TENTATIVE RULING

***At the August 7, 2015 hearing, the court does not plan to read the Tentative Ruling into the transcript as is customary, in order to give the parties ample time to argue the motion. However, the court intends to ask the parties to stipulate that the Tentative Ruling be made part of the record of the hearing as if it had been read into the transcript.

INTRODUCTION

Nominal Defendants PG&E Corporation (PG&E) and Pacific Gas & Electric Company (the Utility) demur to Plaintiffs' Second Amended Consolidated Derivative Complaint (Complaint.) PG&E argues Plaintiffs lack standing because they failed to make a pre-suit demand on PG&E's Board of Directors,[1] and have not pleaded, with the required particularity, why such demand should be excused.

Individual Defendants Directors and Officers (Individual Defendants) demur to the Complaint on the ground that it does not state facts sufficient to constitute a cause of action.[2]. PG&E and the Individual Defendants join in each other's arguments.

[1] The Court previously ruled that the relevant Board for the demand futility analysis is PG&E Corporation's November 2013 Board, which consisted of thirteen board members (1/30/2015 Order.)

[2] This issue is reserved until the question of whether Plaintiffs have established standing is determined..

Derivative Plaintiffs (Plaintiffs) oppose the demurrer. Plaintiffs argue the particularized allegations in the Complaint demonstrate that it is futile to make a demand on the Board because there exists a reasonable doubt that a majority of the relevant Directors are disinterested, given they face a substantial likelihood of non-exculpated personal liability for their breaches of fiduciary duty, or otherwise lack independence.

Therefore, the issue before the court is whether having failed to make a demand on the 2013 Board, Plaintiffs have alleged particularized facts showing that a majority of the 2013 Board, at least seven of the thirteen members, were incapable of considering a pre-suit litigation demand (*Bader v. Anderson* (2009) 179 Cal.App.4th 775, 790.)

Defendants and Plaintiffs have also filed Requests for Judicial Notice, and PG&E has filed a Motion to Strike portions of the Complaint. The court first addresses these Requests and the Motion to Strike.

## REQUESTS FOR JUDICIAL NOTICE

The following three requests were unopposed and contained documents and materials of which a court can take judicial notice (i.e. records of public agencies, and judicial filings and records.) Therefore, the court tentatively rules:

<u>PG&E's Request for Judicial Notice</u>: Granted.

<u>Directors' and Officers' Request for Judicial Notice</u>: Granted.

<u>Plaintiffs' Request for Judicial Notice</u>: Granted.

## SUPPLEMENTAL REQUEST FOR JUDICIAL NOTICE

Defendants also filed a "Supplemental Request for Judicial Notice", which was opposed by Plaintiffs. The Supplemental Request seeks to have the court take judicial notice of six complaints – which were filed in either a United States District Court or the Delaware Court of Chancery – on the basis that this court is authorized to take judicial notice of such judicial records (California Evidence Code section 452(d).)

Plaintiffs oppose the Supplemental Request, arguing Defendants are required to file and serve all moving and supporting papers with their initial motion, and asking the Court to consider new evidence or arguments at the reply stage violates due process, specifically because it prevents Plaintiffs from having a reasonable opportunity to respond to the request. Plaintiffs also argue the documents -- complaints dismissed in other actions -- are irrelevant to any issue raised in the demurrers.

The court finds that the documents are court records of which this court can take judicial notice. The court does not find a due process violation for lack of notice. The Request was filed twenty-one (21) days before the original hearing date on Defendants' demurrer, giving Plaintiffs ample time to respond, and in fact they did respond.

The court agrees with Plaintiffs' argument that the relevance of these documents is questionable. This court's main focus must be on the allegations in this Complaint. However, the marginal relevance of these other complaints is not a basis for denying the Request. Therefore, the court tentatively rules:

<u>Defendants' Supplemental Request for Judicial Notice</u>: Granted.

PG&E'S MOTION TO STRIKE PORTIONS OF PLAINTIFFS' SECOND AMENDED CONSOLIDATED DERIVATIVE COMPLAINT

Pursuant to California Code of Civil Procedure section 436, PG&E seeks to strike twenty-six paragraphs added to the Second Amended Derivative Complaint as being in violation of the Court's 1/30/15 Order which granted Plaintiffs leave to amend their Complaint but forbade "new parties or claims" and permitted amendment only as needed "to assist [the] court in its determination of the pending demurrers (1/30/15 Order at p.13.)

PG&E argues Plaintiffs were authorized by the court solely to revise paragraph 290 to clarify that demand futility is being plead as to PG&E's November 2013 Board, and all other newly added allegations should therefore be stricken. Alternatively, PG&E argues that if this court were to find that Plaintiffs' amendments fall within the leave granted, Plaintiffs' allegations as to PG&E's three new directors, the federal indictment of the Utility, and the Board's consideration of a prior shareholder demand related to the San Bruno accident, should be stricken because they are irrelevant and improper. PG&E specifically objects to Plaintiffs' decision to name three added PG&E directors as "participants" in the wrongdoing alleged in the Complaint.

Plaintiffs oppose the motion, arguing PG&E's argument that the court meant to restrict amendment to simply replacing the names of the 2010 directors with the 2013 directors is a contorted reading of the court's Order because it would require Plaintiffs to establish demand futility based on allegations from the prior Complaint directed to the 2013 Board. Plaintiffs also argue that the new allegations do not exceed the court's order, because Plaintiffs have not added new parties or claims, but have made demand futility allegations relating to the 2013

Board, which the court earlier determined was the appropriate Board for assessing demand futility.

The court agrees with Plaintiffs that PG&E too narrowly interprets the court's comments regarding amendment. The court did not intend to restrict amendment to revising one paragraph. The court has examined the newly alleged allegations and finds that they do not present new theories but, as Plaintiffs argue, are based on allegations found in prior complaints filed in 2013 and/or intended to assist the court in determining demand futility as to the 2013 Board. No new parties were named. Three directors were added as "unnamed participants" because they were members of the 2013 Board.

Regarding PG&E's argument that the allegations are "irrelevant and improper", the court agrees that some of the allegations may prove not to be relevant. However, the Court will not strike them at this time. Furthermore, the court will not consider irrelevant matters in making its ruling on the demurrers.

<u>PG&E's Motion to Strike Portions of Second Amended Complaint</u>: Denied.

## DISCUSSION

A. <u>Composition of the Board</u>

The parties agree that the November 2013 Board of Directors consisted of thirteen members. With the exception of Mr. Earley, the members were independent, outside directors. The members included: (1) Mr. Andrews appointed in 2000[3]; (2) Mr. Cox appointed in 1996[4]; (3) Mr. Williams appointed in

[3] Mr. Andrews passed away in December 2013.

1996; (4) Ms. Herringer appointed in October, 2005; (5) Ms. Rambo appointed in January 2005; and (6) Mr. Meserve appointed in December, 2006.

Additionally, four directors were appointed in 2009 and 2010. The San Bruno fire and explosion occurred on September 9, 2010 and therefore, as the court will explain, the specific and detailed allegations as to these directors is most critical to the court's analysis. Those directors included: (1) Mr. Chew appointed in September, 2009; (2) Mr. Kimmel appointed in January, 2009; (3) Mr. Miller appointed in February, 2009; and (4) Mr. Parra appointed in September, 2009.

Three directors joined the Board after the 2010 San Bruno accident. Those three directors include: (1) Mr. Earley appointed in September, 2011; (2) Mr. Fowler appointed in March, 2012; and (3) Mr. Kelly appointed in June, 2013.

Plaintiffs argue that these Directors systematically failed to sufficiently fund the proper maintenance of PG&E's gas transmission lines; failed to heed an avalanche of "red flag" warnings of safety, maintenance and recordkeeping problems with those lines, including prior explosions, numerous gas leaks, and an internal safety audit showing the Company had serious safety issues; incentivized employees not to report or fix gas leaks; and put "profits over safety."

PG&E focuses its demand futility analysis on the seven most recent additions to the board and argues Plaintiffs have failed to establish demand futility as to these seven members because they joined the Board well after the budget decisions and "red flag warnings" alleged by Plaintiffs in their Complaint. PG&E

[4] Mr. Cox retired from the Board in 2014.

thus concludes Plaintiffs cannot show a majority of the Board was disinterested because these seven constitute a majority.

B. Applicable Law

A shareholder seeking to vindicate the interests of a corporation through a derivative suit must first demand action from the corporation's directors or plead with particularity the reasons why such demand would have been futile (Cal. Corp. Code section 800(b)(2); *Bader v. Anderson, supra,* 179 Cal.App.4th at p. 790.)

