Restructuring in the Rearview Mirror – a 10-Year Retrospective of California's Doomed Experiment with Electric Deregulation. By The Energy Overseer
Courtroom 22 Coverage of the PG&E Bankruptcy

California Sovereign Immunity Claim Puts PG&E in a Corner

Judge Dennis Montali is not one to rush to judgment on a sticky matter of whether the California Public Utilities Commission's claim of sovereign immunity from bankruptcy court jurisdiction completely overrides Pacific Gas & Electric's Chapter 11 reorganization effort. After nearly three hours of oral argument, heavily laced with questions from the bench, Montali on May 14 declined to immediately rule on PG&E's motion to enjoin a CPUC accounting order that could extend the utility's retail rate freeze to the statutory limit. PG&E fears the CPUC ruling will prevent it from recouping billions of dollars in rate "undercollections."

Those looking for a clear sign of Montali's intentions may have been disappointed by how carefully he straddled the fence on whether CPUC immunity trumps all of PG&E's claimed exceptions. "This is an important and complex matter, and I'm not going to do it today," Montali said. The ruling "will be issued when I'm ready to issue it."

However, the tide of argument seemed to turn in the commission's favor when state attorneys pointed out an error in the judge's reading of the bankruptcy code and closed off one potential avenue for asserting court jurisdiction over the regulators. "I must have an out-of-date copy of the code," Montali quipped, but from that point on his questions to CPUC attorney Walter Reiman were discernibly less pointed.

After the hearing, the judge praised both sides for "well-presented, thoroughly researched" briefs and arguments. "It's a delight to have such high-quality lawyering," Montali said.

In what was at times an arcane jousting of legal citations and code sections, PG&E attempted to win an injunction against parts of the CPUC's March 27 rate order, which accepted an accounting proposal from The Utility Reform Network. The ruling, frequently referred to as the "TURN accounting," requires the utility to recalculate various transition cost balancing accounts back to January 1998. PG&E claims the order would harm its estate by diminishing utility revenues--both an $8.9 billion undercollection that accumulated from May 2000 through March 2001 and an estimated $4 billion the utility said that it stands to lose going forward.

Under CPUC rules, outstanding undercollections may not be recouped after the rate freeze ends. PG&E believes it satisfied the conditions for ending the freeze last summer, before the undercollections mounted, but if the freeze extends through next year, it may never get the chance to make up its losses. If the rate freeze ended last May, however, ratepayers would by law be liable for the high power prices.

PG&E's attorney Jerome Falk did not dwell on the past undercollection issue, noting that the CPUC in its filings appeared to agree that was a matter to be decided as part of PG&E's continuing legal challenges to CPUC orders under the federal "filed rate doctrine" case. (Ed. Note: the utility's suit was recently dismissed from federal court as not being ripe).

"The commission recognizes that whatever rights the debtor has under federal law cannot be voided at the state level," attorney Reiman concurred.

Exactly what the CPUC meant by its statement was unclear--Judge Montali seemed to see one big pot of money and no real distinction in legal principles governing their disposition--but at least it resulted in focusing the argument on the impacts of the agency's ruling on future rate collections rather than the dispute over past undercollections.

The hearing was not about the merits of the CPUC order but about what the bankruptcy code says about jurisdiction and the preservation of a debtor's estate for eventual reorganization. PG&E claims that the law's automatic stay on actions against a debtor in possession should apply to the CPUC's accounting order.

The CPUC, however, asserts broad immunity from any injunction imposed by the court and cited the 11th Amendment of the US Constitution as well as a host of court rulings upholding states' rights. While California claimed that its sovereignty preempts all of the utility's arguments about possible exceptions in the bankruptcy law, the judge called that "circular" logic that would prevent him from discussing the utility's arguments or even ruling for the agency on the merits of the motions.

Still, PG&E's last recourse was to prove that the CPUC was engaged in an "ongoing violation of federal law"--thus allowing the court to intercede. The utility argued that the continuation of the rate freeze that necessarily results from the TURN accounting will make it impossible for the utility to successfully reach a plan of reorganization. That violates federal law by threatening the estate. "The bankruptcy court has the power to enjoin acts taken by a state regulatory commission [in order to] preserve its ability to reorganize the debtor," Falk said. "TURN could push PG&E past Chapter 11 into liquidation. It's a real concern."

Montali was sympathetic but skeptical. "If this was a bank or something other than a sovereign entity, I'd have to agree with you. But the argument is that I have to find an ongoing violation of federal law."

