TAXPAYER-OWNED UTILITIES: RESTORING THE APPROPRIATE BALANCE BETWEEN RISK AND REWARD WITH RESPECT TO INVESTOR-OWNED UTILITY COMPANIES

TIMOTHY NIELSEN

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I. INTRODUCTION

The concept of a public utility company is certainly nothing new. Because of the importance and unique costs associated with developing and maintaining a utility company, there have been several policy judgments made over time with respect to the regulation of the industry. One of the largest, most unique benefits that utility companies enjoy is the ability to operate in a monopolistic form. Over time, it was realized that the economically advantageous features of a utility company made them great vehicles for investors seeking reliable, competitive dividends and modest growth targets. Now, utility company stocks trade on the major exchanges and, as with most publicly traded companies, are managed with an eye toward short term profits.

These investor-owned utility companies ("IOUs") focus on paying higher dividends, maintaining their stock price, and attracting institutional money. One unfortunate side effect of these goals is that governance decisions became riskier, leverage ratios grow, and otherwise free cash ends up being funneled to investors. The consequence for some of these IOUs is being forced to file for bankruptcy.

The results of IOU bankruptcy proceedings have been mixed. Sometimes the reorganization process, rather than fixing the underlying problems, simply serves to shift the debt and liability incurred by the IOUs onto their local communities, rate payers, and taxpayers. Subsidization for unpaid liabilities for wildfire damage, emergency bond issuances, and government bailouts only addressed the short-term problem. More importantly, the protections of Chapter 11 were specifically intended to revive the companies that had played too fast and loose and, in the case of IOUs, potentially set them up to do it again.

Part I of this article provides some background information on investor-owned utilities and concepts underlying the risks and rewards of stock ownership. Part II discusses some of the issues arising in the world of investor-owned utility bankruptcies and seeks to understand some of their potential causes. Part III examines PG&E's general governance prior to their most recent bankruptcy filing and draws parallels between the theoretical issues in Part II and the reality of PG&E's current situation. Part IV proposes a solution, imposing a consequence for failing utility companies that would otherwise be bailed out. When an investor-owned utility becomes insolvent, there should be a forced sale of the business to the state so that it can resume operation as a "taxpayer-owned utility."

II. BACKGROUND

A. Publicly Traded, "Investor-Owned Utility" Companies

Utility companies have long operated as governmentally supported monopolies in the United States. In exchange for some limitations and legislative or administrative oversight of retail rates and expansion, utility providers enjoy a monopolistic market in which they are price makers and have no competitive pressure.[1] Utility companies can have ownership structures which include municipal ownership, closely held owners, disinterested shareholders, or a combination thereof. Of significance in this article are utility companies which are owned by investors and are publicly traded on exchanges.[2] This type of investor-owned utility company has been referred to as an "IOU."[3]

IOUs make up over 5% of the S&P 500 and the utility sector has prompted the existence of several utility-based exchange traded funds. In the fourth quarter of 2018, the utility sector outperformed the S&P 500 by more than 15 percentage points overall.[4] Utility companies are widely held, attractive investments for many investors.

B. Stock Ownership and the Risk of Being a Residual Claimant

Stock ownership is generally considered to be riskier than substitute retail investments like bonds or gold.[5] The potential tradeoff for taking this heightened level of risk is that stock ownership comes with a theoretically unlimited return.[6] This is because, unlike bonds which will pay only a set percentage return, referred to as a coupon payment, stock can pay dividends and appreciate in value as long as the underlying company continues to generate profits and grow.[7]

What makes stock ownership riskier than bonds is the heightened probability of losing your investment. Although it is true that a bond issuer may go out of business, common stockholders are known as "residual claimants" and will be prioritized below any bondholder in a liquidation or reorganization proceeding.[8] Thus, stockholders must face the risk that they will be left holding nothing at the end of the day if a business is managed poorly or even if that business is involved in an accident which imposes substantial liability on the corporation rendering it insolvent.

The decision to hold stock in a company is generally a balanced, risk-adjusted decision for investors.[9] There is the possibility of great return in the form of dividends and capital appreciation.[10] The downside risk is also quite great; the shareholder's status as residual claimant means that a common stock holder is among the bottom of the barrel if things do not work out for the company, and often times, shareholders of commons stock lose their entire investment if the corporation enters bankruptcy.[11] The risk and reward balance of stock ownership is a fundamental

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[1] Tim Worstall, *Which Should We Have: Public Utilities Or Regulated Private Monopolies?*, FORBES (Mar. 24, 2013, 2:33 PM), https://www.forbes.com/sites/timworstall/2013/03/24/which-should-we-have-public-utilities-or-regulated-private-monopolies/#429370ac4263.
[2] Stocks of utility companies trade on either major exchanges or over the counter.
[3] *See* Richard T. Boylan, *Power to the People: Does Ownership Type Influence Electricity Service?*, 59 J. LAW & ECON. 441 (2016).
[4] John Kohli, *In the Know: The Current State of the Utilities Sector*, FRANKLIN TEMPLETON (Jan. 10, 2019), https://us.beyondbullsandbears.com/2019/01/10/in-the-know-the-current-state-of-the-utilities-sector/.
[5] Nick K. Lioudis, *Buying Stocks Instead of Bonds: Pros and Cons*, INVESTOPEDIA (July 5, 2019), https://www.investopedia.com/ask/answers/advantages-and-disadvantages-buying-stocks-instead-of-bonds/.
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] Kate Stalter, *4 Tips for Investors to Balance Risk and Reward*, U.S. NEWS AND WORLD REPORTS (Jan. 30, 2019, 10:24 AM), https://money.usnews.com/money/blogs/the-smarter-mutual-fund-investor/articles/4-tips-for-investors-to-balance-risk-and-reward.
[10] Kevin Voigt & Arielle O'Shea, *What is Stock?*, NERDWALLET.COM (May 10, 2019), https://www.nerdwallet.com/blog/investing/what-is-a-stock/.
[11] *Id.*

presumption which is necessary for incentives to be aligned and to protect shareholders, directors, and customers alike. Sometimes the risks and rewards fall out of alignment.