As explained in *Bader*, "given the requirement under section 800(b)(2) that allegations be made "with particularity," it is clear that general averments that the directors were involved in a conspiracy or aided and abetted the wrongful acts complained of will not suffice to show demand futility." The *Bader* court further explained that "the court must be apprised of facts specific to each director from which it can conclude that that particular director could or could not be expected to fairly evaluate the claims of the shareholder plaintiff. Thus, the court, in reviewing the allegations to support demand futility, must be able to determine on a director-by-director basis whether or not each possesses independence or disinterest such that he or she may fairly evaluate the challenged transaction." (*Id.* at p.790.)

A derivative plaintiff may attempt to plead "demand futility" under the standards established in *Aronson v. Lewis* (Del. 1984) 473 A.2d 927 (where it is alleged that the directors made a conscious business decision in breach of their fiduciary duties) or *Rales v. Blasband* (Del. 1993) 634 A.2d 927 (unconscious inaction or oversight is at issue.) California law recognizes both the *Aronson* and the *Rales* tests (*Bader v. Anderson, supra,* 179 Cal.App.4th at p787.)

Under the *Aronson* test, "the trial court is confronted with two related but distinct questions: (1) whether threshold presumptions of director disinterest or independence are rebutted by well-pleaded facts; and, if not, (2) whether the complaint pleads particularized facts sufficient to create a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment. These two inquiries are disjunctive, meaning that if either prong is met, demand is excused. [¶] Under the first prong, 'directorial interest exists whenever divided loyalties are present, or where the director stands to receive a personal financial benefit from the transaction not equally shared by the shareholders.' A director lacks independence when a director's decision is based on extraneous influences, rather than the merits of the transaction.[5] [¶] If the first prong is not satisfied, there is a presumption that the Board's actions were the product of a valid exercise of business judgment. Thus, to satisfy the second prong, a plaintiff must plead sufficient particularized facts to 'raise (1) a reason to doubt that the action was taken honestly and in good faith or (2) a reason to doubt that the board was adequately informed in making the decision'" (*In re Intel Corp Derivative Litigation*, 621 F.Supp.2d 165, 170 (2009); citations omitted.)

Under the *Rales* test, the court must consider whether the plaintiff has alleged "particularized facts establishing a reason to doubt that 'the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand.' "A plaintiff might do this, for instance, by showing that the directors would face a "substantial likelihood" of personal liability by complying with a shareholder's demand to pursue litigation. However, "[w]here directors are contractually or otherwise exculpated from liability for

[5] With the exception of Mr. Earley, Plaintiffs do not appear to be arguing that this prong is applicable.

certain conduct, 'then a serious threat of liability may only be found to exist if the plaintiff pleads a non-exculpated claim against the directors based on particularized facts.'" (*In re Intel Corp Derivative Litigation, supra,* 621 F.Supp.2d at pp.170-171; citations omitted.)

Plaintiffs' first cause of action is an *Aronson* claim for Defendants' conscious and reckless actions in causing or permitting PG&E to violate applicable pipeline safety laws and regulations ("profits over safety") (¶ 342.) Plaintiffs' second cause of action is a *Rales* claim for failure to properly oversee and supervise the corporation (¶ 346.)

PG&E and Individual Defendants argue that an "oversight" claim is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." (*In re Caremark, Int'l Derv. Litig.* (Del.Ch. 1996) 698 A.2d 959, 967.) Under *Caremark*, "only a sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists – will establish the lack of good faith that is a necessary condition to liability (*Id.* at p.971.) Thus a plaintiff alleging a *Caremark* oversight claim under Delaware law must allege a breach of the duty of loyalty and establish "bad faith" (*Id.* at p.967.) PG&E and Individual Defendants also assert that "sound policy reasons" exist for requiring a plaintiff to plead an extreme set of facts constituting bad faith in order to state an oversight claim.

PG&E and the Individual Defendants further argue that Plaintiffs' argument that the directors failed to heed "red flag" warnings and made decisions to put "profits over safety" fails because they fail to link specific decisions in which this occurred to specific board members. PG&E and Defendants generally criticize the Complaint for making general allegations that are not tied to specific directors. Finally, PG&E and Individual Defendants argue that even if Plaintiffs were able to identify a specific decision to put "profits over safety" that decision would be an exercise of the board's business judgment and protected by the business judgment rule (*South v. Baker* (Del. 2012) 62 A.3d 1, 18.)

Plaintiffs argue the *Caremark* standard, and the cases that follow it (e.g. *South v. Baker*), are inapplicable because PG&E is a *California* corporation, and thus a Directors' liability for breach of fiduciary duty is premised on *California* law. PG&E and the Individual Defendants do not dispute that PG&E is a California corporation, incorporated pursuant to the laws of the State of California, and not Delaware. In fact the court granted the Individual Defendants' request for judicial notice of PG&E's Articles of Incorporation, which provide that the Directors are *exculpated* from personal monetary liability "to the fullest extent permissible *under California law*." (Emphasis added.)

Generally, when a corporation includes an exculpation clause in its articles, a serious threat of liability may be found to exist only if the plaintiff pleads a nonexculpated claim (*Wood v. Baum,* 953 A.2d 136, 141 (Del. 2008); *In re Baxter Int'l, Inc. S'holders Litig.*, 654 A.2d 1268, 1270 (Del.Ch.1995.) Plaintiffs argue that California law provides an entirely different and arguably more liberal standard for determining director exculpation, and thus cases which apply Delaware's exculpation statute have no bearing on this case.

California law prohibits the exculpation of directors for liability for acts or omissions that involve the absence of good faith on the part of the director, for acts or omissions that show a reckless disregard for the director's duty to the corporation or its shareholders in circumstances in which the director was aware, or should have been aware, in the ordinary course of performing a director's duties, of a risk of serious injury to the corporation or its shareholders, and for acts or omissions that constitute an unexcused pattern of inattention that amounts to an abdication of the director's duty to the corporation or of its shareholders. [6]

These exceptions do not require, as does Delaware's provision, conscious or knowing bad faith. Also, as Plaintiffs point out, the latter provision pertaining to an "unexcused pattern of inattention", is unique to California and not found in the Delaware statue that served as a model (*FDIC v. Faigin,* 2013 U.S. Dist. LEXIS 94899 at 22-23 and fn.2 (C.C. Cal. July 8, 2013.)[7] Thus California's exculpation statute is much narrower than Delaware's statute.[8]

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[6] *See* California Corporations Code section 204(a)(10), which provides in part: "The articles of incorporation may set forth: (10) Provisions eliminating or limiting the personal liability of a director for monetary damages in an action brought by or in the right of the corporation for breach of a director's duties to the corporation and its shareholders, as set forth in Section 309, provided, however, that (A) such a provision may not eliminate or limit the liability of directors (i) for acts or omissions that involve intentional misconduct or a knowing and culpable violation of law, (ii) for acts or omissions that a director believes to be contrary to the best interests of the corporation or its shareholders or that involve the absence of good faith on the part of the director, (iii) for any transaction from which a director derived an improper personal benefit, (iv) for acts or omissions that show a reckless disregard for the director's duty to the corporation or its shareholders in circumstances in which the director was aware, or should have been aware, in the ordinary course of performing a director's duties, of a risk of serious injury to the corporation or its shareholders, (v) for acts or omissions that constitute an unexcused pattern of inattention that amounts to an abdication of the director's duty to the corporation or its shareholders . . ."

[7] PG&E attempts to distinguish Faigin by arguing it addresses exculpation, which has nothing to do with oversight claims. However, it appears exculpation is tied in with demand futility (*In re Intel Corp Derivative Litigation*, 621 F.Supp.2d 165, 171 (2009).)

[8] Delaware Statute 8 Del. Sec. 102 narrowly and strictly defines the conduct of a director that cannot be exculpated to include: "(7) A provision eliminating or limiting the personal liability of

While a California court "may properly rely on corporate law developed in the State of Delaware given that it is identical to California corporate law for all practical purposes" (*Shields v. Singleton* (1993) 15 Cal.App.4th 1611, 1621), here the exculpation provisions are not identical.

