

UTILITY WILDFIRE LIABILITY WORKGROUP REPORT

Commissioner Kahn and Commissioner Nava

Staff note: The executive summary and the workgroup reports have not been reviewed or approved by the full commission prior to being released publicly. The workgroup reports are the products of the workgroups established at the April 29th commission meeting, and represent consensus thinking of the members of a given workgroup. The executive summary, compiled by commission staff, is an attempt to reconcile the recommendations of the three workgroups into one cohesive set of proposed recommendations for discussion and consideration at the next commission meeting.

I. Findings from Public Testimony

Governor Newsom's April 12, 2019 report Wildfires and Climate Change: California's Energy Future ("Strike Force Report") covers much of the background necessary for this report. In many places, the Strike Force Report provides explanations and supporting data which parallel the work and findings of this workgroup. Herein, where relevant, the workgroup will cite the Strike Force Report rather than reproducing that information.

Finding 1. California faces an unprecedented multi-dimensional emergency caused by catastrophic wildfires.

The commission received evidence that the state faces an emergency with many causes as described in the Strike Force Report.¹ The cumulative effects of population growth and expansion into high fire severity zones, the effects of climate change, and many years of insufficient application of resources to combat and harden against the growing threat of wildfires have created conditions in which millions of Californians now and for the foreseeable future are vulnerable to the devastating consequences of catastrophic wildfires.

¹ Governor Newsom's Strike Force. "Wildfires and Climate Change: California's Energy Future", pp 2

LeRoy Westerling, public testimony. February 25, 2019. "A warming, drying landscape with more variable precipitation has resulted in more, larger, and more severe wildfires across the west."

Though stakeholders and experts provided the commission with evidence of myriad causes of this emergency, this commission's charge was to focus on utility infrastructure. In doing so, the commission received input focused on two subjects related specifically to utility liability:

1. The decentralized manner in which the state's 56 investor-owned utilities (IOUs), publicly-owned utilities (POUs) and cooperatives manage the risk of catastrophic wildfire.
2. The effect the state's current utility wildfire liability regime is having on the ability of the state to properly respond to the fire emergency and to equitably allocate its costs.

In the following findings, the workgroup will discuss both of those subjects.

Finding 2. California has a decentralized system of regulating and governing the wildfire prevention and mitigation activities of its 56 publicly-owned and investor-owned electrical utilities and cooperatives that creates inconsistent rules for addressing wildfire risk, redundancy of effort, and squandering of scarce resources.

The commission heard from a wide variety of fire victims, utility company representatives, government officials, fire emergency experts and other stakeholders, all of whom stated that additional resources are needed to prevent wildfires. The governor and legislature have already recognized this need and have begun to address it,² although substantially greater resources are required, particularly in relation to the threat posed by utility infrastructure.

Currently, as outlined in SB 901 last year, IOUs are required to develop and submit Wildfire Mitigation Plans to the California Public Utilities Commission (CPUC) for approval (PUC section 8386). The majority of the POUs are required to independently develop wildfire mitigation plans and have them available for public comment. Thus, each of the state's POUs sets its own standards and programs in its wildfire mitigation plan, and this behavior is not regulated by the CPUC beyond the existing statewide standards³. Separately, each of the state's six investor-owned utilities sets its own standards and programs for addressing the fire emergency which behavior is regulated by the CPUC.

² Exec. Order No. N-05-19 (2019). Retrieved from <https://www.gov.ca.gov/wp-content/uploads/2019/01/1.8.19-EO-N-05-19.pdf>.

Proclamation of a State of Emergency (22 March 2019). Retrieved from <http://www.fire.ca.gov/general/downloads/45-DayReportPlans/3.22.19-Wildfire-State-of-Emergency.pdf>

Veklerov, K. (2018, August 8). "California giving out \$170 million in cap-and-trade revenue to help prevent wildfires." *San Francisco Chronicle*. Retrieved from <https://www.sfchronicle.com/california-wildfires/article/California-doles-out-170-million-in-13139050.php?psid=6rRXA>

³ See CPUC General Order 95 and General order 165.

