Will Bankruptcy Stay Criminal Proceedings For PG&E?

Pacific Gas and Electric Co.'s announcement that it intends to file a Chapter 11 bankruptcy in the Northern District of California on Jan. 29 elicited many comments about PG&E's horrible safety record. PG&E manages 100,000 miles of power lines and transmission towers. Sixteen million residents and businesses rely on PG&E for power.

Entering bankruptcy, PG&E faces a potential $30 billion in liability from deadly wildfires and ongoing investigations by regulators and lawmakers into its management, safety practices and corporate structure. PG&E also faces changes to its criminal probation that may require implementing extensive and expensive safety and inspection procedures. With regulators requiring, and the U.S. District Court potentially ordering, implementation of extensive inspection and safety procedures, PG&E is likely to face significant costs in connection with safe delivery of power.

California Public Utilities Commission November 2018 Meeting

The California Public Utilities Commission, or CPUC, is one of PG&E's primary state regulators. In November 2018 at a public meeting Michael Picker, president of the CPUC, stated that the CPUC is working diligently to investigate the Camp Fire and to determine whether PG&E's equipment may have been involved in setting off fire in violation of state regulations.

At the same meeting, the CPUC approved North Star Consulting Group's assessment of PG&E's safety culture (the "North Star report") and ordered PG&E to implement North Star's 61 recommendations. Many of the recommendations directly address the need for PG&E to develop and implement a comprehensive safety strategy with associated timelines, resource requirements and budgets. The North Star report is part of the CPUC's ongoing investigation of PG&E's organizational culture and governance, ability to prioritize safety and deployment of adequate resources to promote accountability necessary to achieve safety goals. North Star stated in its summary:

> While PG&E is committed to safety and efforts have been made to reduce incidents and increase the organizational focus on safety, these efforts have been somewhat reactionary – driven by immediate needs and an understandable sense of urgency, rather than a comprehensive enterprise-wide approach to addressing safety.[1]

Picker announced that he planned to open a new phase in the investigation to determine the best path forward. Picker noted the CPUC's path could include a different organizational model to ensure safe and reliable gas and electric service. Picker also noted the CPUC was not the sole authority and that the California legislature, governor's office and other state agencies would be involved. Picker was widely reported as describing the process as

> ...a little bit like remodeling an airplane in midflight. We can't just crash the plane to make it safer, we need to keep flying.

It is not clear how much it will cost PG&E to implement North Star's 61 recommendations and whether PG&E has even started the process. What is clear is that the CPUC, the California legislature, the governor's office and other state agencies are focused on the need for PG&E to implement safety requirements quickly. Creditors can expect the timing to be driven by California's fast approaching 2019 wildfire season, which has been defined as June 21, 2019, through the first region-wide rainstorm in November or December.

PG&E's Criminal Conviction for Willful Safety Violations in Northern District of California

In August 2016, a federal jury convicted PG&E on six felony counts of knowingly and willfully violating safety standards and obstructing an investigation by the National Transportation Safety Board arising out of the San Bruno explosion of a PG&E gas pipeline that killed eight and destroyed 38 homes. PG&E's sentence included a $3 million fine, a five-year probation period, independent safety monitoring and 10,000 hours of community service. During the five-year probation period, PG&E was not to commit new crimes.

In December 2018, federal prosecutors asserted in U.S. v. Pacific Gas and Electric Company,[2] that PG&E may have violated a condition of its probation.

PG&E admitted, in response to a series of wildfire-related questions from U.S. District Judge William Alsup, that it could have violated the terms of its probation, if it recklessly maintained power lines in a way that caused the devastating Camp Fire in Butte County and a number of 2017 fires, including the Tubbs Fire. PG&E has disclosed publicly and to its regulators two separate instances where its equipment malfunctioned in the Camp Fire area.

1 North Star Report at I-1.

2 U.S. v. Pacific Gas and Electric Company, Case No. CR 14-0175 WHA.

On Jan. 9, 2019, Judge Alsup entered an order to show cause why PG&E's probation should not be modified, noting that the California Department of Forestry and Fire Protection, or Cal Fire, has determined that PG&E caused 18 wildfires in 2017, 12 of which Cal Fire referred for criminal prosecution and that Cal Fire is continuing its investigation into the 2018 Camp Fire in Butte County where 86 people lost their lives.

The court's proposed modifications include:

(1) In light of PG&E's history of falsification of inspection reports, PG&E shall, between now and the 2019 wildfire season, re-inspect all of its electrical grid…

(2) For each segment of its electrical grid, PG&E shall document the foregoing inspections and work done and shall rate each segment's safety under various wind conditions…

(3) At all times during the 2019 wildfire season (and thereafter), PG&E may supply electricity only through parts of its electrical grid it has determined to be safe under the wind conditions then prevailing. Conversely, PG&E must de-energize any part of its grid not yet rated safe by PG&E for the wind conditions then prevailing until those conditions subside…[3]

The court also proposed that the appointed monitor promptly spot-check PG&E's compliance and provide a monthly report to the court that plainly and promptly identifies any weaknesses in PG&E's compliance. PG&E is to immediately notify the probation office and the monitor of any violations.