Therefore, it appears that Delaware cases which analyze demand futility based on Delaware's stricter exculpation provision are not controlling. PG&E is a California corporation and adopted in its Articles California's exculpatory provision. Thus the court tentatively finds that California law is applicable, and it establishes the circumstances under which demand would be futile.[9] The court also therefore tentatively rejects Defendants' argument that the *Caremark* decisions and those cases following that decision should guide this court on this issue. The parties may address this issue further at the hearing scheduled for August 7, 2015.

C. <u>Allegations</u>

In order to rule on this demurrer the court has carefully reviewed the parties' briefing and authorities, and has read through the entire Complaint and each of the allegations, including each of the allegations regarding the specific

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a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director : (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law; (iii) under Sec. 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit...(citation omitted)"

[9] A recent unpublished United States District Court opinion provides some guidance on the application of California Corporations Code Section 204 and its application to cases such as the one before this court. (*See, Gordon v. Bindra* (2014) WL 2533798 at*5.)

directors. "It is not the ordinary function of a demurrer to test the truth of the plaintiff's allegations or the accuracy with which he describes the defendant's conduct. A demurrer tests only the legal sufficiency of the pleading. [I]nconsidering the merits of a demurrer, the facts alleged in the pleading are deemed to be true, however improbable they may be'" (*Bader v. Anderson, supra,* 179 Cal.App.4th at p. 787; citation omitted.)

**Allegations from Plaintiffs' briefing that the court found critical to its analysis are attached as Exhibit "A". Allegations which the court found critical based on its independent review of the Complaint are attached as Exhibit "B."**[10]

1. <u>Directors Earley, Fowler and Kelly</u>

These three directors, as was explained in the discussion regarding PG&E's Motion to Strike, were added to the Second Amended Derivative Complaint as "non-defendant Participants." Plaintiffs allege that these three directors, who joined the Board *after* the San Bruno explosion, face a substantial likelihood of non-exculpated personal liability for failing to "rectify" or "change" PG&E's corporate culture after the San Bruno explosion, and by reason of the knowledge and information they obtained in the course of their memberships on the Audit or Finance Committees.

Plaintiffs further allege that Mr. Fowler, a member of PG&E's Nuclear, Operations, and Safety Committee and Public Policy Committee, faces personal liability for supporting and/or approving PG&E's continuing failure to maintain inadequate records and for efforts to conceal the inadequacy of PG&E's records.

[10] These exhibits are incorporated by this reference into the Tentative Ruling.

Finally, Plaintiffs allege Mr. Earley, as President, CEO and Chairman of the Board of PG&E, failed to change PG&E's policies, procedures and practices regarding safety, and also misrepresented PG&E's efforts to effect change. Plaintiffs also allege that the "enormous compensation" paid to Mr. Earley raises a reasonable doubt as to his independence in analyzing a demand from Plaintiffs under the first prong of *Aronson*. Mr. Earley allegedly received more than $31,000,000 in total compensation from 2012 through 2014. In support Plaintiffs cite to *In re The Limited, Inc. S'holders Litig.* (Del. Ch.Mar. 27, 2002) 2002 Del. Ch. LEXIS 28.

The court rejects Plaintiffs' arguments that these three directors should in any way be considered by the court in this analysis. Plaintiffs have failed to allege sufficient facts to establish that these three directors faced a substantial likelihood of personal liability for the explosion, so that they would have been unable to entertain a demand.

Regarding Plaintiffs argument that they are liable for failing to "rectify" or "change" PG&E's corporate culture after the San Bruno explosion, Plaintiffs fail to allege with specificity what these directors failed to do. Plaintiffs do refer to a filing made by PG&E with the CPUC on July3, 2013, but fail to specifically link the information in this filing to these three directors. Nor does it appear plausible that these directors had any concern in 2013 about a substantial likelihood of liability for the San Bruno explosion.

As to allegations regarding committee memberships making them incapable of considering a demand, Plaintiffs fail to specifically explain how memberships in these committees *after* the San Bruno explosion would make them incapable of entertaining a demand. Furthermore, generalized allegations of committee membership are insufficient to plead demand futility (*In re CNET Networks, Inc.,* 483 F.Supp.2d 947,965 (N.D. Cal. 2007).)

Finally, regarding Mr. Earley, the court finds *The Limited* case is distinguishable. It did not hold that substantial compensation to a director alone establishes a lack of independence under *Aronson*. Rather in *The Limited* case the court found the plaintiffs had established demand futility in regards to a director because he was beholden *to the CEO/controlling shareholder of the company* for his compensation. No similar allegations are made here by Plaintiffs. Mr. Earley is paid *by PG&E* and must be presumed to have the company's best interests in mind (*In re Dow Chem. Co. Deriv. Litig.,* No. 4349-CC, 2010 WL 66769 at *8.)

2. Directors Andrews, Cox, Williams, Herringer, Rambo and Meserve

As to the six directors who served from 2006 to the time of the explosion, the court finds that plaintiffs have pleaded demand futility.[11] The exhibits attached to this order list the specific allegations the court found persuasive in making this determination, including safety, operational, maintenance, and cultural problems at PG&E. Highlighted briefly below are some of these allegations.

From 2006 through 2010, the Directors were aware of major maintenance problems with PG&E's gas distribution network, including a very high volume of gas leaks, massive recordkeeping deficiencies, employees who were frustrated that

[11] As argued in Plaintiffs' July 15, 2015 letter to the court addressing the *General Motors* case, the allegations in the Complaint regarding these six directors appear to establish violations of the directors' duty of loyalty under both Delaware *and* California law.

their safety concerns were unaddressed, and insufficient funding for inspections and maintenance. The Enterprise Risk Management Program had regular communications to the Directors to identify potentially catastrophic risks. Investigations and reviews were provided in Board packages. Nevertheless the Directors made constant budget cuts for maintaining pipeline infrastructure, even though sufficient revenue existed to fix these problems. As Plaintiffs argue, the routine reduction of budgets for maintenance of transmission and distribution lines at a time when the Company was facing an aging infrastructure cannot be viewed as an exercise of good faith business judgment.

PG&E argues Plaintiffs admit it had a system in place to detect and address safety issues, including the Enterprise Risk Management Program, and that these admissions defeat any claim that there was an utter failure to establish controls (*Caremark.*) However, as explained above, the *Caremark* standard is not controlling. Furthermore, Plaintiffs allege that while PG&E may have taken some steps to address safety concerns, the mere existence of these programs does not establish that PG&E was successful in addressing safety concerns. In fact the allegations support the opposite conclusion.

Regarding PG&E and the Individual Defendants' arguments that Plaintiffs fail to make specific allegations regarding the individual directors, Plaintiffs do make specific allegations regarding these directors. With the exception of Mr. Meserve, all the other directors were on the Budget or Finance committees and were given reports regarding funding and safety concerns. Mr. Meserve was on the Board from 2006 when the budget cuts occurred as well as numerous "red flags", including the 2008 Rancho Cordova explosion in 2008, which would have been impossible to ignore. As Plaintiffs allege, under proper corporate governance procedures any red flags should have been not only reported to the Board, but addressed by them. Finally, PG&E's own website admits that *"[r]egular Communication to the PG&E Corporation and Pacific Gas and Electric Company Board of Directors* enhances accountability and references the importance of risk management at all levels of the company" (¶ 111.) (Emphasis added.)

3. <u>Kimmel, Chew, Miller and Parra</u>

All four of these directors joined the Board shortly before the San Bruno explosion. Thus the Court has carefully reviewed the Complaint and the allegations against these four directors to determine whether Plaintiffs have alleged sufficient particularized facts showing any one of them was or was not capable of considering a pre-suit litigation demand.

The allegations regarding all four are fairly similar and are briefly set forth below.[12] Roger H. Kimmel has served as a director of both companies since January 2009. Lewis Chew has served as a director of both companies since September 2009. Forrest E. Miller has served as a director of both companies since February 2009. Rosendo G. Parra has been a director of both companies since September 2009.

All have served on various committees. Kimmel and Parra have served as members of the Finance Committee, as well as the Nominating and Governance Committee. Chew has been a member of the Audit Committee and the Public Policy committee. Miller is or has been a member of the Audit Committee, and the Compensation Committee. Although, as set forth above, generalized allegations of

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[12] As previously stated, a complete list of the allegations the court found critical are set out in Exhibits "A" and "B" to this order.

committee membership are insufficient to establish demand futility (*In re CNET Networks, Inc.,* 483 F.Supp.2d 947,965 (N.D. Cal. 2007)), Plaintiffs do allege that as members of Finance and Audit committees these members had an opportunity to review what PG&E was spending on safety measures, and all members approved one budget before the San Bruno explosion. Plaintiffs allege this budget also made cuts to safety programs.