The State of California has no regulatory agency or other body with the responsibility or authority for coordinating and governing the comprehensive wildfire prevention and mitigation of the IOUs, POUs and cooperatives. There are numerous practices which the state's utilities can adopt to improve wildfire prevention and mitigation, however there is no regulatory mechanism for adopting a uniform, flexible statewide approach to the emergency for all electrical utilities.⁴

There is a need for improved data collection about the utility wildfire risk and utilization of advanced technology to combat the emergency. But, there is no centralized method for the state to marshal its resources in this regard as, for example, Florida has adopted with its hurricane agencies.

The approach of consolidating regulations, governance and problem solving into a single agency or board with statewide responsibility has been successfully undertaken in analogous circumstances by California⁵ and other states.⁶

Finding 3. The current application of inverse condemnation imperils the viability of the state's utilities, customers' access to affordable energy and clean water, and the state's climate and clean energy goals and does not equitably socialize the costs of utility-caused wildfires.

The state's three major IOUs—Pacific Gas & Electric (PG&E), Southern California Edison (SCE), and San Diego Gas & Electric (SDG&E)—face a crisis in that they have limited and expensive access to capital to fund their operations, and they face the significant risk of bankruptcy. This case for this is clearly outlined in the Strike Force Report.⁷ This circumstance increases electricity rates, imperils 75 percent of the state's residents' ability to have their energy needs served.

⁴ The CPUC's Wildfire Mitigation Plan proceedings established through SB901 provide a significant step in this direction, however this process needs improvement and leaves out the state's POUs.

⁵ See California Earthquake Authority, public testimony, April 3, 2019.

⁶ John Rollins, public testimony, April 3, 2019. "Over 25 years ago, in the wake of Hurricane Andrew, Florida faced an acute availability and affordability crisis in homeowners insurance. An abrupt rise in insurers' cost of capital after the unexpected and severe storm losses broke the connection between the property hazard risk faced by consumers and the insurers and reinsurers who commit capital to share that risk. Florida had an existing guaranty fund to deal with the dozen insolvent insurers, but responded to the state's future needs by chartering a trio of institutions: a state-backed scientific body to assess hazard risk (the Florida Commission on Hurricane Loss Projection Methodology or "Commission"), a state-backed reinsurer (the Florida Hurricane Catastrophe Fund or "Cat Fund"), and a state-backed direct insurer (now known as Citizens Property Insurance Corporation, or "Citizens"). Each institution plays a unique role in market stabilization."

⁷ Governor Newsom's Strike Force. "Wildfires and Climate Change: California's Energy Future", pp 3

The state's POU's and cooperatives which serve 25 percent of the state's residents, also face financial crisis from the current liability regime. POU's are unable to shift the burden of their liability threat, and as such the costs will be born directly by the ratepayers,⁸ or will force the utilities into bankruptcy. While ratings agencies have indicated that this threat is not as great as that faced by the IOU's, they have nonetheless indicated potential ratings downgrades.⁹

The state's greenhouse reduction goals are also dependent on healthy utilities that are able to support renewable energy markets, energy efficiency programs, and technology advancements. As utilities face a higher cost of capital and the risk of bankruptcy, these programs will suffer.

The state's water providers also face risk from the current liability scheme.¹⁰ Water utilities provided testimony that they are increasingly facing litigation for wildfire damages under inverse condemnation in instances where the water utility had no role in starting the fire. They testified that this liability puts at risk their ability to provide service to customers.