C. Owning Stock in a Publicly Traded Utility Company

Due to certain implicit public-policy-based decisions, some publicly traded companies act with a certain level of implied support from the government.[12] Banks and large insurance companies have seen this bear out during the recession that followed 2008.[13] Although some shareholders in a few of these companies ended up losing their investments entirely, there was also a substantial effort made by the United States Government to stem the losses.[14] This resulted in the largest bailout of private business to date and several institutions which were on the brink of insolvency were nursed back to health.[15]

Utility companies have operated in a similar fashion in the past.[16] The nature of the service they provide in conjunction with their status as the only game in town has led to state and municipal governments taking substantial efforts to aid them in times of financial duress.[17] The end result is an industry which is operating with a sort of implicit bailout provision provided by the taxpayers.[18] Due to the implicit bailout many investors, institutional and retail, flock to utility stocks as a safe bet for long term growth and reliable dividends.[19]

D. Bankruptcy Overview

Chapter 11 of the US Bankruptcy Code allows a failing business to renegotiate some of its debt and to reorganize into a smaller more solvent operation.[20] One of the primary business benefits of a Chapter 11 reorganization is realized simply because a struggling entity can be reduced to a smaller, leaner, more viable entity.[21] Sometimes, in addition, stronger market participants are able to acquire assets of, portions of, or the entire newly viable entity in the process.[22]

These rights could be of substantial benefit to businesses who have expanded too quickly, taken on too much leverage or are rendered insolvent by a large number of above market contracts.[23] It is also not a reach to infer that some companies may become insolvent due to regulatory, statutory, or other forms of civil liability.

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[12] *See* Worstall, *supra* note 1.
[13] *See* Will Kenton, *Financial Crisis*, INVESTOPEDIA, April 14, 2019.
[14] *See* Deborah Solomon et al., *U.S. to Buy Stakes in Nation's Largest Banks*, THE WALL STREET JOURNAL, October 14, 2008.
[15] Kenton, *supra* note 13.
[16] *See* Timothy P. Duane, *Regulation's Rationale: Learning from the California Energy Crisis*, 19 YALE J. ON REG. 471 (2002).
[17] *Id.*
[18] *See* Shlomit Azgad-Tromer, *Too Important to Fail: Bankruptcy Versus Bailout of Socially Important Non-Financial Institutions*, 7 HARV. BUS. L. REV. 159, 180 (2017).
[19] *See* Wilsonville Capital, *PG&E Corporation Is Undervalued, And Institutional Investors Own 84% Stake*, SEEKING ALPHA, November 20, 2018.
[20] *See generally* 11 U.S.C. §§ 1101–1129 (describing the reorganization process).
[21] John F. Lomax, Jr. *Future Electric Utility Bankruptcies: Are They on the Horizon and What can we learn from Public Service Co. of New Hampshire's Experience?,* 12 BANK DEV. J. 535 (1996).
[22] *Id.*
[23] *Id.*

Ultimately, Chapter 11 reorganization serves a very important role within the business cycle of some companies and the current code has been found to be adequate with respect to balancing the public interest and needs of an investor-owned public utility.

III. BANKRUPTCY IN THE WORLD OF INVESTOR-OWNED UTILITIES

A. Intended Purpose

During a Chapter 11 reorganization, the court can help a company restructure their "business affairs, debts, and assets."[24] This can be a necessary step to avoid the permanent closure of an organization and it is not uncommon for businesses to survive a Chapter 11 bankruptcy. Corporate survival is more than a side effect of a Chapter 11 reorganization, it is the driving force behind it.[25]

The availability of bankruptcy and the right to undergo a Chapter 11 reorganization are important factors which are included in macro-scale modeling.[26] Bankruptcy laws can incentivize risk taking at a macroeconomic level and are a vital component of the risk-reward analysis for investment decisions. The right to reorganize under Chapter 11 typically comes with some high costs as well.[27] In addition to the fees and management costs of a Chapter 11 proceeding, which typically range from 1-5% of a debtor's assets, there are other social and reputational costs.[28]

B. Known Issues with Utility Companies and Chapter 11

There are three primary arguments against the efficacy of Chapter 11 reorganization with respect to a public utility company. The first has to do with the perception that judges and courts may not be able to apply the existing Bankruptcy Code effectively given the public costs at stake; the second criticizes the time it takes to proceed thorough a Chapter 11 reorganization; and, the third articulates the lost value of positive externalities which would be undervalued in a debtor in possession financing or third-party acquisition through Chapter 11.

