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PG&E CORPORATION

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF SAN FRANCISCO

Coordination Proceeding Special Title (CRC 3.550) *CALIFORNIA NORTH BAY FIRE CASES*	Case No. JCCP 4955 **PACIFIC GAS AND ELECTRIC COMPANY AND PG&E CORPORATION'S REPLY IN SUPPORT OF THEIR DEMURRER** DATE: May 18, 2018 TIME: 9:00 a.m. DEPT.: 304 JUDGE: Hon. Curtis E.A. Karnow

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PRELIMINARY STATEMENT

The loss of life, homes and businesses in the North Bay Wildfires of October 2017 is heartbreaking. The safety of PG&E's[1] customers, their families and the communities PG&E serves is paramount and PG&E continues to focus on supporting them. While there has been no determination of the causes of any of these fires, numerous lawsuits seek to hold PG&E liable under the doctrine of inverse condemnation. Under this doctrine, PG&E would be liable for damages and attorneys' fees even if it followed every safety regulation, met or exceeded the relevant standard of care and had done absolutely nothing wrong. This potential liability presents significant public policy issues concerning the sustainability of California's private utilities and will ultimately harm PG&E's customers and the state.[2]

Ultimately, while the public policy implications are significant, the legal issue presented in this demurrer is a narrow one: Can inverse condemnation apply to PG&E, a private utility, now that the CPUC has precluded automatic recovery of inverse losses through rate increases? The answer is "no". This newly announced CPUC regulatory policy precludes PG&E from engaging in the very cost-spreading that forms the public policy and constitutional foundation of inverse condemnation. Plaintiffs' arguments to the contrary fail.

First, Plaintiffs raise a series of arguments meant to establish that the CPUC's November 30, 2017, decision is inconsequential, irrelevant and incomplete. They even mischaracterize PG&E's demurrer as one seeking improper judicial review of the CPUC's decision. But that is not what PG&E

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[1] Defined terms have the same meaning as set forth in Pacific Gas and Electric Company and PG&E Corporation's Notice of Hearing on Demurrer; Demurrer; Memorandum of Points and Authorities in Support Thereof filed on March 16, 2018.

[2] *See* Edvard Pettersson et al., Edison, PG&E Seek Mercy from Courts Over Doomsday Fire Payouts, Bloomberg Quint (April 24, 2018), *available at* https://www.bloombergquint.com/business/2018/04/23/edison-pg-e-seek-mercy-from-courts-over-doomsday-fire-payouts (noting that "[t]he scale of the destruction by the [October 2017 and Thomas] fires and the uncertainty around whether [PG&E and Southern California Edison ("SCE")] will be stuck with the bill has prompted investors and insurers to jump ship and state politicians to worry about the companies being pushed into insolvency" and quoting a California Assemblyman as stating that "We have an immediate crisis that is literally going to affect 70 percent of the population of the state of California that receives its electricity from the utilities. . . . If this trend and this arc of facts continues, I think we're headed towards bankruptcy").

is doing. PG&E is *not* asking the Court to review the CPUC's decision; it is asking the Court to accept the CPUC's decision for what it is—an articulation of CPUC policy with respect to the recoverability of inverse condemnation losses by a private utility. Prior to November 30, 2017, the CPUC had never stated, explicitly or otherwise, that the strict liability inverse condemnation principle of cost spreading is "irrelevant" to rate setting. The novelty of the CPUC's ruling is underscored by the reaction of the energy industry, investors, and others, in whose view the ruling has created a potential "crisis" for privately owned utilities and for the State. And it is confirmed by the statements of the CPUC Commissioners at the time they adopted the November 30, 2017, decision, some of whom explicitly called on the courts to review the doctrine of inverse condemnation with this new regulatory policy in mind. The November 30, 2017, decision is now final, and it fundamentally changes the landscape of inverse condemnation in California. (Section I.)

Second, the CPUC's November 30, 2017, ruling disproved the premise upon which *Barham v. Southern California Edison Co.*, 74 Cal. App. 4th 744 (1999), and *Pacific Bell Telephone Co. v. Southern California Edison Co.*, 208 Cal. App. 4th 1400 (2012), were decided—namely, that privately owned utilities, like publicly owned utilities, may spread the costs of inverse condemnation among their customers. Plaintiffs try to avoid the fact that *Barham* and *Pacific Bell* no longer control by arguing that the fundamental policy rationale of inverse condemnation is to prevent any one individual from bearing a disproportionate share of the costs of a public improvements. Plaintiffs are half right; inverse condemnation has been developed to govern the way in which costs of a public good are borne by individual members of the public.