The state must comprehensively address two overriding problems:

- 1. The lack of a coordinated approach by the electric utilities to the climate caused catastrophic wildfires (see Finding No. 2 above) and**
- 2. The flawed system of allocating liability to the state's privately-owned utilities, publicly-owned utilities and publicly-owned water utilities.**

⁸ Sacramento Municipal Utilities District (SMUD). Letter to the commission 22 April 2019 "Publicly owned utilities like SMUD, which don't have shareholders to bear the costs of the damages inflicted by a catastrophic fire, have only one recourse to fund any wildfire liability - to collect from our customers. These inevitable rate impacts cannot avoid having a disproportionate impact on our most vulnerable populations that are least likely to afford it, including low income customers, the elderly, and renters. A major wildfire, like recent fires elsewhere in California, could cause SMUD's electric rates to jump by upwards of 25 percent."

⁹ Sacramento Municipal Utilities District (SMUD). "Recently ratings agencies have started reassessing POU's financial risk to wildfire catastrophes and responsibility for claims given the strict liability standard in California. Like other utilities, SMUD ratings have been recently placed on "outlook negative" by Moody's, a status that is a precursor for downgrading ratings absent any structural risk changes."

¹⁰ California Water Association et al. Letter to the commission. April 22, 2019. "The dangers posed by the current application of the inverse condemnation doctrine are highlighted by the judgment against the Yorba Linda Water District ("YLWD") after the 2008 Freeway Complex Fire. In this case the Superior Court determine that, 'neither the Plaintiffs nor the YLWD (or any YLWD public improvement) caused the Freeway Complex Fire.' Despite this, Yorba Linda Water District had to pay out nearly \$70 million because a portion of its water system was damaged by the fire, which interrupted the flow of water to the fire hydrants in one neighborhood. The Superior Court did not find that Yorba Linda Water District did anything wrong or was negligent. [...] Yorba Linda Water District had 'full liability' even though it was also a victim of the fire and because the fire damaged the water system. And now this same logic is being used as the foundation of suits against other public drinking water providers, including the City of Ventura in relation to the 2017 Thomas Fire.."

Otherwise, the utilities and their ratepayers will suffer significant and increasing consequences.

Finding 4. The increasing costs of capital and the risk of bankruptcy associated with the application of strict liability inverse condemnation doctrine to water companies, publicly-owned utilities, and investor-owned utilities is harmful to wildfire victims, ratepayers, and the utilities themselves.

Victims: The risk of utility bankruptcy harms both major classes of the victims of wildfires. Under bankruptcy, property and casualty victims (i.e., non-property loss victims) are unfairly forced to have their claims moved from civil court proceedings to bankruptcy jurisdiction, and property loss victims may be subordinated to post-bankruptcy victims' claims.

Ratepayers: The application of strict liability to utilities under current law severely and unfairly prejudices the ratepayers of privately-owned utilities, publicly-owned utilities and water utilities.

The IOU Ratepayers: IOUs have two sources of revenue to pay for their inverse condemnation liabilities – their shareholders and their ratepayers. The evidence submitted to the commission is that (a) these utilities face significant difficulty and expense in purchasing insurance to cover these liabilities,¹¹ (b) these liabilities render the IOUs unable to obtain critically needed capital, including capital to invest in fire prevention activities and (c) the effect of these liabilities is to significantly increase the cost of capital, or to render the IOUs (currently PG&E and potentially SoCal Edison & SDG&E) bankrupt.

The alternative to the shareholders of these utilities bearing the costs of strict liability – the ratepayers absorbing this cost - is equally untenable. The commission has received testimony that the consumer, commercial and industrial customers of the IOUs currently pay among the nation's highest utility rates.¹² Additionally, regardless of strict liability costs, these rates will necessarily increase significantly because the ratepayers will pay for fire prevention efforts and

¹¹ Josh Jiang, Marsh Risk and Insurance Services. Public testimony. March 13, 2019. "Most traditional liability insurers have already decided to exclude wildfire liability insurance or discontinue writing liability insurance for California utilities going forward. A few remaining large carriers with strong parents and balance sheets are still offering large capacity limits, but at a premium level pricing at a 1 in 2 or 1 in 3 loss ratio. Attachment points on liability vertical towers no longer seem to matter given the severity of those losses as carriers want to charge the same rate for the capacity even at a higher attachment point. If wildfire losses of the last few years continue for the California utilities, a collapse of the insurance market will follow. We expect the liability insurance market to continue being distressed until meaningful regulatory reform, new and improved technology and mitigation tools can be implemented to reduce wildfire frequency and severity."