Plaintiffs further allege all four directors were responsible for implementing an internal control system to ensure that PG&E identified, corrected and mitigated potential risks that PG&E's pipelines would cause harm in areas that could affect human safety. Furthermore, in their capacity as directors all were specifically charged with overseeing PG&E's risk management practices and policies.

However, even given these allegations, the court has questions as to whether they are sufficient to find that any one of these directors was incapable of entertaining a demand from Plaintiffs. Therefore, as explained below, the court invites the parties to address their arguments to these four directors at the August 7, 2015 hearing.

## CONCLUSION

In preparation for the arguments on PG&E and the Individual Defendants' demurrer, the court asks that the parties specifically address the following two issues:

First, in determining demand futility, why should Delaware law be determinative when PG&E is a California corporation? What is the effect if California law, specifically Corporations Code section 204, is applicable?

Second, are the allegations in the Complaint sufficient to find that the four directors who joined PG&E's Board in 2009 were incapable of assessing a demand?

What does the Complaint specifically allege that they knew, when and how did they know of any safety problems, and how did they respond? Were the only "red flags" that came to the Audit Committee's attention those in 2007 and 2008 before Chew and Miller joined the Committee? Who was responsible for the reduction in the 2010 budget, who knew about it and why was it done? Did the Finance Committee receive any "red flags" during the brief time Kimmel and Parra were members? Is the result the same under both California and Delaware law?

Finally, in order to address these questions, the court would like to know whether the Plaintiffs made an inspection demand pursuant to Corporations Code section 1600, which allows a shareholder to seek inspection of "the accounting books and records and minutes of proceedings of the shareholders and the board and committees of the board of any domestic corporation."

EXHIBIT A

The allegations included in Plaintiffs Opposition that the court found to be crucial are as follows:

The directors all knowingly allowed PG&E's gas transmission and distribution lines, the heart of the Company's assets, to remain under-maintained (¶. 2), rejected internal budgets regarding how much money was needed to safely maintain gas transmission and distribution lines and cut those budgets, leaving the lines perennially under-maintained, were well-aware that their decisions on matters such as budget approval were exposing the Company to increased risk (¶ 6), consciously failed to properly fund and staff pipeline operations and maintenance for nearly a decade (¶ 9), knew that there was an insufficient commitment of resources to process safety, operations, and maintenance (¶113), were aware of the need to test and/or replace aging pipelines, including Line 132 (¶ 154), and consciously and/or recklessly caused or permitted PG&E Corporation to violate applicable pipeline safety laws and regulations (¶ 342.)

The Directors created a culture of mismanagement diverting for other purposes money needed for critical safety and operational purposes all the while approving lavish bonuses to management and making gas distribution profits that exceeded levels authorized by the CPUC. (¶ 2, 7)

The Directors allowed PG &E's natural gas transmission and distribution lines-the heart of the Company's assets-to remain uninspected and under-maintained. Year after year, the Directors-who set or approved the budgets, oversaw the Enterprise Risk Management (ERM) program, and managed the relationship with the CPUC-rejected budget recommendations for money needed to safely maintain PG&E's natural gas lines and cut those budgets, leaving lines unrepaired and fragile. As a result, a catastrophic incident was a likely and forseeable outcome of their deliberate corporate mismanagement. (¶¶ 2, 5-6)

Plaintiffs, in their Opposition to the demurrer, detail the events that the Directors knew or should have known in Paragraph 154. The court finds significance in these detailed warnings and allegations.

Plaintiffs further allege that a 2008 regulator audit of PG&E's Sacramento division found that the Company failed to meet deadlines for fixing leaks or inspecting repairs in 23 instances over two years. That audit, which was brought to the attention of the Boards, also revealed that PG&E could not prove they were doing annual drills to shut gas off during emergencies. (¶ 199)

Plaintiffs further note in their opposition, that in August 2008, the CPUC audited PG&E's Fresno division and its pipeline field inspections and concluded that PG&E did not have sufficient training and/or appropriate equipment to confront pipeline leaks. The audit found a number of major violations of safety regulations established by PHMSA; that PG&E's procedures did not define what constituted a "hazardous " leak, meaning that there were no standards for determining the severity of outdoor leaks in response to customer calls about the smell of gas; and that procedures did not provide for or require field service representatives to be qualified in the use of gas detection equipment or to possess knowledge needed to properly grade an outdoor leak. Consequently, field service representatives were left on their own to make subjective decisions, and were unable to rely on any standards as to the severity of leaks and how to respond. (¶¶ 200-201)

Other critical allegations include: While numerous "red flag" safety, maintenance, and recordkeeping problems piled up from 2006 through 2010, (¶¶ 145-95), the Directors, who were aware of these problems and regulatory findings, took little remedial action. (¶ 207)

The Directors knew and understood that it was their responsibility to manage risk and ensure that safety was a priority. They used an Enterprise Risk Management Program ("ERM") to identify regulatory issues and evaluate the most significant concerns facing PG&E, including potentially catastrophic risks. It was overseen by "senior officers" and involved"[r]regular communication" to the Boards. (¶¶ 111-118)

The Directors were well aware of serious risk management policy shortcomings. In May 2007, an internal enterprise risk management assessment noted that "PG&E lacks a well-defined documented risk policy/standard at the enterprise level that 1) explains PG&E's overall risk assessment methodology, 2) defines the business roles and responsibilities, 3) specifies the requirements for performing and documenting risks, 4) links risk assessments to controls, self-assessment, reviews and audits, and 5) specifies the requirements for metrics to track the risks." The report also found that "Energy Delivery and Engineering & Operations do not have an integrated, documented, consistent approach with clear organizational roles and responsibilities for dealing with their risk and associated corrective actions. " (¶ 208)

Internal PG&E documentation as early as 2006 identified a dangerous and catastrophic explosion as a well-known risk. PG&E also knew that such an incident would dramatically affect the Company and that imprudent decision-making could be costly. Despite this knowledge, the Directors continued to operate PG&E in a lax and imprudent manner in violation of their fiduciary duties to the company. (¶ 209) Although PG&E's executive leadership was well aware that a gas pipeline explosion (or a "system safety" event as PG&E called it) was a possibility, no effort was made to determine if a manufacturing defect could be the cause of that explosion. Despite this common sense possibility, PG&E did not make any effort to analyze it and, therefore, had no mitigation plans, which would have cost $100 to $500 million to put into place. (¶¶ 212-13)

***A September 2007 report to the Finance Committee advised that PG&E had inadequate gas and electric system safety controls, and that these deficiencies had led to accidents.*** The report also warned that ***"PG&E continues to experience potentially catastrophic equipment failures where the inability to analyze and trend historical patterns or to review the maintenance history of equipment has been identified as a contributing factor."*** In order to reduce these risks, new initiatives were being considered, including the establishment of an "asset registry to capture information about the design, maintenance, and failure of gas and electric T & D equipment," improvements in program implementation; improvements in collecting and maintaining operational data in an accessible manner; and the implementation of a gas distribution system integrity program to "assess threats to the distribution system, providing a basis for appropriate system-wide inspection and mitigation measures to be taken in order to address those threats." ***Yet the Finance Committee never ensured that these new measures were effectively implemented.*** (¶ 119)

Risk Management was supposed to be reviewed annually, but had not been reviewed for ***five*** years. (¶ 210) In 2007 a new Senior Vice President of Engineering and Operations was hired to manage ERM and immediately determined that risk management problems were "unactionable" because almost everything at PG&E in regards to safety was "broken." Indeed, the new Vice President was personally told by Individual Defendants Darbee and Johns that PG&E has a long history of safety and operational problems that were deeply ingrained into the corporate culture (¶ 211.) Presciently, he concluded: "PG&E lacks a well-defined documented risk policy/standard at the enterprise level. One that explains PG&E's overall risk assessment methodology; defines the lines of business roles and responsibility; specifies the requirements for performing and documenting risks; links risk assessments to controls, self-assessment, reviews and audits; and specifies the requirements for metrics to track the risks." (¶ 136)

Thus, through investigations and reviews provided in Board packages, the Directors were well aware that ERM was broken and that there was an insufficient commitment to resources to process safety, operations and maintenance. Nevertheless, the Directors ignored the problems and put profits before safety, which resulted in significant harm to PG&E (¶ 113.)