The court ordered PG&E and the government to transmit a copy of the order to the CPUC noting:

> If the CPUC (or the California legislature) comes up with a better plan for insuring the safety of California before the 2019 wildfire season, the court will consider conforming its proposed conditions to any such plan.[4]

PG&E and the government were further ordered to transmit a copy of the order to Cal Fire with the court requesting

> [I]nput from Cal Fire concerning its investigation into the specifics of wildfires caused by PG&E and on what operating restrictions going forward might be adopted by the court as a condition of probation to maximize the safety of California.[5]

The CPUC and Cal Fire were invited to comment by Jan. 25 and to attend the Jan. 30 hearing on the order to show cause. PG&E's decision to file its Chapter 11 proceeding on Jan. 29 will likely prevent the Jan. 30 order to show cause hearing from proceeding on Jan. 30 and will delay a final order from Judge Alsup regarding safety procedures required under PG&E's probation.

3 Order To Show Cause Why PG&E's Conditions of Probation Should Not Be Modified ("OSC"), Dkt 961, 2:1-27 and 3:1-14.

4 Id., 4:5-7.

5 Id., 4:10-12.

While the Jan. 30 order to show cause hearing may be delayed, the delay is likely to be temporary. The hearing can be expected to proceed, likely after consultation and input from PG&E's regulators, because the U.S. Department of Justice is exercising police powers to protect the public by requiring PG&E to safely deliver power. Under Bankruptcy Code Section 362(b)(4), the filing of a bankruptcy does not operate as a stay "of the commencement or continuation of an action or proceeding by a governmental unit … to enforce such governmental unit's or organization's police and regulatory power." This power clearly extends to public safety proceedings and a change of PG&E's terms of probation.

PG&E and United States Respond

On Jan. 23, PG&E and the United States filed their responses to the proposed modifications in the order to show cause. PG&E's comprehensive response captures the complexity of the PG&E's regulatory environment stating:

> The proposed modifications involve a host of policy decisions about how to address safety, reliability and cost, and in particular, how to do so against the backdrop of both drastic climate change and a complex state and federal regulatory framework that requires the delivery of electricity to everyone in California through an interconnection grid.[6]

PG&E states that it would need more than 650,000 full-time employees to implement the proposed modifications and the cost of full compliance would run between $75 to $150 billion. PG&E unequivocally states that it does not have the ability to raise this amount of money.

PG&E and the United States seem to agree that it would be appropriate for the monitor to have a more active role in reviewing and monitoring the progress of PG&E's wildfire mitigation work and reporting back to the court on a periodic basis. In its response, the United States asserts:

> Because of the complexity of the regulatory scheme involved in electric transmission and distribution lines, the government recommends that the court request that the monitor review and evaluate the proposed probation conditions.
>
> The monitor is in a unique position to perform this work.
>
> If the monitor believes new probation conditions are appropriate, then the monitor can draft these conditions after consulting with the federal and state regulatory agencies, and thereby ensure that they are properly tailored to remedy the specific harm without conflicting with existing regulations.[7]

The responses from PG&E and the United States are clear and unequivocal regarding PG&E's complex regulatory environment and the need for efficient coordination between regulators. Orders from PG&E's regulators and the potential change in PG&E's probation requiring PG&E to implement safety policies and procedures may be delayed while the bankruptcy court determines that exercise of power by the Department of Justice and the CPUC constitute the proper exercise of police power.

6 PG&E Response to Order to Show Cause, Dkt. 976 at 2:6-10.

7 United States Response to Order to Show Cause, Dkt. 975 at 5:8-11 and 21-24.

Ultimately, implementation of required safety measures will not be stayed. PG&E and its creditors can expect the CPUC, Cal Fire, the California legislature, the governor and other state and federal agencies, including Federal Energy Regulatory Commission and the Department of Justice, to be involved actively in PG&E's bankruptcy, in order to collectively manage and regulate the risks of California's 2019 wildfire season.

It is extraordinary that PG&E faces potential criminal charges for recklessly maintaining power lines, while delivering power while on probation for criminal convictions for knowingly and willfully violating safety standards and obstructing an investigation by the National Transportation Safety Board. PG&E is alleged to have violated its probation in connection with multiple fires – at a minimum of 12 2017 fires that Cal Fire has referred for criminal investigation. As noted above, Cal Fire has not completed its investigation into the 2018 Camp Fire. PG&E, however, has disclosed at least two instances where its equipment malfunctioned near the Camp Fire.

The disturbing breadth and depth of PG&E's historical safety failures provide the basis for the actions of the Department of Justice, Judge Alsup, the CPUC, Cal Fire, the legislature and other regulators. Compliance costs will need to be budgeted and included in PG&E's cash flow, a point the North Star report also makes. The CPUC has ordered PG&E to implement the 61 findings set forth in the North Star Report, in addition to stating it is expanding its investigation. PG&E does not appear to have disclosed estimates for implementing the findings set forth in the North Star report.

PG&E, its regulators and creditors will need to find a way to reach agreement on necessary safety policies, procedures and actions and how to pay for them. Otherwise, as noted by Judge Alsup, there will be service interruptions as PG&E will not be able to deliver power to areas that have not been rated safe for prevailing wind conditions.

Determining the scope of PG&E's safety inspection and remediation program will be a significant part of PG&E's bankruptcy process. PG&E is subject to a complex regulatory scheme which requires coordination and cooperation between PG&E and its regulators. In addition to determining what safety policies, procedures and actions are necessary, PG&E, its regulators and creditors and interest holders will need to reach agreement or obtain orders regarding compliance costs and the inclusion of those compliance costs in PG&E's operating budget. It is without question that safe delivery of power and navigating the regulatory system will be a central and ongoing component of PG&E's bankruptcy case.

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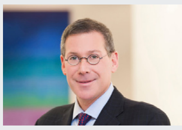

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