¹² The California Large Energy Consumers Association. Letter to the commission. April 22, 2019. "California's industrial electricity rates are almost double those of other western states. For example, in January 2019: Nevada's average industrial rate was 4.94 ¢/kWh; Arizona's was 5.96 ¢/kWh; Texas' was 5.25 ¢/kWh; these can be compared to California's average industrial rate of 11.43 ¢/kWh."

capital costs.¹³ The result of the application of strict liability for inverse condemnation is the risk of significantly increasing the already-high cost of electricity service to 75% of the state's electricity customers either directly through cost-shifting or indirectly as a result of bankruptcy.

The POU Ratepayers: The current application of strict liability to POUs and cooperatives serving 25% of the state's residents also significantly burdens ratepayers. This is because the shareholders of these utilities are the ratepayers. Thus, under current law, 100% of the cost of inverse condemnation liability is passed through to these ratepayers. Testimony submitted to the commission demonstrates that POUs are already are facing (1) the inability to obtain insurance at reasonable costs¹⁴ if at all;¹⁵ (2) rising costs of capital; and (3) rising fire prevention costs.¹⁶ Under the current liability scheme, many of the state's publicly-owned utilities and cooperatives are one catastrophic fire away from financial ruin, the cost of which will be entirely the responsibility of the ratepayers. In particular, testimony from Plumas-Sierra Rural Electric Cooperative demonstrated the paralyzing consequences of the application of inverse condemnation to our residents in remote forested counties.¹⁷

Water Utilities: The state's water utilities similarly face the risk that the current utility liability scheme will imperil their services and customers. These companies point to the liability imposed by the application of the inverse condemnation rule to them in the Yorba Linda case to assert – without contradiction – that unless the inverse condemnation law is changed, they

¹³ The Utility Reform Network. Letter to the commission. April 22, 2019. "For example, the amount Pacific Gas & Electric Company (PG&E) proposes to spend in 2020 to prevent wildfires and purchase wildfire liability insurance would increase average annual electric bills by \$84 for residential customers. Customers will face additional bill increases from PG&E's wildfire prevention activities and insurance costs before 2020 that are not yet reflected in rates. And these wildfire-related costs are likely to increase further for many years after 2020."

¹⁴ Sacramento Municipal Utilities District (SMUD). Letter to the commission 22 April 2019. "Last year we were able to roughly double our wildfire insurance, while incurring a four-fold increase in premium costs. Renewal conversations have started and while we don't expect the market to move away from us, we do anticipate even higher costs."

¹⁵ Bob Marshall, Plumas-Sierra Rural Electric Cooperative. Public Testimony, March 13, 2019. "Last year, we went up for renewal and got \$35,000 costs for \$15 million of umbrella coverage. This year, no one would touch it except for Lloyd's of London, who was \$7 million for a massive deductible. That would have been a 10% to 15% rate increase for something that didn't provide very much cover."

¹⁶ SB 901 requires both investor-owned utilities and publicly-owned utilities to develop and implement wildfire mitigation plans. The cost of implementation will be passed directly on to ratepayers.