The CPUC attorney denied that an exercise of CPUC ratemaking authority, done before PG&E filed for Chapter 11 protection, should be considered a violation of law. "I don't see how anyone can argue this is not an exercise of regulatory powers. This is classic ratemaking in its purest form," Reiman concluded.

Following the hearing, CPUC general counsel Gary Cohen remarked to reporters, "There is no property right at all. All PG&E could point to was a hope and expectation" of rate recovery.

Cohen also rejected reporters' suggestions that if Montali rules for PG&E, it will necessarily lead to higher utility rates. "The judge is not being asked to raise rates," he responded. Even if a reorganization plan included a recommendation of higher rates, they would have to be approved by the CPUC, he said.n"We don't want or expect that everything we do needs approval in bankruptcy court."

Nonetheless, Cohen expects similar issues to arise, and how Judge Montali rules in this case "could be an indicator of how we're going to proceed from now on" **[Arthur O'Donnell].**

CEO Glynn Defends Bankruptcy Strategy to Shareholders

Bob Glynn, chief executive officer of PG&E Corporation and Pacific Gas & Electric Company, stood before company shareholders during their concurrent annual meetings in San Francisco May 16, explaining the utility's decision to seek Chapter 11 bankruptcy protection and projected a brighter future for the troubled company. "Chapter 11 is not a destination," Glynn said. "It's a portal through which we're moving to restore PG&E to full economic health."

Glynn said that the decision was forced by the continuing losses on power purchases, which reached $9 billion by April and were growing by $300 million each month. He also blamed the California Public Utilities Commission for issuing a series of decisions that "economically disadvantaged" the utility and said "talks with Governor Davis were going nowhere."

When challenged by a shareholder on the decision, Glynn responded, "We never thought and don't think now that going into Chapter 11 was a great idea. But we were faced with these forces and it just looked worse and worse" with each passing day. He pinned the problem on state regulators refusing to allow full recovery of wholesale power costs, an action PG&E alleges is a violation of federal law.

Though he said that PG&E does not want to sell either its transmission lines or its hydroelectric system, he would agree to do so if it was in the best interests of shareholders. "We are not seeking a rescue, a handout or a bailout from the state or anyone else. We're simply asking the state to follow the law."

There were a few seams showing in the tightly scripted annual meeting presentation, as questions from the audience repeatedly turned to the energy crisis and PG&E management's responsibility for suspended dividend payments, decimated stock prices and the bankruptcy filing.

Most of those on hand, representing a tiny fraction of the nearly 350 million shares of PG&E Corp. stock, appeared to extend their support to Glynn and the board of directors. Nonetheless, there were plenty of grumblings about management compensation programs, shareholder voting rights and the continuing contracts with Deloitte & Touche LLP as both a $3 million per year auditor and an $11 million per year consultant.

Investor Jane Kennedy confronted Glynn, "It seems to me we're in a disaster and the people in policy are getting more money. This worries me about the future of the company." Nick Rossi, a perennial sponsor of shareholder rights motions and critic of the further dilution of share values caused by long-term incentive programs, chimed in, "You're giving away the store."

Some shareholders recognized that management is also taking a financial hit through the lost value of their stocks and incentives. The mixed feelings were voiced by one elderly shareholder: "I think you're doing a great job and deserve everything you get."

It would not be a PG&E meeting without protestors--including a small group of consumer activists who won entry by carrying proxies for investors.

June Brashares of the group Global Exchange called for the company's board to fire Glynn and other managers for "gross mismanagement." She claimed to represent "angry shareholders and irate consumers" who believe that PG&E has not done enough to stop price gouging by power suppliers. "Global Exchange is investigating legal action on the company's behalf through a shareholder derivative lawsuit." The group also urged PG&E Corp. "to be accountable to the public by assuming the debt of its subsidiary."

Brashares and a few other activists, including Medea Benjamin of Global Exchange, were ejected from the meeting when Glynn declared an end to the question period to record votes on various motions. They did not exit quietly.

Not surprisingly, the two boards of directors were affirmed along with the Deloitte & Touche contract and the incentive plan. Shareholder motions were all defeated, except for one questioning a "fair price" anti-takeover policy put into effect last year. Aside from the activists' statements, there was no formal motion to replace Glynn or any of the two companies' senior management teams **[Arthur O'Donnell]**.

These articles originally appeared in California Energy Markets, May 18, 2001.