Although some scholars argue that the United States Bankruptcy Code is "inadequate to deal with the complexities of a utility bankruptcy,"[29] others argue that this "void in the Bankruptcy Code may be more imagined than real."[30] The latter conclusion is based on an argument which analyzed the extent to which the public interest was protected by the court in the bankruptcy proceeding of the Public Service Co. of New Hampshire.[31]

The argument that bankruptcy reorganization is inefficient because it is too time intensive is perceived as a major obstacle to relying on Chapter 11 reorganization when a public utility is insolvent.[32] Although it may be true that debtor in possession rules may not have been developed with the specific goal of maintaining utility service, this does not mean that they cannot serve to

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[24] Maya E. Dollarhide, *What is Chapter 11?*, INVESTOPEDIA, January 17, 2019.
[25] *Id*.
[26] *See* JAVIER SUAREZ & OREN SUSSMAN, FINANCIAL DISTRESS AND THE BUSINESS CYCLE 1 (1999).
[27] Kenneth A. Rosen, *What does Chapter 11 Really Cost?*, BLOOMBERG BNA, Apr. 27, 2016.
[28] *Id.*
[29] Lomax, *supra* note 21, at 556.
[30] Lomax, *supra* note 21, at 581 (quoting Frank P. Darr, *Federal-State Comity in Utility Bankruptcies*, 27 AM. BUS. L.J. 63, 93 (1989)).
[31] Lomax, *supra* note 21, at 581.
[32] Shlomit Azgad-Tromer, *Too Important to Fail: Bankruptcy Versus Bailout of Socially Important Non-Financial Institutions*, 7 HARV. BUS. L. REV. 159, 162–63 (2017).

allow for uninterrupted provision of a public good. Whether being overseen by debtor in possession or by a trustee, there is no reason that a public utility could not continue to provide service during a reorganization.

Finally, the idea that a public utility is only fairly valued when one considers the positive externalities it provides as a socially important institution could mean that investors would lose value during debtor in possession financing or an acquisition because these externalities will likely not be accounted for in the valuation process.[33]

C. Conflict of Laws

Chapter 11 of the United States Code § 1129 provides that a court shall confirm a plan only if every required element is satisfied.[34] One of the requirements is that a plan not "be by any means forbidden by law."[35] Due to this, local governments and administrative agencies historically had a great deal of power when utility companies sought relief under Chapter 11.[36] The Bankruptcy Code currently contemplates the need of utility companies to seek approvals for rate increases and due to the evolution of the law, conflicts in this regard now pose a smaller hurdle.[37]

D. Effects of the Implicit Bailout

i. Distorted Governance

There are three phenomena that can, and do, occur which exemplify the distorted governance practices which creep into investor-owned utilities. The first is elevated risk-taking and overuse of leverage;[38] second is rapid, unwarranted expansion;[39] and the third is irresponsible expenditures which benefit investors.[40]

The implicit "assumption of rescue upon failure" which exists for investor-owned utility companies creates incentives for both increased debt and other, riskier activities.[41] This distortion exists because it is known and understood, by both shareholders and managers, that taxpayers will ultimately be stuck paying the bill if the risks do not pay off.[42] Behavior gets even more risky when executives and managers are compensated with equity or stock options because then, the management is personally incentivized to take risks.[43] Thus, investors, managers and especially managers who are also investors, are all poised to benefit from leverage and high-risk decisions while simultaneously being insulated from the potential downsides.[44]

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[33] *Id.* at 176–77.
[34] 11 U.S.C.S. § 1129 (LEXIS, through Pub. L. No. 116-6).
[35] 11 U.S.C.S. § 1129 (a)(3) (LEXIS, through Pub. L. No. 116-6).
[36] *See* 11 U.S.C.S. § 1129 Notes to Decisions (35) (Means Forbidden by Law).
[37] *Id*.
[38] Azgad-Tromer, *supra* note *32*, at 181–83.
[39] *Id.* at 180–85.
[40] *See infra* Part III(A).
[41] Azgad-Tromer, *supra* note 32, at 181–82.
[42] *Id.*
[43] *Id.*
[44] *Id.*

ii. Overleverage and Underinsurance

One of the side effects of this heightened risk taking is an overuse of debt and leverage by IOUs. This is because the implied subsidization and scale of the IOU can afford them lower cost borrowing than other businesses of similar capitalization.[45] In a sense, the willingness to take higher risk is contagious and is passed on to the lender.[46] This lower cost of borrowing compounds the already risk-preferring nature of IOU management and leads to a more leveraged balance sheet than would otherwise be considered prudent for a business of its size, scope and risk profile.

Selecting how much insurance to carry for catastrophic disasters is a very delicate balancing act for utility companies.[47] Business decisions must be made with respect to the risk of loss and the risk of overpaying for unneeded insurance.[48] Because this decision rests on executives who seek to maximize profit and minimize expenses, it is not surprising that some utilities have been accused of carrying insufficient insurance.[49] This increasingly risky behavior is likely partly the result of the general distorted governance problem that plagues investor-owned utilities and is compounded by the perception that investor-owned utilities have a sort of "implied insurance policy" in taxpayer money and government bailout.[50] Whether motivated by money, policy or naivete, public utility companies have been found to be underinsured in the face of disasters and accidents. This can leave the general public and ratepayers picking up the financial slack[51] instead of prompting a change in governance or insurance practices.