¹⁷ Bob Marshall, Plumas-Sierra Rural Electric Cooperative. Public Testimony, March 13, 2019. "The bottom line is that we are trying to self-insure because we can't get commercial insurance because of the strict liability issue. I know that someone needs to pay for that and the driving issue at the heart of this is climate change; but this is not socializing the damage, it is dumping the costs on us. Adding millions of dollars of cost to a small utility is going to put a lot of us out of business. We believe the answer is reformation of the law; however, even a cap would be tremendous."

could face the possibility of being unable to provide clean drinking water to the state. The union employees of these companies (and the other utilities) have provided similar testimony.¹⁸

Finding 5. The current process for determining prudence and cost-recovery contributes to the uncertainty that utilities face, ultimately increasing costs to ratepayers while resulting in insufficient investment in wildfire mitigation.

Establishing that strict liability does not apply to the state’s electric and water utilities,¹⁹ without further legal reform, will not rectify the problems identified above. The consensus of the electrical utilities and their lenders and investors is that the state must adopt uniform, objective fault-based standards and a mechanism for implementation of those standards in order for the state to meet the wildfire challenges identified in this report and the Strike Force Report.

II. Utility Liability Recommendations

Recommendation 1. Replace the current strict liability application of inverse condemnation for electric and water utilities with a fault-based negligence standard.

Rationale: As discussed above, the current liability regime creates the potential that the state’s electric and water utilities will be unable to meet their responsibilities; unfairly overburdens ratepayers; and inequitably allocates the costs of the fires.

In their work soliciting and receiving extensive public, stakeholder and expert input, the members of this workgroup did not hear from a single source that the current liability scheme works satisfactorily as implemented. Suggested alternatives focused on two solutions to the current crisis if the current liability scheme were left in place and included bonding, cost recovery fund, risk spreading and others. However, each alternative pointed either to the

¹⁸ California Water Service & Utility Workers Union of America. Letter to commission. April 22, 2019. “With the climate change-fueled proliferation of wildfires, community water systems facing unrestrained wildfire liabilities will, no doubt, find it increasingly difficult to make needed improvements to the State’s drinking water infrastructure. The Governor’s Strike Force explains...that the absence of a fault-based wildfire liability standard will negatively affect the ability of energy utilities to provide customers with safe and affordable electricity. The same is true for community water systems, only more so because their customer totals, invested plant and equipment, and sources of investment capital are orders of magnitude smaller than those of electric utilities.”

¹⁹ The commission notes that neither the Supreme Court nor the legislature has ever opined on this subject and, of course, has not opined on this subject in response to the unique wildfire emergency the State now faces.

ratepayers or the taxpayers assuming the crushing, uninsurable, unlimited liability created by the application of strict liability inverse rules.

Changing the strict liability rules for applying inverse condemnation to a fault-based standard allocates the cost of catastrophic wildfires more equitably than those which impose these costs on ratepayers or taxpayers.

Recommendation 2. Revise and clarify the prudent manager standard

Along with changing the strict liability application of inverse condemnation to a fault-based standard, the workgroup recommends the legislature undertake modifications to the prudent manager standard, to provide greater certainty regarding when utilities are able to recover costs related to wildfire damages. *[Staff Note: these concepts are discussed further by the Wildfire Fund Workgroup in their findings and recommendations]*

Recommendation 3. Establish an Electric Utility Wildfire Board which consolidates governance of all electric utility catastrophic wildfire prevention and mitigation into a single entity separate from the California Public Utilities Commission.

A single, purpose-built state entity should be created to have governing authority over all utility wildfire prevention and mitigation activities. The entity would set and enforce safety standards and implement, administer and adjudicate fault-based standards for both IOUs and POUs. The workgroup envisions a robust entity with (a) data collection and other information technology efforts; (b) liability and conduct standards development activities; and (c) liability standards enforcement activities.