PG&E consistently cut its budget for maintaining transmission and distribution lines and other key infrastructure, while paying quarterly cash dividends, repurchasing stock, and/or providing bonuses or "incentives" to management and employees. PG&E has internal departments that are specifically responsible for the safety of the Company's vast pipeline network, and each year, these departments determine how much money is needed for evaluation, testing, maintenance, and/or repairs. The proposed budgets would go up the department chain all the way to the Directors who were ultimately responsible for budgeting (¶¶ 120-122.)

**Parenthetically, plaintiffs in a footnote state: In one particularly galling example, PG&E purportedly charged its customers $5 Million to fix the San Bruno pipeline in 2009, but delayed the repair, citing other priorities. The same year, PG&E spent $5 Million on executive bonuses (¶ 120.)** [Emphasis added.]

In order to increase profits, the Directors routinely cut these department budgets without any legitimate engineering basis for believing that the budgets were too high and unnecessary to maintain the pipelines. Furthermore, year after year, PG&E misrepresented to the CPUC the amount of funds necessary to maintain the infrastructure (¶¶ 122-123.)

Plaintiffs provide detailed examples of these allegations on page 9 of their Opposition to the Demurrer with references to paragraphs 154-55, and 228 of the Second Amended Complaint that allege:

From 2008 to 2010 PG&E reduced compliance and other Integrity Management expenses by consciously deciding to defer projects, in particular by deferring or downgrading assessment methods to inadequate and less costly techniques; moreover, PG&E ceased preparing metrics, goals, or annual reports for its gas transmission pipeline Risk Management Program. The Overland CPUC review concluded that risk management continued to be a separate program "in name only after 2004."

Approved budgets for Integrity Management were slashed nearly 50% from what was requested in 2008 for compliance and integrity activities, and a review noted that "expected flat funding in 2009 and 2010 will drive the program into non-compliance in 2012."

Budget cuts for safety programs continued in 2008, 2009, and 2010. Actual 2008 for compliance and safety funding was 35% below the initial request and 16% below "minimum funding to achieve 2012 compliance." [sic] PG&E's maintenance budget was 47% below the initial request and 25% below the "recommended minimum level."

Integrity Management budget cuts for 2009 resulted in deferring or eliminating replacement of over 44 miles of gas transmission pipelines in high consequence areas. PG&E also deferred 41 miles of integrity management assessments of gas transmission pipelines.

The PG&E 2010 budget was reduced for the third straight year and set at $6.7 million below already constrained 2009 actual expense levels.

**PG&E contemplated replacing a 7481 foot segment of Line 132 north of San Bruno in 2007, which PG&E had already identified as one of the 100 riskiest pipelines in the system. Replacement was scheduled for completion by October 2009 and was included in a list of projects that PG&E submitted to the CPUC to justify a rate-hike request. PG&E was awarded $5 million of ratepayer money to replace the line. But rather than conduct the repairs, PG&E repurposed the money and left the old segment in place.**

**Despite safety concerns being directly addressed with the Boards in 2007, the Finance Committee in 2008-2009 slashed budgets for pipeline Integrity Management, forcing gas operations departments to defer pipeline inspection and replacement projects, and changing assessment methodologies from ILI (In-Line-Inspections designed to detect material defects and corrosion) to less expensive technology like ECDS (designed to detect corrosion only).**

The CPUC would later find that actual revenues collected from customers exceeded adopted revenues by $224 million from 1997 to 2010. The audit also showed that PG&E was provided rate recovery for pipeline transmission operations and maintenance, but that every year since 1996 PG&E spent $39 million less than the CPUC authorized. ***So for 10 years, PG&E intentionally spent less money on maintenance and operations than it represented was necessary to ensure that PG&E's pipelines and infrastructure were safe.*** (¶ 223) [Emphasis added]

Budget decisions and CPUC funding requests were done through the Executive Management Committee with oversight and final authority residing with the Boards. Thus, the Directors knew of and approved PG&E's budgeting for safety and maintenance, and they knew that PG&E was diverting resources purportedly pledged to safety, operations, and maintenance. The Directors consistently spent less and less money on operations and maintenance, fully aware of the dangers they were creating. (¶ 124)

At PG&E, supervisors and employees received bonuses for *not* reporting or fixing gas leaks that they found, and for keeping repair costs down. Thus, PG&E supervisors and employees were incentivized to pretend that leaks did not exist and to perform minimal work on any leaks that were detected (¶¶ 125-26.) Moreover, management ignored or even retaliated against mechanics and engineers who flagged and tried to remedy systematic safety problems (¶¶ 129-135.) This incentive bonus program was created and approved by the Boards in order to further the goal of cost reduction and short-term profit maximization while ignoring long-term ramifications. The Directors had intentionally and knowingly created a program in which the risk of a catastrophic incident would increase dramatically (¶ 128.)

The incentive program was ended at the end of 2008 after the Rancho Cordova explosion. PG&E then began rushing inspections of its gas pipeline network and found many more leaks than had been detected in earlier surveys. This led the CPUC to conclude that virtually every leak survey that PG&E had conducted since 2004 was "not effective." (¶¶ 125-26)

On January 12, 2012, the CPUC released to the public its San Bruno "Incident Investigation Report" on the PG&E Pipeline Rupture in San Bruno. It concluded that the incident was caused by PG&E's failure to follow accepted industry practice when constructing the section of the pipe that failed, PG&E's failure to comply with integrity management requirements, deficiencies in PG&E's systems and emergency response actions, and "a systemic failure of PG&E's corporate culture to emphasize safety over profits." (¶ 214) PG&E treated ***safety as a "low priority"*** and chose to use surplus revenues for "general corporate purposes" rather than improved gas safety. By cutting back on pipeline-replacement projects and maintenance, laying off workers, using cheaper but less effective inspection techniques, and trimming other pipeline costs, PG&E saved upward of 6% of the money designated for public safety, maintenance, and operations programs. PG&E diverted customers' fees from safety purposes to short-term profit (¶ 215.)

The CPUC hired and retained Overland Consulting to review PG&E's gas transmission safety-related activities. After an exhaustive investigation, Overland issued reports in 2011 and 2013.

Although PG&E and the individual defendants dismiss the findings of Overland Consulting, the court finds these allegations critical to its analysis. The key findings include:

**2008 and 2009 maintenance budgets were under-funded, showing "significant resource constraints directly impacting pipeline safety funding." (¶¶ 229-30) Gas distribution operations, and particularly safety-related categories, were underfunded (¶ 238.)**

**Over a ten-year period ending in 2010, PG&E intentionally spent less money on maintenance and operations than it represented was necessary to ensure that PG&E's pipelines and infrastructure were safe (¶ 223.)**

**PG&E does not monitor the miles of pipeline that its leak surveys on a centralized basis, and cannot provide actual leak survey mileage statistics for its backbone and local transmission systems-indicating a weakness in policies and procedures and safety-related resource constraints (¶ 228.)**

**PG&E reported a large increase in the number of transmission pipeline leaks in 2009 and 2010, which were discovered in special leak surveys implemented in response to the discovery of serious systemic deficiencies in the leak survey program and the San Bruno Incident. The large number of leaks discovered in the special leak surveys indicates that leak survey resources were inadequate prior to 2009 (¶ 228.)**

**PG&E cut the 2010 Integrity Management budget by deferring projects to future years and reducing scope by changing the definition of covered pipelines. (¶ 232)**

**Employee complaints about work practices and staffing levels prompted two significant internal audits in 2007 -- one in the North Bay and North Coast Divisions, and one in Marin County. The internal audits discovered critical deficiencies in leak survey and maintenance practices. PG&E's follow-up investigations demonstrated the deficiencies were pervasive throughout its system (¶ 251.)**

**An October 2007 internal leak grading process study conclusively demonstrated that PG&E's leak grading standards were not being applied consistently in the field (¶ 251.)**

**A 2009 report, issued prior to the San Bruno explosion, had already warned the Defendants that PG&E's safety procedures and policies were inadequate. "PG&E discovered critical deficiencies in its record keeping for service lines installed by residential subdivision developers. Many of the records that developers were required to provide were missing. The problem was pervasive system-wide. The root causes included wide-spread non-compliance with PG&E's standards, inadequate record management controls, inadequate auditing and poor communication between departments." (¶ 255)** [Emphasis added.]

