG&E lacked staff to complete locator work, and management allegedly pressured staff to file late tickets as completed on time. PG&E might have undercounted tens of thousands of late tickets between 2012 and 2017. As of the timing of this hearing, the investigation remains active.

This hearing intends to provide members of the committee and the public an opportunity to understand what is entailed in a Chapter 11 reorganization bankruptcy process, including its phases, conventions, structures, roles, timeline, and potential implications for California. After opening comments from the Chair and members of the committee, Assistant Professor of Law at UC Hastings College of Law, Jarrod Ellias, will present the overall framework, general timeline, key actions, and roles involved in a Chapter 11 bankruptcy case. Professor Ellias will share the general process involved in a reorganization case, including: how unsecured and secured creditors are treated in the process, as well as, an understanding of the distinctions between pre-petition and post-petition claims. Thereafter, the CPUC staff, specifically the Executive Director Alice Stebbins, General Counsel Arocles Aguilar, and Deputy Executive Director for Energy and Climate Policy Edward Randolph will provide information concerning the state's standing in the bankruptcy process, in particular the CPUC's role in the PG&E bankruptcy case. The CPUC can provide further information about how the Chapter 11 process as it relates to a regulated utility. In this regard, CPUC can also share some insights from the 2001 bankruptcy experience that might be useful as it relates to the recent filing. CPUC staff have also been asked to provide information concerning the implications to gas and electric service and safety, including the safety of the utility's gas, electric, and nuclear assets. Additionally, the CPUC may speak to the recent actions concerning the brewing tension among PG&E and some energy suppliers about the jurisdictional authority of the Federal Energy Regulatory Commission (FERC) and the bankruptcy court related to the ability to alter contracts for energy supply. These issues were prompted by separate filings to FERC by NextEra and Exelon, who have existing energy supply contracts with PG&E, requesting FERC jurisdictional authority to preserve contracts that could be affected by the bankruptcy and PG&E's filing in the bankruptcy court seeking an injunction and stay on FERC jurisdiction.

In order to help members of the committee and public better understand the multitude of issues of the bankruptcy that could affect Californians, the final panel of this hearing will focus on some of the potential implications of the bankruptcy. While not intended as an exhaustive list of all the potential implications of the bankruptcy filing, the panelists include representatives who can speak to issues of concern to wildfire victims, ratepayers/customers of the utility, the utility workforce, local governments, community choice aggregators (CCAs), and energy suppliers who hold existing power purchase agreements (PPAs) with PG&E. Each of these stakeholders have immediate and long-term potential financial implications arising from the bankruptcy.

This committee expects the culmination of witnesses of this hearing will provide members and the public a greater understanding of the Chapter 11 reorganization bankruptcy process and the potential implications to the state and to some key stakeholders. Noticeably not included in the agenda are representatives of PG&E. However, the focus of this hearing is on the process of the bankruptcy case, as well as, to help surface some of the implications for California. The committee does not intend to have this hearing resolve the issues within the bankruptcy process or to have witnesses litigate their claims in this hearing. With this in mind, the committee has chosen to focus comments from other key stakeholders in the process at this time. However, there may come a time in the bankruptcy process whereby hearing directly from PG&E may be useful to this committee.

The committee intends this hearing to answer many of the initial questions raised in response to PG&E's bankruptcy filing, including:

- What is entailed in a Chapter 11 bankruptcy case?
- What is a general timeline and the various phases of the bankruptcy case?
- How are secured and unsecured creditors treated?
- What is involved in the process to adopt a reorganization plan in the bankruptcy process?
- What standing does the state have in the bankruptcy case vis-à-vis the CPUC? Other state agencies?
- What are some important lessons from the 2001 PG&E bankruptcy case that might be useful in this bankruptcy case?
- How is gas and electric service affected by the bankruptcy filing?
- How are PG&E's safety responsibilities (gas, electric, nuclear) affected by the bankruptcy filing?

- How might other regulatory and statutory requirements of the utility be affected by the bankruptcy, such as clean energy policy?
- While not intended as an exhaustive list and recognizing there are other stakeholders affected, what are the potential immediate and longer-term implications of the bankruptcy to:
  - wildfire victims' claims?
  - ratepayers?
  - the utility workforce?
  - local governments?
  - CCAs?
  - energy suppliers?