What Plaintiffs ignore is the fact that inverse is designed to achieve that result not by shifting loss from one private entity to another private entity, but instead by shifting the cost to the public at large through taxation or rate increases. *See, e.g., Gutierrez v. Cty. of San Bernardino,* 198 Cal. App. 4th 831, 837 (2011) ("[T]he underlying purpose of [the]constitutional provision in inverse—as well as ordinary—condemnation is to distribute throughout the community the loss inflicted upon the individual by the making of public improvements" (internal quotation marks and citations omitted)). This doctrine works in the context of a public utility, with its inherent authority to raise rates and/or collect taxes. In

that scenario, the public utility is but a conduit, shifting funds from the public at large to one individual. In light of the CPUC's recent regulatory decision, however, the private utility is not a conduit of public funding, but a source of private funding with no guarantee whatsoever that any other members of the public will share in inverse losses. Inverse condemnation cannot be applied in these circumstances. (Section II.)

Third, and for many of the same reasons, Plaintiffs' response to PG&E's constitutional arguments fail. Indeed, their arguments for the application of inverse under California law confirm the unconstitutionality of the result they advocate. Now that it is clear that the application of inverse condemnation will result in the court simply shifting the costs of wildfires from one private individual (the victim of a wildfire) to another (the utility), the constitutional problem is obvious. This redistribution of private assets by the government, without any just compensation paid to PG&E, would constitute an unconstitutional taking or, in the alternative, a violation of the utility's rights to substantive due process. (Section III.)

ARGUMENT

I. THE COURT CAN AND SHOULD CONSIDER THE CPUC'S DECISION IN DETERMINING THE APPLICABILITY OF INVERSE CONDEMNATION TO PRIVATELY OWNED UTILITIES.

In its November 30, 2017, decision, the CPUC determined for the first time that it will not permit automatic cost-spreading of inverse condemnation losses as part of its regulatory oversight of private utilities. This was a new policy that the CPUC explained applies to all CPUC-regulated utilities. The CPUC's decision became final on March 2, 2018, 60 days after applications for rehearing were filed.[3]

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[3] As a threshold matter, the Subrogation Plaintiffs argue that PG&E's request for judicial notice is improper because (they claim) the CPUC decision is not final. (*See, e.g.*, Subrogation Pls.' Opp. 6-7.) They are incorrect. As explained below, the CPUC decision is final. (Section I.B.) California law is clear that the official pronouncements and acts of the CPUC in its decision are properly subject to judicial notice. *See, e.g.*, *People ex rel. Orloff v. Pac. Bell*, 31 Cal. 4th 1132, 1143 n.4 (2003) (taking judicial notice of CPUC's final decision pursuant to California Evidence Code Section 452(c)); *Panoche Energy Ctr., LLC v. Pac. Gas & Elec. Co.*, 1 Cal. App. 5th 68, 902 (taking judicial notice of "developments in the [CPUC] regulatory proceedings"), *review denied* (Oct. 12, 2016). Indeed, both other Plaintiff groups request judicial notice of facts based on precisely that same doctrine. (*See* Individual Pls.' RJN 2-4; Public Entity Pls.' RJN 1-5 (requesting judicial notice of orders and filings with the CPUC pursuant to California Evidence Code Section 452(c)).)

A. The CPUC's Decision Is a Statement Of New CPUC Policy Concerning Inverse Condemnation That Is Applicable To PG&E.

The CPUC's decision announced for the first time that "[i]nverse [c]ondemnation principles are not relevant to a Commission reasonableness review", (Eggleton Decl. Ex. B ("WEMA Decision") at 65), thereby establishing that the CPUC will not permit automatic cost-spreading for inverse losses. Plaintiffs' attempts to suggest that this was not a new, broadly applicable policy statement fail.