E. Climate Change Factors

It was noted previously in our history that the deregulation of public utility companies would result in a larger number of utility bankruptcy filings.[52] Whether or not this has proven to be causally true, there is now a much more important factor which has the ability to wipe out utility companies—climate related incidents.

i. Increased Risks and Cost of Insurance

The number of acres burned annually by wildfires has generally risen every year and the top two years in which, historically, the greatest amount of acreage was burned are both within the past five years.[53] This is likely because recent wildfire seasons last 78 days longer than they did in the 1970s.[54] Climate change has been linked to this direct cause of increased wildfires as well as

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[45] *Id.* at 181.
[46] *Id.*
[47] Katherine Chiglinsk & Will Wade, *PG&E's $1.4B in Wildfire Insurance May Not Be Enough, But Was 'Regular Amount'*, INS. J., Nov. 20, 2018.
[48] *Id.*
[49] *Id.*
[50] Azgad-Tromer, *supra* note 32, at 159.
[51] *Id.*
[52] Lomax, *supra note* 21, at 581.
[53] KATIE HOOVER & LAURA A. HANSON, CONG. RESEARCH SERV., IF10244, IN FOCUS–WILDFIRE STATISTICS (last updated Oct. 3, 2019), https://fas.org/sgp/crs/misc/IF10244.pdf.
[54] CENTER FOR CLIMATE AND ENERGY SOLUTIONS, WILDFIRES AND CLIMATE CHANGE (available at https://www.c2es.org/content/wildfires-and-climate-change) (last visited Mar.ch 21, 2019).

some indirect causes. It is estimated that every one-degree Celsius increase in the general climate could result in as much as a 600% increase in the annual median burned area.[55]

These climate change outcomes will invariably affect governance decisions by requiring increased maintenance and supervision of now riskier infrastructure and business practices. The widespread and ever-increasing devastation wrought by fires and other disasters must affect insurance and decision-making. Additionally, the effect of bankruptcy laws on civil liability and damages resulting from these disasters will also come to bear on the ratepayers and general public.

ii. Laws which seek to impose liability are gaining popularity

As states begin to address climate change and natural disaster liability through legislation, IOUs are increasingly likely to encounter a situation in which state law will conflict with federal bankruptcy law.

IV. CASE STUDY: PACIFIC GAS AND ELECTRIC COMPANY

A. Possible Motives Behind PG&E's 2019 Chapter 11 Filing

When attempting to infer the considerations which may have motivated PG&E to file for bankruptcy in January of 2019, it is important to note that PG&E has previously filed for bankruptcy.[56] Nearly two decades ago, the utility company filed for Chapter 11 protection after reaching $9 billion in debt.[57] The filing was seen as a "slap in the face" to the state of California according to the then Governor of the state.[58] The 2001 filing was "carefully orchestrated," and interrupted collaborative political efforts to help PG&E.[59] PG&E felt at the time that the Governor and the State of California had not gone far enough to help them resolve their debt and filed for bankruptcy despite being informed that bankruptcy would risk service disruptions and substantially higher rates for consumers.[60]

In the present case, PG&E found itself again the beneficiary of moderate reform efforts despite failing to achieve their primary objective. As recently as September of 2019 the Governor and State Legislature of California had been debating a bill which sought to change the inverse-condemnation-based strict liability standard for wildfire liability in California.[61] This strict liability standard is rooted in the California Constitution and essentially provides that an investor-owned utility is strictly liable for damages caused from a wildfire started by its powerlines or equipment.[62] In defending this standard, the court in *Barham v. Southern California Edison Company* cited the ability to condemn property through the doctrine of eminent domain as a key consideration and held that there was no significant difference between a publicly owned or privately owned electric

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[55] *Id.*
[56] David Lazarus, *PG&E Files for Bankruptcy / $9 billion in debt, firm abandons bailout talks with state*, SFGATE, Apr. 7, 2001, https://www.sfgate.com/news/article/PG-E-Files-for-Bankruptcy-9-billion-in-debt-2933945.php.
[57] *Id.*
[58] *Id.*
[59] *Id.*
[60] *Id.*
[61] Nossaman LLP, *Governor Brown Signs SB 901, Addressing Wildfire Cost Recovery, But Ignoring Inverse Condemnation Liability*, JDSUPRA, Sept. 24, 2018, https://www.jdsupra.com/legalnews/governor-brown-signs-sb-901-addressing-12208/.
[62] *See* Barham v. S. Cal. Edison Co., 74 Cal. App. 4th 744 (1999).

utility for the purpose of finding inverse condemnation.[63] The proposed reform effort came to the attention of the broader population in the form of SB 901 and was being heavily negotiated as PG&E began to threaten bankruptcy over the liability arising from the 2017 wildfires.[64] Ultimately a version of SB 901 was passed by the legislature and signed into law by Governor Brown.

The final version of the law, however, failed to change the strict liability standard and left the inverse condemnation doctrine largely untouched.[65] It did, however, create several tools for the California Public Utilities Commission ("CPUC") to mitigate liability for wildfires.[66] The new law allows CPUC to use a modified reasonableness standard when deciding whether an IOU can recover wildfire costs from rate increases and it allows for the issuance of rate recovery bonds with respect to 2017 wildfire liability.[67] Although potentially life-saving for an IOU, it can be inferred that PG&E found SB 901 to be insufficient in its final form. Roughly 15 weeks after Governor Brown signed the bill into law, PG&E filed for Chapter 11 protection.[68]

It is not improbable that PG&E has used Chapter 11 as a tool to pressure legislators, state leaders, and members of the public to acquiesce to broader liability reform efforts. Certainly, from a political perspective, PG&E's most recent Chapter 11 bankruptcy filing has sent a message that SB 901 was insufficient and that this time, bond issuance and even a more generous reasonableness standard for the 2017 wildfire season is not enough.

