Rising from the Ashes: How PG&E's Bankruptcy Threatens the Energy Sector and California's Progress on Climate Change

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Energy

With potential liabilities in excess of $30 billion stemming from a series of deadly wildfires that ignited across Northern California in 2017 and 2018, Pacific Gas and Electric Company and its holding company PG&E Corp. (PG&E) filed for Chapter 11 relief in the United States Bankruptcy Court for the Northern District of California on Tuesday.

The filing triggers a complex, multi-forum struggle among creditors, energy providers, and many other diverse stakeholders. The impact of the restructuring process will be far reaching, jeopardizing compensation to wildfire victims, the state's implementation of its ambitious climate and renewable energy policies, and the ultimate future of the utility as a partner in those efforts.

2017 and 2018 Northern California Wildfire Liabilities

Although California has always experienced wildfires, due to the trifecta of climate change-induced drought and excessive heat, poor forest health caused by bark beetle infestation, and increasing encroachment of development into the urban wildland interface, the past two fire seasons have been the most calamitous in California's history.

PG&E's significant liability exposure for wildfire damages is rooted in the California constitutional doctrine of inverse condemnation, which subjects privately-owned public utilities to strict liability when their equipment is a substantial cause of a plaintiff's damages.[1] Investigations by the California Department of Forestry and Fire Protection (Cal Fire) into the 2017 Northern California wildfires implicated PG&E equipment as the cause with respect to a majority of the fires, although Cal Fire recently concluded that PG&E equipment was not the cause of the most destructive of them, the Tubbs Fire.

And while Cal Fire has yet to determine the cause of the devastating 2018 Camp Fire, which wiped most of the town of Paradise off the map, according to PG&E's own Form 8-K filing, utility equipment in the vicinity of the ignition point experienced problems shortly before the fire began

[1] *See* Cal. Const., art. I, § 19; *Barham v. Southern Cal. Edison Co.*, 74 Cal. App. 4th 744, 753 (1999) (holding that privately-owned electric utility is public entity for purposes of inverse condemnation claim).

and damage was observed to a PG&E transmission line later that day. Thus, despite Cal Fire's report on the Tubbs Fire, PG&E continues to face tens of billions of dollars in potential wildfire liability (before accounting for punitive damages, fines, or penalties), while possessing insurance coverage of an order of magnitude less. Coupled with the prospect that the California Public Utilities Commission (CPUC) will ultimately disallow recovery of those costs from the utility's ratepayers, as it has in another case, these risks pushed the utility to the brink.

Stopping short of altering the doctrine of inverse condemnation, the California Legislature enacted Senate Bill (SB) 901 in 2018 due to the then-unprecedented level of damages and costs stemming from the 2017 fires. SB 901 allows for securitization of 2017 liabilities in excess of what the utility can bear and changes the regulatory framework for consideration of whether post-2018 wildfire liabilities should be borne by the utilities' shareholders or ratepayers. SB 901 did not, however, address liability associated with the disastrous 2018 wildfires, which began a few short weeks after it was signed. After the CPUC instituted a rulemaking to implement SB 901 that the utility believed would postpone its ability to securitize costs for the 2017 fires for several years, PG&E concluded that bankruptcy was the only viable option and in the best interests of all stakeholders.

PG&E's bankruptcy filing creates significant uncertainty for wildfire victims: PG&E announced just days before filing that it would stop paying negotiated settlement amounts to victims of the 2015 Butte Fires. Due to the effect of the automatic stay, victims of the 2017 and 2018 fires are now barred from prosecuting their claims against PG&E in state court. As a consequence, regardless of where they are liquidated, the claims of victims of the state's deadliest wildfires are subject to the rules and statutes applicable to creditor recoveries in bankruptcy.

The Risk to Renewable Energy Contracts

Other than the wildfire victims, perhaps no group of stakeholders has received more attention from the Governor's office and Legislature than the renewable energy generators who provide the power needed for PG&E to meet its obligations under the California's Renewables Portfolio Standards (RPS) Program and climate change mandates.