First, Plaintiffs contend, in varying ways, that the CPUC's November 30, 2017, decision did not establish *any* policy with respect to inverse condemnation since SDG&E was not found liable in court for inverse condemnation with respect to the 2007 wildfires for which it was seeking cost recovery. (Individual Pls.' Opp. 10-12; Public Entity Pls.' Opp. 5-6; *see also* Subrogation Pls.' Opp. 10 ("[T]he CPUC has not applied its interpretation of the relationship of liability under inverse condemnation to a concrete set of facts. . . .").) However, SDG&E argued to the CPUC that a significant portion of the litigation settlement for which it was seeking rate recovery was driven by a court ruling that it could be held liable under inverse for the 2017 fires. (*See* Eggleton Decl. Ex. D ("CPUC Concurrence") at 5.) That is why, in denying SDG&E's application, the CPUC explicitly stated:

> Inverse Condemnation principles are not relevant to a [CPUC] reasonableness review under the prudent manager standard . . . *Even if SDG&E were strictly liable*, [the CPUC] see[s] nothing . . . that would supersede [the CPUC's] exclusive jurisdiction over the cost recovery/cost allocation issues involving [CPUC] regulated utilities.

(WEMA Decision at 65) (emphasis added); *see also* Subrogation Pls.' Opp. 9 ("[A] finding of liability under Inverse Condemnation has no effect on a determination by the CPUC of whether rates should be adjusted").) The argument that the CPUC decision did not address its regulatory policy with respect to inverse cannot be squared with the plain text of that decision or the contemporaneous Commissioner statements.

Second, Plaintiffs argue that the November 30, 2017, decision related only to the specific facts concerning SDG&E and the 2007 wildfires and does not apply to any future rate-making proceedings before the CPUC. (Individual Pls.' Opp. 11; Public Entity Pls.' Opp. 5-6.) That is incorrect. Plaintiffs ignore the clear distinction the CPUC made between its ruling on SDG&E's prudence and its sweeping

statements about the impact—or lack thereof—of inverse condemnation on its ratemaking authority. While it is true that prudence determinations are fact specific, the CPUC clearly stated that "[i]nverse [c]ondemnation principles *are not relevant to a Commission reasonableness review under the prudent manager standard*". (WEMA Decision at 65 (emphasis added).) The CPUC did not qualify that statement to apply only to the case before it. It instead made a broad regulatory policy finding.

Indeed, were the CPUC's statements intended to apply only to SDG&E, there would have been no need for the Commissioners to call on the courts to address the consequences of the decision. As but one example, at the November 30, 2017, meeting, Commissioner Rechtschaffen stated:

> [I]t is worth noting that the doctrine of inverse condemnation, as its been developed by the courts and applied to public utilities, may be worth re-examining in a sense that the courts applying the cases to public utilities have done so without really grappling with the salient difference between public and private utilities, which is that there's no guaranty that . . . private utilities can recover the cost from their ratepayers, so this is an issue that the legislature and the courts may wish to examine and may be called on to examine in the future.

(Eggleton Decl. Ex. A ("CPUC Hearing") 21:29-22:15.) Likewise, Commission President Picker and Commissioner Guzman Aceves, in a joint concurrence to the CPUC's decision, directly urged the courts to reconsider the rationale for applying inverse condemnation to privately owned utilities, specifically because "the logic for applying inverse condemnation to utilities—costs will necessarily be socialized across a large group rather than borne by a single injured property owner, regardless of prudence on the part of the utility—is unsound". (CPUC Concurrence at 1, 5.)[4]

Third, Plaintiffs argue that because the CPUC has always reviewed rate applications pursuant to a reasonableness standard, nothing new has happened as a result of the November 30, 2017, decision. (Individual Pls.' Opp. 12.) Prior to November 30, 2017, however, the CPUC had never before announced that it would ignore inverse condemnation principles in conducting its reasonableness

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[4] Equally unconvincing is Plaintiffs' argument that the CPUC would have opened a rulemaking proceeding it if intended to create new policy. (Individual Pls.' Opp. 11.) The CPUC did not create or amend any "rules, regulations [or] guidelines". (*Id.* (citing Cal. Pub. Util. Comm'n. Rules of Practice and Procedure Rule 6.1).) Rather, the CPUC articulated its policy with respect to how it applies a standard that is already in place, *i.e.*, the prudent manager standard, in the context of inverse condemnation. There was, therefore, no need for the CPUC to initiate a rulemaking proceeding.

review. It was this brand-new announcement that confirmed, for the first time ever, that a privately owned utility would not be entitled automatically to spread the costs of inverse damages across its entire customer base and thereby negated the cost-spreading rationale underlying the imposition of inverse condemnation liability. And that is precisely why the CPUC has now—for the first time—directly invited the courts to reassess the applicability of inverse condemnation to utilities like PG&E. Those public CPUC statements confirm that even the CPUC viewed its November 30, 2017, decision as altering the legal landscape in fundamental ways.

