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Bailout doubt – PG&E faces bankruptcy amid California's 'first climate change-caused emergency'

Stakeholders say few will benefit from bankruptcy, but alternatives have been dubbed "politically too hot to touch."

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Barring a deal brokered by the new California governor, Pacific Gas and Electric (PG&E), the state's biggest electricity provider, will file for bankruptcy at the end of January.

However, the state and the utility are examining other options in their limited time frame. PG&E wants lawmakers to authorize a financial tool called securitization to raise capital. But many equate that to a bailout for a company they say should not be saved without complete corporate restructuring, considering its safety record.

PG&E's preliminary filing said bankruptcy is "the only viable option" after its stock value and credit rating plummeted.

The utility's Jan. 14 Securities and Exchange Commission (SEC) filing was a formality required by California law in advance of a bankruptcy declaration. Settlement talks are ongoing among the utility, wildfire victims, insurers, ratepayer advocates, power sector stakeholders and lawmakers, including just-inaugurated Gov. Gavin Newsom.

"No decisions have been made," Newsom told a press conference hours after the utility's SEC filing, but the matter is a "top priority." The challenge is protecting power system "safety, reliability and affordability" for almost half the state's total utility customers in a region particularly vulnerable to wildfires, he added.

PG&E's controversial history of safety violations and the rapidly rising costs from the past two years of wildfires seem to make bankruptcy difficult to avoid, stakeholders told Utility Dive. But it is unlikely to greatly benefit any of the involved parties.

Bankruptcy makes victims' claims subordinate to other utility obligations and is a gamble for PG&E because a bankruptcy court could judge the company harshly, McCallum Group President Patrick McCallum told Utility Dive. McCallum, who barely survived the 2017 Wine Country wildfire, leads a coalition of victims' groups, and is participating in the current settlement talks.

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He argued a settlement now would be the best choice because it "would address compensation, calm the markets, allow some utility borrowing and avoid the unknowns." By contrast, victim compensation could take years and a federal court might allow takeover or dismiss the utility's Board, he said.

But a settlement would require stakeholders and victims to trust PG&E enough to accept its commitments in a Newsom-brokered settlement.

State Senator Jerry Hill, whose district includes the San Bruno neighborhood devastated by a 2010 natural gas pipeline explosion for which PG&E was found criminally negligent, does not think PG&E will negotiate in good faith. "They might commit to working with us and then change direction and file for bankruptcy," he told Utility Dive.

A settlement also would not address the bigger challenge of climate change, Center for Energy Efficiency and Renewable Technologies Executive Director V. John White told Utility Dive. "The wildfire threat has to be treated as California's first climate change-caused emergency, or losses on this scale will keep happening, quite apart from what happens to PG&E."

PG&E's Financials

The 2018 Camp Fire was the deadliest and most destructive in California history. It destroyed 18,661 structures and killed 86 people. When it started on Nov. 8, PG&E's stock price was $47.80. A day after the utility filed for bankruptcy, it was $6.19.

All PG&E "costs, expenses and other losses" through December 2018 for the 2017 and 2018 wildfires "could exceed $30 billion," its SEC filing reported.

"[P]otential punitive damages, fines and penalties or damages related to future claims" not included in the $30 billion estimate could make the utility's liability "substantially greater," the filing added. Including some of those unattributed liabilities, it could be among the 10 biggest bankruptcies in the U.S. PG&E's insurance coverage is approximately $2.24 billion, and it expects "increasing difficulty securing liability insurance."

The utility's available "cash and cash equivalents" totaled just over $1.5 billion in early January, the utility reported. With its credit rating "below investment grade," and severely limited capital at the beginning of 2019, it has been unable to meet financial obligations and is "exposed to significant constraints on its customary trade credit."

Securitization

PG&E's bankruptcy is not unprecedented. In April 2001, it "made a business decision to cut off serious negotiations" over California energy crisis losses and "go to court," according to a statement from then California Public Utilities Commission (CPUC) President Loretta Lynch. The utility emerged from a 2003 settlement agreement, with securitized assets, temporarily restricted returns and significant forfeitures.

Securitization allowed PG&E to meet its 2001 obligations with asset-secured low interest loans. As a financial strategy outside utility regulation, it requires legislative approval. California lawmakers last year approved securitization for 2017 utility liabilities as a part of Senate Bill 901, a package of measures to address wildfires.

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> *President, McCallum Group*

PG&E is seeking support for securitizing its 2018 liabilities in the current settlement talks, California State Association of Counties (CSAC) Policy Director Darby Kernan told Utility Dive. CSAC represents members who were wildfire victims.

PG&E "seems to be leveraging negotiations to get securitization," McCallum added. Though he is not confident PG&E is negotiating in good faith, an agreement "could provide some amount of securitization," he said.

A settlement is still possible and securitization could be included, International Brotherhood of Electrical Workers (IBEW) 1245 Assistant Business Manager Hunter Stern told Utility Dive. IBEW members are a significant part of PG&E's workforce.

Financial distress is driving the bankruptcy, Stern said. But the market might renew its investing confidence in PG&E if there were strong enough indications that the utility, its regulators and the governor "are working effectively toward solutions and are optimistic about finding them."

Legislation from Assemblyman Chris Holden would have extended securitization to 2018 utility liabilities, but will not move forward because "the playing field seems to have shifted to the courts," a spokesperson for Holden, Garo Manjikian, told Utility Dive. The legislature may, however, "weigh in, through the CPUC."

Credibility issues

Reasons for mistrust of PG&E are substantial. In December, U.S. District Court Judge William Alsup cited PG&E's "history of falsification of inspection reports" in an order requiring rigorous re-inspection and hardening of its system.