Many of these power purchase agreements (PPAs) are now significantly above market rates, as the price of procuring renewable energy resources has declined precipitously in recent years. At the same time, PG&E has experienced a substantial decline in demand for renewable energy due largely to the departure of its customers to Community Choice Aggregators (CCAs) within its service territory. CCAs are projected to serve a significant and increasing percentage of load within PG&E's service territory in the near future, resulting in a corresponding reduction in PG&E's obligation to procure renewable energy resources to meet the RPS. Although PG&E may still seek to reject many of its renewable energy PPAs or renegotiate them at lower rates under the threat of rejection, PG&E said in its filing with the court that it has not made "any decisions yet regarding whether to assume or reject any PPAs . . . ."[2]

But with some renewable project developers seeing their project's credit downgraded to junk status in the weeks leading up to PG&E's filing, and facing the prospect of contract rejection,

[2] Debtors' Complaint for Declaratory Judgment and Preliminary and Permanent Injunctive Relief at 10, In re PG&E Corporation et al. v. Federal Energy Regulatory Commission, Adversary Proceeding No. 19-03003 (Bankr. N.D. Cal. filed Jan. 29, 2019).

NextEra and Exelon filed petitions with the Federal Energy Regulatory Commission (FERC) in advance of PG&E's Chapter 11 filing, asking FERC to issue an order that its approval must be obtained for any rejection of wholesale PPAs. Only a few days later, FERC granted the requested relief on January 25 and January 28, asserting that it has "concurrent jurisdiction" to review disposition of wholesale contracts and that its "approval is required" for PG&E to reject wholesale PPAs. As FERC acknowledged in its orders, however, the jurisdiction issue is unresolved and has been decided differently by a federal appeals court and two district courts, with one of the district court decisions currently on appeal.

Along with its Chapter 11 filing, PG&E also commenced an adversarial proceeding requesting a declaratory order that the bankruptcy court has exclusive jurisdiction over its rejection of contracts and that it is not required to seek or obtain FERC approval of any rejection of its contracts. PG&E also asked the bankruptcy court to enforce the automatic stay provisions of the bankruptcy law and enjoin FERC from enforcing its orders in the NextEra and Exelon cases. FERC will almost certainly oppose PG&E's filings, as it has done in the First Energy bankruptcy pending in the Sixth Circuit. FERC must file its answer by March 5 in the Adversary Proceeding before the bankruptcy court, and the court has scheduled a status conference on the automatic stay motions for March 26. The resolution of this jurisdictional dispute will have significant implications for renewable energy providers that are party to contracts with PG&E, with the potential for FERC to act as a significant check on PG&E's ability to reject and renegotiate its contracts.

Impacts May Ripple Broadly Across the Energy Sector

Beyond the impacts on renewable energy providers, PG&E's January 29 filing may result in potential financial exposure and disruption for a diverse group of stakeholders, including:

- CAISO market participants, which may be required to fulfill PG&E's share of grid management payments in the event PG&E defaults and its collateral is exhausted.
- CCAs, for which PG&E continues to manage customer billing and transfer of customer payments back to the CCAs, which may face interruptions in cash flow as payments are held up as a result of the bankruptcy filing.
- Electric vehicle charging infrastructure investments, which, while already authorized by the CPUC, may face delays or suspension as the bankruptcy process continues to unfold and other issues and expenditures are prioritized.
- Producers and consumers of energy, who may need to take up the slack and achieve even deeper reductions in their own emissions to keep the state on track towards its climate targets if PG&E should default on its expected share of reductions.

Indeed, the prospect of PG&E halting its heavy investments in energy efficiency, transportation electrification, electric system decarbonization and grid modernization could realistically put the state's attainment of its ambitious climate goals at risk. More broadly, due to California's outsized role in climate change mitigation, the outcome of the Chapter 11 case could realistically influence the progress that other states and subnational jurisdictions are making to address climate change and decarbonize their energy sectors.

Covington has considerable expertise on the intersection of the Federal Power Act and bankruptcy law, as well as other issues that may well arise as a consequence of PG&E's bankruptcy filing, spanning all of the expected forums in which litigation may occur. Our highly experienced team of bankruptcy specialists, FERC lawyers, litigators, CPUC practitioners, and California energy policy advisors are closely monitoring the PG&E bankruptcy.

Outside of FERC and the federal courts, the California legislature, the Governor's office and the CPUC will be important forums and influencers affecting the relationships between PG&E and its many counterparties. Our California-based energy policy team has been deeply involved in wildfire and energy policy efforts in all three of these forums.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Energy practice:

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