B. The CPUC's November 30, 2017, Decision is Final.

Plaintiffs also argue that the CPUC's November 30, 2017, decision is not final because the parties to the SDG&E WEMA applied for rehearing. (Individual Pls.' Opp. 12-13; Public Entity Pls.' Opp. 8; Subrogation Pls.' Opp. 6-7.) That is incorrect.

Pursuant to the California Public Utilities Code, "[a]ny application for rehearing . . . not granted within 60 days, may be taken by the party making the application to be denied". Cal. Pub. Util. Code § 1733(b). The applications for rehearing were filed on January 2, 2018. As a result, when the CPUC failed to rule on the parties' rehearing applications by March 2, 2018—60 days from the date of the applications—the November 30, 2017, decision became final as matter of California law. The cases cited by Plaintiffs (Public Entity Pls.' Opp. 8; Subrogation Pls.' Opp. 7) do not suggest otherwise, as those cases explicitly concern challenges to non-final decisions. *See Commc'ns. Telesystems Int'l v. Cal. Pub. Util. Comm'n*, 196 F.3d 1011, 1016 (9th Cir. 1999) (initial decision not final where time to apply for rehearing had not yet expired); *City of Los Angeles v. Pub. Util. Comm'n*, 15 Cal.3d 680, 707 (1975) (initial decision not final where CPUC granted petition for rehearing).

The Subrogation Plaintiffs also assert that PG&E has failed to exhaust its administrative remedies (Subrogation Pls.' Opp. 9), but do not explain what it is that they claim PG&E was required to do. To the extent this is just another argument that the CPUC decision is not final, that is incorrect for the reasons stated in the preceding paragraph. To the extent the argument is that PG&E has not at this time sought review of the CPUC decision by the Court of Appeals or the California Supreme Court, that has no bearing on the finality of the CPUC's November 30, 2017, decision. In any event, the concept of

exhaustion has no applicability in these circumstances, where PG&E is *not* seeking review of the CPUC decision through this demurrer.[5] Although the Subrogation Plaintiffs are correct that this Court lacks authority to "[r]ule [o]n [t]he [v]alidity [o]f [t]he WEMA [d]ecision", (Subrogation Pls.' Opp. 7), that is irrelevant. PG&E is asking this Court to interpret the law of inverse condemnation—a legal issue that all parties agree is before this Court—precisely because the CPUC's November 30, 2017, ruling is now final. PG&E is asking this Court to *rely* on the CPUC's decision, not *review* it.

II. THE FUNDAMENTAL POLICY RATIONALE FOR INVERSE CONDEMNATION IS TO SPREAD COSTS FROM INDIVIDUALS TO THE COMMUNITY.

Even the case Plaintiffs tout as the final word on inverse condemnation recognized that the reason it was applying inverse to a private utility was to ensure that the risks posed by the utility's services would be "spread among *the benefitting community*". *Barham*, 74 Cal. App. 4th at 752 (emphasis added). Cost-spreading, or socialization of losses, is at the core of inverse condemnation doctrine. In their oppositions, Plaintiffs argue that inverse condemnation can apply to a private utility even where (as here) it is clear that this assumption of cost-spreading is a fiction. Those arguments fail.

First, Plaintiffs try to focus the discussion on the concept of cost-shifting rather than cost-spreading. In particular, the Plaintiffs argue that inverse should apply simply because PG&E is in a better position to "absorb" the losses caused by wildfires than individual property owners. (Public Entity Pls.' Opp. 7 ("When distilled, the policy and rationale behind the applicability of inverse condemnation to a privately-owned utility company lies not in 'loss-spreading' in the sense of taxing authority, but rather, the fact that a utility company, and not a homeowner, is in the best position to