Days later, the CPUC launched and investigation and found "PG&E has had serious safety problems with both its natural gas and electric operations in recent years." Based on an independent analysis of the utility's safety practices, the commission said it would consider restructuring the corporation to ensure "safe energy service."

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> *Former CPUC Commissioner*

"It is fair to say PG&E has credibility problems," Independent Energy Producers Association Executive Director Jan Smutny-Jones told Utility Dive. Bankruptcy will benefit PG&E because the court rehabilitates it financially, he recalled from his work in PG&E's 2001 bankruptcy proceedings. "But it only benefits by surviving, not by making money."

In November, "many stakeholders and lawmakers would have supported the Holden proposal to extend securitization," former CPUC Commissioner Mike Florio, a consumer advocate in the 2001 bankruptcy proceeding, told Utility Dive. "But sentiment has shifted dramatically, and securitization is now seen as a bailout too politically hot to touch."

Because bankruptcy puts settlement with investors first, it could benefit PG&E's major shareholders, Florio said, while also allowing the utility to avoid "juries across California that might prefer hanging PG&E."

A huge disruption

Another bankruptcy "would be really unfortunate," Florio said. But alternatives seem politically untenable. "Even Democratic legislators supported by labor, which would like to avoid a PG&E bankruptcy, can't support something seen as a PG&E bailout."

Bankruptcy is "a huge disruption" and "everybody is worse off afterward," he said, adding that the move could delay victim compensation, increase ratepayer costs and cause executives to leave PG&E "who could help stabilize it."

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> *Assistant Business Manager, International Brotherhood of Electrical Workers*

Accomplishing the court-ordered system hardening is also now in doubt, Florio said. Bankruptcy will delay whatever potential there might have been for a "cash infusion" from securitization or the return of investors that might have allowed it to "do what is necessary to prevent wildfires in 2019."

Hundreds of electrical workers have been inspecting and upgrading PG&E's lines since before the grid-hardening ruling, Stern said. "Inspections can be completed ahead of the 2019 wildfire threat, but completing upgrades depends on funding."

The state has leverage over final bankruptcy agreement on meeting PG&E's obligations, Senator Hill said. CPUC oversight of the regulated utility requires its acceptance of whatever agreement would come in a bankruptcy proceeding and the legislature has authority over the commission.

Bankruptcy will delay important work, "but you can't trust PG&E" because it might accept terms of an agreement not to enter bankruptcy that would bail it out financially and then declare bankruptcy to get something more, he said. "We have to shift the Board's emphasis to safety and deal with the threat to California's work on climate and renewables."

Emissions-free uncertainty

The potential bankruptcy adds "enormous uncertainty" to California's efforts to meet the state's 100% emissions-free by 2045 goal, Florio said. And it puts PG&E's investments in new technologies and contracts with renewable and conventional project developers "in limbo."

PG&E's contracts present a unique problem. As California's biggest utility, it has been central in meeting the state's renewables mandates for two decades. But it now owns a lot of older, above-market priced power purchase agreements (PPAs).

"It has over 400 contracts with various third parties, including independent power producers, and over 250 of those contracts, representing over 7,000 MW, are for mandated renewables," Smutny-Jones said. "In the 2001 bankruptcy, the utility honored its contracts, but this time, claims exceed its cash and, until the bankruptcy is settled, there is uncertainty."

Market reaction to that uncertainty includes a devaluation of stock prices for "yieldcos" that hold those renewables, according to 24/7 Wall Street.

"It is clear the electricity system was involved in almost all the big fires and the markets are saying this is too much risk," Stanford University Climate and Energy Policy Program Director and CPUC consultant Michael Wara told Utility Dive.

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> *Co-Director for Climate and Clean Energy, NRDC*

Wind, solar, geothermal and biomass developers' advocacy groups wrote to Newsom January 15, asking him for "immediate assurance" that PG&E's contracts "will be protected" worried about compromising the state's climate and renewables progress.

Other stakeholders have proposed ways to make bankruptcy better.

Better ideas

"PG&E is the first to fall, but this story will be repeated as long as California effectively forces utilities to own wildfire liability without any showing of negligence or unreasonable conduct," Natural Resources Defense Council (NRDC) Co-Director for Climate and Clean Energy Ralph Cavanagh told Utility Dive.

The threat of wildfires imposed by climate change must be addressed, Cavanagh, who represented NRDC in the first PG&E bankruptcy proceeding, acknowledged. But California lawmakers must reform laws that require no proof of malfeasance to impose the cost of wildfires on utility customers.

"Historic grievances against PG&E miss the point," he said. "Strict liability laws create a bankruptcy trap because any company facing the legal and financial jeopardy they impose would do what PG&E is doing."

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But the "too hot to touch" politics of liability reform makes most lawmakers more willing to consider a public fund to cover the cost of wildfire prevention, mitigation and damages, stakeholders agreed. White suggested a climate disaster mitigation fund from fees on fossil fuel emitters. Senator Hill proposed the state's asbestos fund as a model.

"A fund will not be popular politically," White acknowledged. "But we need to think about bigger steps than just managing a bankruptcy."

The interests of ratepayers, wildfire victims and the markets are now aligned on the message that the 2017 and 2018 California wildfires are totally unacceptable and "that is a huge opportunity" to take on wildfire prevention, Wara said.

To take advantage of it, mandate de-energization of power lines during high wind events "so dry debris isn't flying around hot wires," he said. And provide funding for all customers in high wildfire risk areas "to obtain solar-plus-storage systems to power themselves when the electricity is turned off."

Addressing PG&E's liabilities through securitization, in or out of bankruptcy. then becomes more viable, Wara added. "It will raise rates, but it will be a problem in the rearview mirror instead of an ongoing cost of doing business, which is where we are now."