The Overland Report concluded that "[t]he pervasiveness of the deficiencies [at PG&E] demonstrates that their ultimate root cause was ineffective or unresponsive executive management." (¶¶ 233, 238-62) The report confirmed that the Directors were aware, for over a decade, that PG&E's operational and process safety procedures were grossly inadequate and not being applied consistently. The Directors were well aware that PG&E was understaffed and that the budget was insufficient to ensure that the gas pipeline network was safe and secure. Nevertheless, they continued to push PG&E to cut costs at the expense of safety, with full knowledge that they were creating a foreseeably increased risk of a deadly explosion, such as those that occurred in Rancho Cordova and San Bruno (¶ 252.)

The NTSB determined that the probable cause of the San Bruno accident was: (i) PG&E's inadequate quality assurance and quality control during its Line 132 relocation project, which allowed the installation of a substandard and poorly-welded pipe section with a visible seam weld flaw that, over time, grew to a critical size, causing the pipeline to rupture during a pressure increase stemming from poorly planned electrical work at the Milpitas Terminal; and (ii) an inadequate pipeline integrity management program, which failed to detect and remove the defective pipe section (¶ 89.) The report found that PG&E's geographic information system still contained a large percentage of errors, which contributed to PG&E's failure to prevent the San Bruno disaster and continues to hamper

PG&E's ability to identify and correct potential future disasters (¶ 134.) The recurring deficiencies are evidence of a "systemic problem" finding issues of "significant concern" with each element of PG&E's integrity management program: "accurate, complete and verifiable data; threat identification and risk assessment; evaluation and correction, and self-assessment of program effectiveness."

EXHIBIT B

In addition to the allegations noted in Plaintiffs' Opposition to the Demurrer, the court independently notes below relevant charging allegations contained in the Second Amended Derivative Complaint.

Defendant Forrest E. Miller was appointed to the Board of Directors in February 2009. He is a member of the audit committee, and the compensation committee of PG&E Corporation (¶ 40.) He was responsible for implementing an internal control system to ensure that PG&E identified, corrected, and mitigated any potential risks that the company's pipelines would cause harm in areas that could affect human safety (¶ 41.) **"Miller also approved and supported the underfunding of PG&E's pipeline operations and maintenance."** (¶ 41) [Emphasis added]

Defendant Lewis Chew is a director of both companies and has been since September 2009. He is a member of the audit committee of PG&E Corporation and a member of the public policy committee of PG&E (¶ 43.) **"Chew knew or recklessly allowed PG&E to violate CPUC and PHMSA regulations. Chew also approved and supported the underfunding of PG&E's pipeline operations and maintenance…"** [Emphasis added]

Defendant Roger H. Kimmel has been a director of both companies since January 2009. He has served as a member of the finance committee of PG&E Corporation as well as the nominating and governance committee (¶ 52.) **"In his capacity as a director of PG&E Corporation and PG&E, Kimmel was specifically charged with overseeing PG&E's risk management practices and policies. Kimmel knew or recklessly allowed PG&E to violate CPUC and PHMSA regulations by failing to implement and/or maintain adequate internal controls with respect to PG&E's compliance with CPUC and PHMSA regulations. Kimmel also approved and supported the underfunding of PG&E's pipeline operations and maintenance…"** (¶ 53) [Emphasis added]

Paragraph 100 describes the requirements that a provider must implement a written integrity management program which is required to include: **A Baseline Assessment Plan that: identifies potential threats to each covered segment: identifies methods to assess integrity based on the threats identified for each**

**covered segment (*e.g.* internal inspection, pressure testing, direct assessment, or other technology); identifies a schedule for completing the assessments including the risk factors used in determining schedule priorities; contains a direct assessment plan, if applicable (including the gathering and integration of risk factor date, indirect examination or analysis to identify areas of suspected corrosion, direct examination of the pipeline in these areas, and post assessment evaluation) appropriate for the threats identified for the covered segments; and includes a procedure for ensuring that the baselines assessments are conducted in a manner that minimizes environmental and safety risks; Identification of threats to each covered segment, including by the use of date integration and risk assessment; Provisions for remediating conditions found during integrity assessments; A confirmatory direct assessment plan, if applicable; A process to identify and implement additional preventative and mitigative measures; A performance plan including the use of specific performance measures; Recordkeeping provisions; Quality Assurance process; A communication Plan; and Procedures for providing to regulatory agencies copies of risk analysis or integrity management program.** [Emphasis added]

Paragraphs 101-109 set forth in detail the PHMSA requirements and Paragraph 110 indicates that the regulations were known to the individual defendants. This paragraph asserts that the officer and Directors had a fiduciary duty to ensure that the regulations were met and that safety was a top priority at PG&E.

**These regulations were known to the Individual Defendants. As the top officers and directors of PG&E, they had a fiduciary duty of ensuring that these regulations were met and that safety was made a top priority at PG&E, in order to ensure that there were no serious events that would significantly impact and harm PG&E. The Individual Defendants failed in their obligations to ensure that PG&E complied with federal and California state regulations. (¶ 110)** [Emphasis added]

PG&E's own website identifies a program called the "Enterprise Risk Management (ERM)" program, which purportedly takes a hostile approach to managing risk. This ERM program is led by PG&E's Chief Risk and Management

Officer. As the website states: For potentially catastrophic risks, cross-functional teams, guided by subject matter experts and experienced managers, followed a systemic method to identify the risks, evaluate the likelihood and severity of consequences as well as the adequacy of controls, and monitor ongoing risk management activity. Oversight by senior officers helps ensure risk management activities are consistent with the company's overall corporate strategy. ***Regular Communication to the PG&E Corporation and Pacific Gas and Electric Company Board of Directors enhances accountability and references the importance of risk management at all levels of the company*** (¶ 111.) [Emphasis added.]

This allegation is important in that it references nominal defendant PG&E Corporation's own website and serves to support the other allegations concerning information that was shared with the Directors.

**PG&E's website further notes that the ERM program is a "sustainable process." The ERM program at PG&E is cyclic: we identify and evaluate the top risks facing the company every two to three years. In this way, senior management has a periodic opportunity to evaluate the most significant concerns facing PG&E and can calibrate the program with challenges in the current business environment and external stressors that potentially affect operations.**

**The program also has a mechanism to introduce new risks mid-cycle, if a new risk emerges in the business environment that requires immediate attention. We follow a "bottom-up, top-down" approach to identifying risks, with technical staff and managers at the business-unit level participating in a risk identification and characterization process. We subsequently review the identified risks, add additional risks if necessary to address senior management concerns, prioritize them for analysis and assign them to specific officers-owners. Beginning in 2009, we evaluated the risks identified in the process cycle that started at the end of 2008 and we are in the process cycle that started at the end of 2008, and we are presenting and acting on these risks during 2010. Each iteration of the ERM process improves the understanding of the risks facing PG&E and allows management to make better informed risk-based decisions (¶ 112.)** [Emphasis added.]

This indicates that the Individual Directors knew and understood that it was their responsibility to manage risk and ensure that safety was a priority. Furthermore, through investigations and reviews they sponsored, the PG &E Corp. and PG&E Boards of Directors were well aware of the operations of the ERM program. The Boards of Directors of PG&E Corp. and PG&E therefore knew that there was an insufficient commitment of resources to process safety, operations and maintenance. The Individual Defendants, nevertheless, put profits before safety, which resulted in the significant harm to PG&E that is the subject of this lawsuit. The chronic underfunding and understaffing of PG&E's pipeline network was well known to the Individual Defendants, who would have been aware of its safety concerns from these periodic ERM evaluations. **Information from ERM safety reviews were provided to the Individual Defendants in Board packages, showing that the Individual Defendants were well aware that PG&E was putting budgetary concerns before the safety of its employees and the residents of California (¶ 114.)**

**The court notes that plaintiffs mentioned this paragraph specifically in their opposition to the demurrer, but the court accentuates this as important to its analysis:**

The PG&E 2008 Corporate Responsibility Report assures shareholders that "[o]versight by a committee compromising senior officers helps ensure risk management activities are consistent with the company's overall corporate strategy. ***Regular communication to the PG&E Corporation and Utility Boards of Directors enhances accountability and reinforces the importance of risk management at all levels of the company."*** (¶ 115.) [Emphasis added.]