Although it is possible that PG&E acted in a reasonable and safe manner it is also possible that the IOU was taking a greater amount of risk than may have been prudent. It is not outrageous to assume that management and investors alike may have been relying on an implicit bailout when making decisions.

B. Effects of the Implicit Bailout on PG&E

i. Examples of Distorted Governance Decisions

In PG&E's 2016 annual report to investors, PG&E announced its "first dividend increase in six years," it also contemplated both an increased risk in overspend and explained that it was unable to foresee the potential ceiling of financial liability resulting from the Butte fire.[69] PG&E then continued to increase its dividend by more than 8% the following year[70] despite any indication that the wildfires which have been increasing steadily over recent years would slow.[71] Although PG&E did ultimately suspend their dividend, these increases were purportedly intended to make PG&E more competitive in raising capital so that they could invest in "safety . . . and clean energy."[72]

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[63] *Id*.
[64] Nossaman LLP, *Governor Brown Signs SB 901, Addressing Wildfire Cost Recovery, But Ignoring Inverse Condemnation Liability*, JDSUPRA, Sept. 24, 2018.
[65] *Id.*
[66] *Id.*
[67] *Id*.
[68] Rob McLean & Chris Isidore, *PG&E Files for Bankruptcy After Wildfires*, CNN BUSINESS, Jan. 29, 2019.
[69] PACIFIC GAS AND ELECTRIC COMPANY, PG&E INVESTOR REPORT 2016 at ii (2016).
[70] PACIFIC GAS AND ELECTRIC COMPANY, LETTER TO SHAREHOLDERS: DIVIDEND HISTORY (Dec. 27, 2017).
[71] Russell Gold, Katherine Blunt & Rebecca Smith, *PG&E Sparked at Least 1,500 California Fires. Now the Utility Faces Collapse*, WALL ST. J., Jan. 13, 2019.
[72] PACIFIC GAS AND ELECTRIC COMPANY, PG&E INVESTOR REPORT 2016 at ii (2016).

This move prompted institutional investors to take and expand positions in PG&E and by the end of 2018, more than 83% of PG&E stock was owned by institutional investors.[73] One of the largest bets on PG&E was placed by BlueMountain Capital who have placed a new board member and had been fighting, unsuccessfully, against PG&Es plan to declare bankruptcy.[74] It is hard to say what the purpose of the increased dividend truly was given that it, alone, would not have raised any additional capital for PG&E to invest into "safety" measures or "green energy" but it did allocate otherwise free cash to investors.

ii. Overleveraged and Underinsured

With respect to the prediction that IOUs would overuse leverage and practice excessive borrowing, PG&E is again guilty as charged. From November 2017-18 alone PG&Es debt load rose by $1 billion.[75] Although superficially it appeared as though PG&E has adequate cash flow to support their liabilities, their short-term obligations were high when compared to their assets.[76]

At the end of 2018, PG&E was leveraged at approximately 98%, which is not entirely unusual for large capitalization companies because of the relatively cheap cost of debt when compared to equity.[77] However, a deeper inquiry reveled that their earnings before interest and tax was unlikely to "strongly cover" their interest and dividend expenses.[78] All of this was calculated just before the Camp Fire liability was found to rest with PG&E and this exemplifies the point that maintaining a nearly 100% leveraged balance sheet, although possibly appropriate for some large capitalization companies, is inappropriate for a IOU given the ever-increasing risks of natural disaster.

At the time of the 2017 and 2018 California wildfires, PG&E carried a $1.4 billion wildfire insurance policy.[79] This amount has been described as a "regular amount" of insurance for utility companies of PG&Es size.[80] However, just because it is a regular amount does not mean that it is in any way sufficient. The fact that many IOUs collectively make similarly risky decisions does not establish that it is the prudent or appropriate standard. In fact, all IOUs likely suffer from the same distortions and perverse incentives and the industry consensus in underinsuring is little more than a symptom of a larger problem. A utilities analyst opined that PG&E should have been carrying $10-15 billion in insurance at the time.[81]

The $10-15 billion suggestion may have been much closer to the mark but still likely would have come up short by more than 50%.[82] The total wildfire liability attributable to PG&E has reached $30 billion at this point.[83] The purchase of insurance is a balancing act that must be