The Electric Utility Wildfire Board would have the following functions, among others:

1. It would set rules, regulations and procedures for governing all California electric utility wildfire reduction activities including any wildfire mitigation plans, rules for hardening the grid, and electricity shut offs. It would consolidate the current California expertise in those areas to perform these functions and it would be sensitive to local needs and conditions in doing so.
2. It would advise the CPUC and other ratemaking authorities of the burdens placed on the utilities and mandate or request (as the law allows) those authorities to provide the ratepayer funding for such activities
3. It would develop research and data collection and public education capabilities, and consolidate those already existing, to provide a robust proactive forum for California to meet the utility wildfire challenge in the future
4. It would have authority to fine or otherwise punish the utilities and their officers and directors for non-compliance and to refer more serious violations to criminal authorities. These powers shall be independent of its liability adjudicating functions described below. Thus, a

utility and its officers and directors could be subject to punishment in circumstances in which the utility is not liable for the consequences of a particular fire. This is intended to address the moral hazard issue.

5. It would have adjudicative functions regarding the fault based liability standard using administrative law judges pursuant to California's administrative law system. If a victim of a wildfire claims that a utility is liable for the consequences to it of a wildfire under the fault based liability system the victim shall file a claim with the board and that claim shall be resolved under fault based standards with Judicial review. If the claim is upheld the utility shall pay the claim, not the ratepayers in the case of the IOUs. If the claim is denied because the utility was not at fault under the circumstances, the victim shall have recourse to a possible wildfire fund if qualified thereunder and otherwise the consequences of the fire will be treated identically with other no-fault based circumstances. All property owners and other potential victims will be encouraged to continue to utilize California's property insurance resources which should be augmented to make more robust.

Rationale: Currently the six IOUs and 50 POUs and cooperatives are governed by separate and different wildfire prevention and mitigation rules. Moreover, there is no consolidated data gathering, best practices development and other centralized efforts to maximize the state's fire prevention and mitigation efforts. This results in inconsistent policies, duplication of efforts and lack of efficient coordination.

The Strike Force Report recommends the CPUC undertake significant efforts to remedy these deficiencies for the IOUs.²⁰ The workgroup supports the Strike Force's suggestions but instead recommends that all of such efforts be placed in a new entity which applies these efforts to all of the state's electric utilities. This workgroup is skeptical of the efficacy of the Public Utilities Commission handling this responsibility for the investor-owned utilities, as the CPUC is already overburdened with regulatory responsibility over water utilities, transportation, telecommunications and other activities. In addition, the CPUC has evolved a quasi-judicial process which does not offer the flexibility and speed required in responding to the evolving threat of wildfires, or the needs of the victims in an aftermath of a fire, and the CPUC's actions leading up to and during the current crises has saddled it with a credibility crisis with respect to these issues.

In order to fairly implement a fault based-liability standard, all electric utilities must be governed by a single set of liability standards and a single oversight authority. By consolidating statewide expertise in the prevention and mitigation activities of state vis-à-vis utilities and wildfires, the state will achieve a maximum level of efficiency and expertise.

²⁰ See Governor Newsom's Strike Force. "Wildfires and Climate Change: California's Energy Future" "Part 4: A More Effective CPUC with the Tools to Manage a Changing Utility Market". pg. 40-43

Considerations regarding liability recommendations

The workgroup recommends the above as the clearest and most durable way to more equitably socialize costs, relieve the extreme burden of ratepayers, and meet the principles enumerated by the Strike Force Report.

These actions would not entirely eliminate the risk of overwhelming liability from utilities and ratepayers. However, they would go a significant way toward reducing that risk. An additional funding mechanism should be considered to create a buffer against the shock of additional liability. Under the recommendations above, if a fund is needed, the cost of capitalizing it would be significantly reduced.

As noted earlier, wildfire prevention and risk mitigation are a critical aspect of any effort to manage the costs of utility-related catastrophic wildfires. *The recommendations above should be undertaken in conjunction with significant effort to reduce overall risk.* To this end, the Strike Force Report notes that 25% of the state's population or 11 million people live in a high fire risk area. There are many reasons for this reality, but one critical element is that local city and county governments permitted such development. As California struggles with new approaches to forest management, continued approval for homes in high fire risk areas will exacerbate the problem. Local governments must recognize this risk as they make land use decisions.