**Budgeting decisions and CPUC funding requests were done through the executive management committee with the oversight and final authority of the PG&E Corp. and PG&E Boards of Directors. The Individual Defendants in this case were the top officers of PG&E Corp. and PG&E, members of the executive management committee (which included both board members and officers) and the members of PG&E Corp. and PG&E Boards of Directors. All of them knew of and approved PG &E's budgeting for safety and maintenance, and that PG&E was diverting resources purportedly pledged to safety, operations and maintenance to other corporate purposes. The**

**Individual Defendants consistently spent less and less money on operations and maintenance, fully aware of the dangerous risks they were creating and probable dangerous consequences of their failure to address the risk of a catastrophic loss caused by PG&E's deficient transmission and distribution pipeline system (¶ 124.)** [Emphasis added]

**PG&E's Senior Vice President of Engineering and Operations, who oversaw PG&E's ERM program, confirmed that the formal ERM Program fell under the Chief Risk and Audit Officer but the operational ERM program (meaning day-to-day risk management in the field) was under his purview. He revealed that PG&E already realized by the spring of 2007 that it needed to "shift culture," develop greater "operational discipline" and "build an integrity from top to bottom of the organization." When that same official reviewed PG&E's Enterprise Risk Management for Energy Delivery and Engineering and Operations shortly after joining PG&E in May 2007, he concluded: the program seemed "unactionable because almost everything is broken . . . need to triage." Presciently, he concluded that: *"PG&E lacks a well-defined documented risk policy/standard at the enterprise level. One that explains PG&E's overall risk assessment methodology; defines the lines of business roles and responsibility; specifies the requirements for performing and documenting risks; links risk assessments to controls, self-assessment, reviews and audits; and specifies the requirements for metrics to track the risks."* When the Senior Vice President of Engineering and Operations joined PG&E in 2007, Defendants Darbee and Johns, on behalf of PG&E Corp. and PG&E Boards of Directors, informed him that PG&E's risk management protocols were woefully deficient (¶ 136.)** [Emphasis added]

Paragraph 154 outlines, in extraordinary detail, the knowledge provided to PG&E officers and the Board of Directors concerning the need to test and replace Line 132 yet consciously failed to do so as part of its overall commitment to profits over safety.

**According to documents released by The Utility Reform Network ("TURN"), PG&E contemplated replacing a 7481 foot segment of Line 132 north of San Bruno in 2007. TURN, however, alleges that PG&E deferred maintenance on a wide variety of its pipelines and equipment in recent years. At the time of**

**the 2007 request, PG&E had already identified that section of Line 132 as one of the 100 riskiest pipelines in PG&E's system. PG&E was awarded $5 Million to ratepayer money to replace the line. The replacement was scheduled to be completed by October 2009. This work was included in a list of projects that PG&E submitted to the CPUC to justify a rate-hike request related to natural gas transmission and storage. Rather than conduct the repairs, PG&E repurposed the money and left the old segment in place. Especially troubling is that, according to TURN, in 2009 PG&E spent nearly $5 million on bonuses for six of its top executives, nearly the same amount that PG&E was awarded to replace an extremely risky segment of Line 132. In this case, PG&E did not just put profit before safety; it put personal benefit before safety (¶ 155.)** [Emphasis added]

Even worse, that same project appeared again in 2009, on a list of projects that PG&E submitted to the CPUC in a "Capital Project Summary." PG&E again sought $5 million for the same project. PG&E justified the project and second request for $5 million in funding by characterizing the risk of failure to replace Line 132 as follows: **If the replacement of this pipe does not occur, risk associated with this segment will not be reduced. Coupled with the consequences of failure of this action of pipeline, the likelihood of a failure makes the risk of a failure at this location unacceptably high (¶ 156.)** [Emphasis added]

One PG&E document noted in an apparent reference to an explosion that it "**has a potential impact radius of 415 feet and is located in a heavily urbanized area.**" In 2009, the $5million was awarded again to PG&E and again the project was deferred. Line 132 has been a concern for years, PG&E knew that the risk was "unacceptably high" and could result in a deadly explosion. The Individual Defendants knew of the risk, and were using that risk to obtain more money from ratepayers, yet they continued to delay necessary repairs that they knew about (¶ 157.) [Emphasis added]

**In early 2009, PG&E became aware that "significant amounts" of compressor oil and water was accumulating in Line 132 and three other transmission lines in the Peninsula area south of San Francisco connected to the Milpitas terminal. The liquids were, according to Pacific Gas & Electric**

**Company, "an ongoing concern for internal corrosion."** **(¶ 159)** [Emphasis added]

Prior to the 2010 San Bruno explosion, the Boards of Directors of both PG&E Corp. and PG&E were fully aware of the serious safety, operational, maintenance and cultural problems at PG&E. The Boards of Directors of PG&E Corp. and PG&E sponsored internal investigations and reviews revealing that PG&E was in a "crisis" mode due to a lack of process focus, quality control, operational discipline, and planning and resource allocation. Between 2007 and 2010, the Boards at PG&E Corp. and PG&E were specifically informed and knew about the following:

**Assertions of management improprieties in PG&E's gas operations by employees at the 2007 Annual Shareholder's Meeting.**

**The explosion and failure of network transformers in July 2007 and the subsequent discovery of maintenance and engineering breakdowns.**

**A business transformation failure in October 2007 that impacted primarily work flow processing in T & D.**

**System wide problems in recordkeeping relating to gas matters, such as leak surveys, maintenance process records, and emergency valve and regulation station records.**

**Repeated meetings with the City and County of San Francisco due to explosions and significant service outages.**

**Multiple Direct Current ("DC") system failures in San Francisco, which culminated in the Polk and O'Farrell event and which led to PG&E's retirement of its extremely old DC system.**

**In 2008 and 2009, the Diablo Canyon electric yard events relating to high voltage bushing explosions and transformer issues.**

**The Rancho Cordova explosion of December 24, 2008 and the subsequent NTSB investigation.**

**The accelerated leak survey from late 2008 through early 2010, which resulted in record levels of work being executed in a compressed timeframe.**

**Findings and records relating to Transfer Ground Rocker Arm Main ("TGRAM") and Transfer Ground Rocker Arm Line ("TGRAL") oil filled switches.**

(¶ 168) [Emphasis added]

PG&E internal corporate memos reveal that the Defendants knew, no later than 1993, that PG&E was losing track of documents for its gas-transmission system and that a catastrophe was not only possible, but likely, which would result in serious financial and reputational harm to PG&E, not to mention potential property damage and loss of life (¶ 182.)

**According to PG&E's 2009 Annual Report, it had incurred "approximately $100 million of costs to perform accelerated natural gas leak surveys and associated remedial work" which according to the 2009 10-K, was expected to be completed in April 2010. However, information discovered years after the San Bruno explosion in 2010 showed that PG&E did not meet its obligations. PG&E again began downgrading the amount of money it would spend on gas leak surveys in the months leading up to the tragic San Bruno incident. Moreover, the required gas leak surveys did not occur by April of 2010, as PG&E had promised (¶ 205.)** [Emphasis added]

In October 2008, CPUC engineer Dennis Lee stated publicly that PG&E was not keeping proper logs of pressure problems in the gas distribution system (¶ 207.)

**The Individual Defendants were aware of the foregoing audits and findings (¶ 208.)** [Emphasis added)]

**Moreover, by at least 2009 and 2010, the executive management committee at PG&E (which included senior officers and directors such as Defendants Darbee and Johns) was well aware that the company faced a significant risk of a single major catastrophic event. In a document entitled "Enterprise Risk Management Risk Review," it was identified to PG&E's executive management that one of the "top" enterprise risks was the risk of a**

**"system safety" event. However, although PG&E 's executive leadership was well aware that a gas pipeline explosion, or a "system safety" event as PG&E called it, was a possibility, no effort was made to determine if a manufacturing defect could be the cause of a gas pipeline explosion. Despite this being a commonsense possibility of what could cause a pipeline to explode, PG&E did not make any effort to analyze that possibility and therefore had no plan in place to mitigate that risk. (¶ 212)** [Emphasis added]

The executive management committee, in putting together this "Enterprise Risk Management Risk Review," determined that the financial impact of risk mitigation was $100 to $500 million. The executive management committee considered the reputational and environmental impact of risk mitigation, but dismissed the impact on human lives that would happen if there was a failure to mitigate the risk of a catastrophic "system safety" event. In the work performed by PG&E, they referred to a catastrophic event that could cost human lives a "significant event in a high density area" which is a euphemism for an explosion in a place where people live and work (¶ 213.)