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[73] Wilsonville Capital, *PG&E Corporation Is Undervalued, And Institutional Investors Own 84% Stake*, SEEKING ALPHA, Nov. 20, 2018.
[74] Stephen Alpher, *BlueMountain Continues Campaign Against PG&E Bankruptcy*, SEEKING ALPHA BLOG, Jan. 22, 2019, https://seekingalpha.com/news/3424750-bluemountain-continues-campaign-against-pg-and-e-bankruptcy.
[75] Simply Wall St, *Is PG&E Corporation's Balance Sheet A Threat to Its Future?*, SIMPLY WALL ST NEWS, Nov. 15, 2018.
[76] *Id.*
[77] *Id.*
[78] *Id.*
[79] Will Wade & Katherine Chiglinsk, *PG&E's $1.4B in Wildfire Insurance May Not Be Enough, But Was 'Regular Amount'*, INS. J., Nov. 20, 2018.
[80] *Id.*
[81] *Id.* (quoting Kit Konolige).
[82] Christopher Helman, Christopher, *As $30B In Wildfire Claims Bankrupt PG&E, California Wonders Who Will Pay After The Next Conflagration*, FORBES, Jan. 21, 2019.
[83] *Id.*

engaged in by many businesses.[84] The failure to adequately insure a business may result in insolvency and in the case of PG&E, the recent wildfire liability has indeed been blamed for their recent Chapter 11 filing.[85]

iii. The Bottom Line

Ultimately, as PG&E engaged in the types of behaviors which were encouraged by the implicit bailout and the costs were exported to outside stakeholders. While the shareholders and executives stood to benefit from the positive outcomes of PG&Es gambles, when negative consequences materialized, the ratepayers paid more, the taxpayers paid more and the shareholders retained a substantial portion of their value.

C. Conflict of Laws

Although United States bankruptcy laws have evolved specifically to address some historical legal conflicts with respect to utility company bankruptcies, there is a looming issue which could result in an unforeseen conflict of law with respect to PG&Es present bankruptcy filing.

Chapter 11 of the United States Code § 1129 provides that a court shall confirm a plan only if every required element is satisfied.[86] One of the requirements is that a plan not ". . . be by any means forbidden by law."[87] The problem is that California applies strict liability to IOUs who damage private property when the damage was caused by the utility company's equipment.[88] This doctrine is referred to as "inverse condemnation" and is rooted in the California State Constitution.[89]

Although there has been some legislative action attempting to change how California applies liability to utility companies, these efforts have not succeeded in amending the constitution or altering the California courts interpretation thereof.[90] Recently, SB 901 failed to directly change the strict liability standard as applied to IOUs and was perceived by some to be a "bailout for utilities."[91]

Thus, the Bankruptcy Court will have to contemplate to what extent any plan to mitigate any portion of PG&Es liability for wildfire damage will be in violation of applicable state laws.

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[84] Will Wade & Katherine Chiglinsk, *supra* note 79.
[85] Christopher Helman, *supra* note 82. Christopher.
[86] 11 U.S.C.S. § 1129(a) (LEXISNexis, Lexis Advance through Pub. L. No. 116-108), approved 2/15/19).
[87] 11 U.S.C.S. § 1129 (a)(3) (LEXISNexis, Lexis Advance through Pub. L. No. 116-108), approved 2/15/19).
[88] CALIFORNIA STATE ASSOCIATION OF COUNTIES, INVERSE CONDEMNATION and Utility Liability 1CALIFORNIA STATE ASSOCIATION OF COUNTIES, ISSUE BRIEF – IN (stating that "In 1999, the California Supreme Court held an investor-owned utility liable for damages caused from a wildfire started by its powerlines under inverse condemnation. In the decision, the court cited the ability to condemn property through eminent domain as a key factor in its ruling that there was no significant difference between a publicly owned or privately owned electric utility for the purpose of finding inverse condemnation) (citing Barham v. Southern California Edison Company, 74 Cal. App. 4th 744, (1999).
[89] *Id*.

[90] Iulia Gheorghiu, *California Approves Bill to Limit Utility Liability for Wildfires, but not CAISO Expansion*, UTILITY DIVE, Sept. 4, 2018.
[91] *Id.*

Special consideration by bankruptcy judges for utility companies is not new.[92] The Unites States Bankruptcy Code includes provisions which seek to eliminate some potential conflicts with respect to utility company regulation.[93] The Code requires that "[a]ny governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval."[94] This prevents some potential regulatory conflicts but does not address the conflict between inverse condemnation and any potential of PG&E to reduce, reclassify, or in any other way alter its wildfire liabilities in bankruptcy.

D. Climate Change Factors

With respect to climate change, PG&Es bankruptcy may have unforeseen consequences. PG&E has several contracts with renewable energy providers and may threaten to walk away from them in their present Chapter 11 proceeding.[95] In some cases, these contracts provide a large portion of the renewable energy company's revenue.[96] These contracts are older and are now considered to be above-market contracts meaning that PG&E is overpaying for the renewable energy that these companies provide.[97] It is estimated that PG&E could save over $2.2 billion per year by renegotiating these contracts down to current market rates.[98]

This could have a detrimental affect not only on PG&E's contractors but also on the future of innovation in the green energy space. California companies seeking to innovate will be less likely to partner with PG&E if PG&E is permitted to renegotiate long-term contracts every time they are in over their head.

Another unfortunate climate-change-related factor is the cost of insurance. As noted in Section II(e)(*i*), wildfire damage is an increasing problem.[99] The cost of insurance is likely to rise in response to the increasing frequency and scope of fires. Ultimately, PG&E may simply be too large in physical scale to be able to adequately insure against the possible liabilities that could result from its infrastructure and actions.

