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PG&E Bankruptcy May Have Wider Ramifications for California.

The municipal bond market has a small amount of direct exposure to the bankruptcy of PG&E (PCG), California's largest utility, though the Chapter 11 filing creates uncertainty for the state and localities where the utility operates.

The company, which provides natural gas and electric service to 16 million people in northern and central California, emphasized in a customer alert that it will not be "going out of business" as it embarked on plans to restructure an estimated $51.7 billion in debts balanced by assets of $71.4 billion.

PG&E Corp. (PCG) and its primary operating subsidiary, Pacific Gas and Electric Co. filed for Chapter 11 Tuesday in the U.S. Bankruptcy Court for the Northern District of California.

All three ratings agencies dropped the utility's ratings to junk after it reported a few weeks ago that it was facing up to $30 billion in liabilities from California wildfires.

The California Public Utilities Commission, the utility's regulator, reported in December it was exploring such options as splitting PG&E's (PCG) gas and electric operations or even requiring that regional companies be created.

San Francisco Mayor London Breed, in a letter to the director of San Francisco's Public Utilities Commission, reportedly requested an analysis of the city's options in the face of PG&E's (PCG) likely bankruptcy, "including the possibility of acquiring and building electrical infrastructure assets."

A California PUC spokeswoman said she did not know if the commission would have the power to move ahead on those plans now that the utility is in bankruptcy, but said the commission would work with the court.

The company signaled earlier this month that it planned to file for bankruptcy in compliance with a recently enacted state law that requires it to provide a 15-day notice before taking that step.

Municipal bonds comprise less than $1 billion of PG&E's outstanding debt. "And $762 million of the $920 million in municipal debt was backed by bank letters of credit, so actual exposure to PG&E (PCG) in the municipal market is quite small," Nuveen analysts wrote in a Jan. 22 report.

The municipal bonds are unsecured general obligations of PG&E (PCG), according to Nuveen.

"The corporate bonds generally have a covenant by which if a lien is granted to other creditors it must be granted to the corporate bonds," Nuveen analysts wrote. "The municipal bonds are exempt from this provision and could be subordinated to the other debt."

The municipal debt was issued through two state conduit issuers, the California Pollution Control Financing Authority and the California Infrastructure & Economic Development Bank.

The conduit issuers provide access to the tax-exempt bond market for private companies and nonprofits and have no responsibility to pay the debt back.

Put simply, the conduit issues the bonds, places the proceeds with the trustee, who then re-lends the money to the borrower, said Tim Schaefer, California's deputy treasurer for public finance. The CPCFA is staffed out of the treasurer's office.

The borrower, in this case PG&E (PCG), has the responsibility to provide disclosure prior to the bond sale and after on the risks for bondholders, Schaefer said.

The risk to bondholders is minimal, because the banks will buy the variable rate demand obligations back from the current bondholders, said Matt Fabian, a partner with Municipal Market Analytics.

A search on the Municipal Securities Rulemaking Board's EMMA site of the CUSIPs indicated the banks had not executed a mandatory tender of the debt as of Tuesday afternoon.

In an earlier interview with The Bond Buyer, Joan Hempel of Moody's Investors Service said that the banks have the right to terminate the letter of credit early and call for a mandatory tender. The banks can make the payment and pay the bondholders off early and then PG&E (PCG) would be obligated to pay the bank back directly.

The bank letters of credit means the bank has an irrevocable and unconditional obligation to make the payments directly to the bondholders, Hempel said. The bank then has a reimbursement agreement under which PG&E (PCG) agrees to pay the bank. So the bondholders look to the bank as the first source of payment of the bonds, she said.

There are five banks with exposure instead of just one with a concentrated position, which helps to spread out the risk, Fabian said. As of last Friday, he said, the liquidity banks were MUFG Union Bank with $149 million, Sumitomo Mitsui Banking Corp. with $165 million, TD Bank with $100 million, Mizuho Bank with $200 million and Canadian Imperial Bank with $149 million.

In conjunction with the bankruptcy filings, PG&E (PCG) also filed a motion seeking interim and final approval of the bankruptcy court to enter into an agreement for $5.5 billion in debtor-in-possession financing with J.P. Morgan, Bank of America (BAC), Barclays (BCS), Citi, BNP Paribas (BNPQF), Credit Suisse (CS), Goldman Sachs (GS), MUFG Union Bank and Wells Fargo (WFC) acting as joint lead arrangers.

The DIP financing, when approved, will provide PG&E (PCG) with capital needed to operate throughout the bankruptcy, according to the company.

The PUC board granted exemptions for the utility to obtain the DIP financing at a heated meeting Monday at which protestors shouted "no bailout for Wall Street" while commissioners discussed the matter. The extensions do not extend to the transfer of ownership of any utility asset that is pledged as part of the DIP finance, however.

PUC President Michael Picker urged his fellow commissioners to approve the exemptions, saying that if PG&E (PCG) were not able to secure the financing and continue to operate it could represent a substantial public safety and health risk because it could compromise hospitals and public facilities.

California Gov. Gavin Newsom said his focus through the bankruptcy remains "protecting the best interests of the people of California."

“My administration will continue working to ensure that Californians have access to safe, reliable and affordable service, that victims and employees are treated fairly, and that California continues to make forward progress on our climate change goals,” Newsom said.

By Keeley Webster

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