**The Panel also found that PG&E lacked core technical expertise and that the expertise it did have was being lost. The Individual Defendants had allowed that knowledge base to be lost while increasing layers of management, in which businessmen and lawyers were essentially running one of the nation's largest utilities. The Individual Defendants themselves came largely from financial and legal backgrounds and had no understanding or knowledge of process or system-wide safety at PG&E. Despite being informed that more money was needed for overall safety, the Individual Defendants consistently rejected those recommendations in order to cut costs. The Individual Defendants were well aware that the company lacked the technical expertise needed to ensure process and operational safety. However, since the Individual Defendants were ignoring PG&E's own experts in setting budgets, it did not matter to the Individual Defendants that the company lacked the expertise needed to operate a utility of the size and scope of PG&E** (¶ 218.) [Emphasis added]

The 2013 Overland Report found that PG&E's budget documentation process was woefully inadequate, and that that "[t]he available documentation for the 2008 to 2010 budget years demonstrates that **PG&E gave a relatively low priority to gas safety spending** in those years: The budget process started with initial budgets set by senior management. The basis for the initial budget targets was poorly documented. The next major step in the process was the submission of initial budget requests by the various organizations included in the budget. PG&E did not retain the gas distribution initial budget requests for the 2003 through 2008 budget years. PG&E cannot show how the budget requests in those years were prioritized. **The gas distribution budget requests for 2009 and 2010 were poorly documented.**

**The initial budget requests were reviewed and adjusted by a central budget committee and senior management. Those processes were completely undocumented.** PG&E did not retain the initial approved budgets for most years in the study period. PG&E cannot provide the initial approved gas distribution expense budgets by MWC [Major Work Categories] for 2003, 2004, 2005, 2007 or 2008 (¶ 248.) [Emphasis added]

**These process failures are the responsibility of the Individual Defendants who have the ultimate responsibility for ensuring that operational and process safety is a priority at PG&E, as reflected in the budget, and there is adequate documentation to show that those safety objectives are being met. Instead, PG&E made safety a very low priority. Furthermore, PG&E's poor documentation makes it impossible to assess the methodology behind PG&E's budgeting of operational and process safety** (¶ 249.) [Emphasis added]

To discharge their duties, the officers and directors of PG&E Corp. were required to exercise reasonable and prudent supervision over the management, policies, practices, and controls of the financial, business, and corporate affairs of the Company. By virtue of such duties, the officers and directors were required, among other things, to:

a. Manage, conduct, supervise, and direct the business affairs of PG&E Corp. and PG&E in a manner consistent with their duties of care to the companies. In other words, the officers and directors of the companies were required to exercise due diligence and consistent supervision to ensure that the companies were always operating in an appropriate and safe manner.

b. Manage, conduct, supervise, and direct the business affairs of PG&E Corp. and PG&E in a manner consistent with their duties of loyalty to the companies. **In other words, the officers and directors of the companies were required to always put the best interests of the company and its shareholders above their own self-interest.**
c. **Manage, conduct, supervise, and direct the business affairs of PG&E Corp. and PG&E in accordance with the laws, rules, and regulations of the United States and the State of California, as applicable to both PG&E Corp. and PG&E.**
d. Implement and oversee in good faith adequate internal controls sufficient to monitor and prevent the directors, officers, and employees of the companies from violating or acting in contravention of all applicable laws, rules and regulations; and
e. Refrain from using their status as directors of PG&E Corp. and PG&E to the detriment of the companies (¶ 306.) [Emphasis added]

From 2004 to 2009, PG&E was responsible for 59% of the 410 "probable violations" of federal or state safety rules and regulations CPUC regulators identified during that period, despite the fact that it operated only 41% of the State of California's pipelines. Also during this period, PG&E was responsible for more "reportable incidents" that any other utility in the United States. In this total are nine explosions that together injured or killed at least sixteen people, in particular the 2008 Rancho Cordova explosion and the 2010 San Bruno explosion. Furthermore, PG&E's survey conducted in 2007 identified leaks and other problems in 28 HCA residential areas that it tested. All four of the residential distribution lines PG&E examined in the Peninsula area south of San Francisco had leaks. PG&E's November 2009 report failed to identify the cause of leaks that PG&E's own records identified as a defective longitudinal seam weld. The San Bruno incident was caused by the defective nature of that longitudinal seam weld (¶ 307.) [Emphasis added.]

**PG&E's failure to follow safety regulations imposed by PHMSA and CPUC has been sustained and systematic. Such conscious inaction could not have been an action taken in good faith and is accordingly not protected by the business judgment rule** (¶ 308.) [Emphasis added.]

**Due to the Individual Defendants' positions with PG&E Corp. and PG&E, they had access to adverse undisclosed information about the business, operations, operational trends, financial statements, markets, and present and future business prospects of the Companies via receiving internal corporate documents (including the operating plans, budgets and forecasts, and reports of actual operations of the companies), conversations and connections with other corporate officers and employees, attendance at management and Board of Directors' meetings and committees thereof and via reports and other information provided to them in connection therewith** (¶ 310.) [Emphasis added.]

Both PG&E Corporation and PG&E had Audit Committees, generally composed of the same directors. PG&E Corp. directors who served as members of the Audit Committees violated additional duties that they had as members of the Audit Committees. The Audit Committees of the Board were responsible by the Charters for, among other things: reviewing the adequacy of internal controls, external and internal auditing programs, business ethics, and compliance with laws, regulations, and policies that may have a material impact of the consolidated financial statements. The Audit Committees were responsible for ensuring that PG&E Corp. and PG&E were in compliance with all laws and regulations and was meeting safety obligations as a regulated utility. Defendant Andrews served as a member of the Audit Committees from 2003 to 2013. **Defendant Chew has served as a member of the Audit Committees since 2009. Defendant Herringer has served as a member of the Audit Committees since 2006. Defendant Miller has served as a member of the Audit Committees since 2009, and is currently the chair.** Defendant Williams served as the Chair of the Audit Committees since at least March 2005 to 2014. Defendant Kelly has served as a member of the Audit Committees since June 2013. These Defendants were responsible, as members of the Audit Committees for ensuring that Companies' internal controls were adequate and that the Companies were complying with federal and CPUC rules and regulations. The significant safety violations alleged herein were so pervasive that they could not have been the result of an isolated failure of oversight. Indeed, the wrongdoing in questions reveals a corporate culture that regularly and consciously ignored sustained and systematic red flags.

In light of the number, duration, and severity of the violations, as well as the responsibilities outline in the Audit Committee Charters, the facts compel the conclusion that the Audit Committee members had to have known about the frequency and extent of the safety violations in question, both before and after the 2010 explosion (¶ 311.) [Emphasis added.]

Notwithstanding this knowledge, the Audit Committees' members failed to take steps to assure and/or improve PG&E's compliance record (¶ 312.)

The Finance Committee of PG&E Corp., under its Charter, is responsible for advising and assisting the Board with respect to strategic plans and initiatives. Specifically, the Finance Committee Charter provides that the Finance Committee is responsible for presenting for the Board's review and concurrence: (i) a multi-year outlook for PG&E and its subsidiaries that incorporates, among other things, key current and emerging issues, strategic initiatives, risk factors, and projected financial results; and (ii) an annual financial performance plan for operating expense and capital spending budgets that reflect the first year of the approved multi-year outlook. **The Finance Committee is responsible for the budget and the Finance Committee failed to ensure that sufficient resources and monies were devoted to safety, operations and maintenance, despite their knowledge of the serious problems at PG&E.** Defendants Coulter, Cox, Kimmel, Parra, Williams and Rambo were members on the Finance Committee of PG&E Corp. Coulter served on the Finance Committee from the 1990s until he resigned in 2008, serving as Chair between 2005 and 2008. Cox served on the Finance Committee from 2004 to 2014. **Kimmel has served on the Finance Committee since 2009.** Williams has served on the Finance Committee since the 1990s, and served as Chair from 2000 to 2004. Parra has served on the Finance Committee since 2010. Rambo has served on the Finance Committee since 2004, and served as the Chair of the Finance Committee since 2008. **As members of the Finance Committee, Defendants Coulter, Cox, Kimmel, Rambo, Parra and Williams were responsible for reviewing and approving PG E's operating expense and capital spending budgets, which severely curtailed spending on safety and IMP implementation** (¶ 321.) [Emphasis added.]

The directors of PG&E Corp. adopted a Code of Business Conduct and Ethics for Directors on December 16, 2006, which was amended on December 16, 2009. **Under the Code of Business Conduct and Ethics, each Director is "accountable for adherence to this Code. (website omitted) Under the Code of Business Conduct and Ethics, the Board of Directors asserts that the "Companies have adopted the following values: We are accountable for all of our own actions: these include safety..."** (¶ 325) [Emphasis added]