V. PROPOSED REFORM

A. State Ownership of Utility Companies

Scholars have discussed the option of a state acquiring an investor-owned utility company as a way to recover stranded costs when a state abrogates a regulatory contract with the IOU.[100] In addition, some have proposed ways in which states may expand eminent domain power to take

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[92] *See* 11 U.S.C.S. §§ 1123; In re Pac. Gas & Elec. Co, 283 B.R. 41, 60 (N.D. Cal. 2002) (stating that "no other debtor is subject to as much state regulation as the public utility.").
[93] *Id.* 11 U.S.C.S. § 1129 (a)(6) (LexisNexis, Lexis Advance through Public Law 116-91, approved Dec. 19, 2019).
[94] *Id.*

[95] Ivan Penn & Peter Eavis, *PG&E Bankruptcy Could Deal Blow to Its Solar-Power Suppliers' Finances*, THE N.Y. TIMES, (Jan. 17, 2019), https://www.nytimes.com/2019/01/17/business/pge-bankruptcy-solar-power.html.
[96] *See Id.*
[97] *Id*.
[98] *Id*.
[99] *Supra* section II(e)(*i*).
[100] J. Gregory Sidak & Daniel F. Spulber, *Deregulatory Takings and Breach of the Regulatory Contract*, 71 N.Y.U.L. Rev. 851 at 994 (1996).

control of ongoing investor-owned utilities.[101] And still, others have argued for the separation and complete nationalization of the electricity transmission grid.[102]

It has also been stated that prior to PG&E's 2001 bankruptcy filing, the state of California should have exercised its police power to seize ownership of utility power plants,[103] concluding that "[s]tate ownership would have temporarily stabilized the electrical system itself while offering breathing room to decide what type of long-term institutional reform was appropriate. Moreover, such stability probably could have averted PG&E's bankruptcy filing. . . ."[104]

These arguments may tend to raise more constitutional and antitrust issues than the proposal offered here,[105] therefore, this article stops short of evaluating antitrust and constitutional implications.

Rather than restructuring the existing energy distribution infrastructure or encouraging the acquisition of solvent IOUs by the state, this article proposes that upon filing for Chapter 11 protection, an investor-owned utility undergo a forced sale to the state. The bankruptcy proceeding triggers the event and the state may exchange debt or financial liability for equity. In addition, once owned by the state, the previous IOU will be able to generate revenue, and hopefully profit, for the state.

B. Forced Sale of IOU to the State – The Taxpayer-Owned Utility

It is not unusual for creditors to exchange debt for equity in a business going through a Chapter 11 proceeding.[106] Where the debt holders in PG&Es case are the citizens of California, a logical starting position could be that the citizens of California emerge with a significant equity stake in PG&E. It is also not unprecedented for the government to strongly encourage acquisitions of socially important institutions when they become insolvent.[107] Governmental pressure to complete business transactions was present during the financial crisis. J.P. Morgan Chase purchased Washington Mutual at the request of political leadership and Bank of America was all but forced to acquire Merrill Lynch.[108] Although none of these examples involve the "nationalization" of the insolvent companies, the federal government did purchase preferred equity stakes in several of the nation's largest financial institutions in the wake of the 2008 crisis and had the power to influence many corporate transactions.[109]

There may or may not be a persuasive argument for nationalizing all public utilities or redistributing the ownership of all IOUs. That being said, once an IOU has become insolvent and

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[101] *See* Shelley Ross Saxer, *Government Power Unleashed: Using Eminent Domain to Acquire a Public Utility or Other Ongoing Enterprise*, 38 Ind. L. Rev.IND. L. REV. 55 (2005).
[102] Rick Bradley, *Over the River and (Around) The Woods to Grandma's House We Go: Long-Term Firm Transmission Rights, Transmission Market Power, & Gaming Strategies in a Deregulated Energy Market – An International Comparison*, 30 HOUS. J. INT'L L. 327, 512 (2008).
[103] Timothy P. Duane, *Regulation's Rationale: Learning from the California Energy Crisis*, 19 YALE J. ON REG. 471, 527-30 (2002).
[104] *Id*. at 537.
[105] *See* Bradley, *supra* note 10279.
[106] Kenneth A. Rosen, *What Does Chapter 11 Really Cost?*, BLOOMBERG L.BNA, (April 27, 2016, 12:28 PM), https://perma.cc/Z62U-4TTH.
[107] John Carney, *Did The Government Force Bank of America To Buy Merrill?*, BUS. INSIDER (Feb. 2, 2009), https://www.businessinsider.com/2009/2/did-the-government-force-bank-of-america-to-buy-merrill.
[108] *See generally iId.*
[109] *See* Deborah Solomon et al., *U.S. to Buy Stakes in Nation's Largest Banks*, WALL STREET J., (Oct. 4, 2008), https://www.wsj.com/articles/SB122390023840728367.

has no alternative but to reorganize under Chapter 11, that IOU should be required to transfer ownership to the state in which it operates. In other words, a Chapter 11 filing would trigger a mandatory sort of "taking private" transaction between the IOU and the state.

Taking private in this context is a bit of a misnomer, however, because although it contemplates a transaction by which the "public ownership" of the IOU by investors is terminated, the end result will be that the utility is owned by the taxpayers as a whole as "implicit shareholders."[110] To avoid the potential confusion between the implicit public ownership the taxpayers will have and the "public" ownership of a publicly traded company, the term "taxpayer-owned utility" can be used for a utility company that has transitioned from being an IOU to being a state owned utility through this proposed process.

There is a great deal of criticism with respect to how well a government can manage the affairs of a business. Although this article does not claim that a state government would be the most efficient manager of a utility company, it is clear that the regime which managed the utility into insolvency was at least equally as bad as critics may assert that a government may be. For this reason, this article does not claim that state governments are the optimal owner of all utility companies. That being said, when a management team has proven ineffective and an IOU has failed, there is arguably nowhere to go but up.

C. Recovery of Costs and Liabilities

One obvious benefit of this arrangement is that the state would then have an opportunity to rely on the taxpayer-owned utility to recoup the costs that the taxpayers incurred at the hand of the previous management team. A good way to think of this would be to imagine that instead of paying a dividend to corporate shareholders and executive bonuses, the taxpayer-owned utility would allocate profits to any remaining liabilities and debts of the previously investor-owned utility.

This should be the most preferred use of any excess cash generated by the taxpayer-owned utility because of the substantial debt that the previously-investor-owned-utility imposed, knowingly, upon the taxpayers. After the costs and liabilities of the previously-investor-owned-utility are recovered, the taxpayer-owned utility may continue to operate for the benefit of the public and will have no reason to revert to the previous unbalanced, misaligned structure.

D. Realignment of Incentives – The Right Amount of Risk-Taking

There are several ways in which state ownership will realign the incentives that are so often misaligned in an IOU. First, it will eliminate the implicit-bailout-driven risk taking. The state will have no motivation to engage in excessively risky governance because the state will be held directly accountable when the consequences are realized. Not only will financial responsibility still be tied to the taxpayers, much as it is now when an IOU is insolvent, but the state led management will be subject to political pressures and checks as well. In essence, the bailout will no longer be perceived as a bailout since it comes from the new implicit owners and the new owners have a political voice that can influence the management.

Secondly, the potential profits will benefit those who are truly acting as residual claimants for the utility. The revenue that can be gained through the operation of the utility can go to the benefit of the taxpayers who bear the burden of the residual losses. This is a simple but effective adjustment that will impact the governance practices of a company.

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[110] *See* Sidak & Spulber, *supra* note 10098, at 994.

Finally, with respect to risks posed by legislation and administrative rules, the taxpayer-owned utility will be better positioned to adapt and drive for positive political change. Voters and taxpayers are not likely to take actions that would substantially hinder the taxpayer-owned utility and the utility company would be less likely to lobby for changes that would overburden the taxpayers or ratepayers.

E. Duration and Exit

Upon taking ownership of a previously-investor-owned utility, the state will have the ability to modify governance practices, change management, sell assets, and in every other way, run the company. The motivation of the state will be to ensure that the utility regains solvency and can begin to generate positive cash flow to reimburse the state and the citizens for the financial losses resulting from the excessive risks taken previously.

Although it could be possible for a state to re-sell ownership in the entity at some point in the future, it would arguably be more beneficial for the state to retain ownership for as long as possible. The realignment of incentives is strongest and will have a longer lasting effect if the taxpayer-owned utility is not promptly re-spun out to investors. So, although a state could retain the right to IPO or sell a taxpayer-owned utility after the state has recovered its financial losses resulting from the previous insolvency, it would also likely be best served to continue to operate the entity in the long term. For this reason, this article does not recommend any particular exit strategy for a taxpayer-owned utility but also falls short of encouraging a mandate which would prevent a state from doing so.

F. Possible Implementation Methods

There are a few different ways in which a policy like this could be implemented. First, there could be an amendment to the United States Bankruptcy Code which would articulate the process for the state taking ownership of an investor-owned utility as part of a Chapter 11 reorganization. As discussed above, this would not be the first time that the U.S. bankruptcy laws adapted to accommodate the unique needs of public utility companies.[111]

Another option would be for an individual state to act as a laboratory and legislate the process. Either as a state law, or as a condition of a utility charter or contract. This would likely be the most appropriate solution for both logistical and constitutional reasons. A state could contract the solution into the approval process or pass a law that effected the same result. Either way, it is more likely to be effective when states have the freedom to customize components of the taxpayer-owned utility policy given the unique environmental and commercial circumstances of each state.

VI. CONCLUSION

It is safe to say that in the world of investor-owned utilities; the financial risks and rewards have fallen out of balance. PG&E specifically has demonstrated many of the theoretical pitfalls of the investor-owned utility structure and has sought relief under Chapter 11. Their motivations for the filing, whether political or financial, are nevertheless selfish in nature. After years of reaping the rewards of a government supported monopoly in an essential product market, the ratepayers and taxpayers in California will be stuck paying for the excessive risks taken by PG&E.

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[111] *See supra* Section III(c).

If the state of California were able to negotiate ownership of PG&E due to their liabilities and then operate it moving forward, there is the potential for recouping losses and realigning incentives. As PG&E faces an uncertain future because of potential conflict between California's inverse condemnation doctrine and the restructuring or relief from their wildfire liabilities, something will have to give.

Laws implementing the concept of the taxpayer-owned utility – which would be assumed and managed by the state will be able to help restrike balance between the risks and rewards of investor-owned utilities. By raising the stakes for investor-owned utilities by terminating their ownership structure upon insolvency, there will be more severe consequences for dangerously risky behavior. Additionally, states will be able to recoup financial losses caused by the risks taken by the previously-investor-owned-utility as the state operates the taxpayer-owned utility company. Lastly, the taxpayer-owned utility will grant ownership to the taxpayers as "implicit-shareholders"[112] when the taxpayers have been forced to act as residual claimants.

[112] *See* Sidak & Spulber, *supra* note 100, at 994.