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[5] It is for this reason that the cases cited by Subrogation Plaintiffs at page 9 of their Opposition are inapposite, as each involves an attempt to challenge administrative action through the courts prior to the exhaustion of all administrative appeals. *Pac. Legal Found. v. Cal. Coastal Comm'n*, 33 Cal. 3d 158, 171 (1982); *see also Davis v. S. Cal. Edison*, 236 Cal. App. 4th 619, 645 (2015) (sustaining demurrer where question for court was within CPUC's exclusive jurisdiction); *PegaStaff v. Cal. Pub. Util. Comm'n*, 236 Cal. App. 4th 374, 388-90 (affirming dismissal of case where superior court did not have jurisdiction over challenge to CPUC code); *PG&E Corp. v. Pub. Util. Comm'n*, 118 Cal. App. 4th 1174, 1216-17 (2004) (holding "interim" CPUC interpretation not ripe for review where CPUC had not yet issued decision); *Schell v. S. Cal. Edison Co.*, 204 Cal. App. 3d 1039, 1045-47 (1988) (sustaining demurrer where question for court was within CPUC's exclusive jurisdiction and was pending before CPUC in three cases).

absorb the risks from an improvement made for public use.").) Although Plaintiffs are correct that the inverse condemnation cases discuss the public policy benefit of ensuring that no single member of the public bears a disproportionate share of the loss, they ignore the second half of the inverse equation. As PG&E detailed in its demurrer, California courts have repeatedly held that inverse is designed not to *shift* costs from one party to another, but instead to *spread* those costs among the entire community that benefits from the public improvement.

- *See Albers v. Cty. of Los Angeles*, 62 Cal. 2d 250, 263 (1965) (costs of damage from a public good "can better be absorbed, and with infinitely less hardship, by the *taxpayers as a whole*" (emphasis added));
- *Mercury Cas. Co. v. City of Pasadena*, 14 Cal. App. 5th 917, 925-26 (2017) ("The fundamental policy underlying the concept of inverse condemnation is that the costs of a public improvement benefiting the community should be *spread among those benefited* rather than allocated to a single member of the community." (internal quotation marks omitted) (emphasis added));
- *Gutierrez v. Cty. of San Bernardino*, 198 Cal. App. 4th 831, 837 (2011) ("[T]he underlying purpose of our constitutional provision in inverse—as well as ordinary—condemnation is *to distribute throughout the community the loss inflicted upon the individual by the making of public improvements: to socialize the burden* . . . to afford relief to the landowner in cases in which it is unfair to ask him to *bear a burden that should be assumed by society.*") (ellipses in original) (internal quotation marks omitted) (emphasis added));[6]
- *Pac. Bell v. City of San Diego*, 81 Cal. App. 4th 596, 602 (2000) ("the costs of a public improvement benefiting the community should be *spread among those benefited* rather than allocated to a single member of the community" (emphasis added));

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[6] Plaintiffs' characterization of *Gutierrez* is misleading. (*See* Individual Pls.' Opp. 10 (citing *Gutierrez* and omitting portion of ruling concerning the need to socialize inverse costs).) Further, Plaintiffs' statement that *Gutierrez* involved a publicly owned utility rather than a private one is of no moment. The underlying rationale of inverse condemnation applies equally to private and public entities, and no court has suggested otherwise.

- *Magnuson-Hoyt v. Cty. of Contra Costa*, 228 Cal. App. 3d 139, 144 (1991) ("[T]he fundamental policy underlying inverse condemnation actions . . . is to *distribute throughout the relevant community* the loss inflicted on the individual by a public improvement." (emphasis added));
- *Holtz v. Superior Court*, 3 Cal. 3d 296, 303 (1970) (the "underlying purpose of [inverse condemnation] is to *distribute throughout the community* the loss inflicted upon the individual by the making of the public improvements: to socialize the burden . . . that should be assumed by society" (internal citations and quotation marks omitted) (emphasis added)).

Second, Plaintiffs argue that this Court is compelled to follow the rulings in *Barham* and *Pacific Bell* regardless of the CPUC's new policy statement. (Individual Pls.' Opp. 6-10; Public Entity Pls.' Opp. 1-8; Subrogation Pls.' Opp. 3-4.) But the CPUC's decision vitiated the foundation underlying those holdings which, as with all the other cases cited above, was the presumption of cost-spreading, and therefore these cases are fairly distinguishable and this Court need not follow them. (PG&E Demurrer 15-16.) Indeed, as discussed above, the *Barham* court's analysis began with the court stating that "[t]he fundamental policy underlying the concept of inverse condemnation is to spread *among the benefiting community* any burden disproportionately borne by a member of that community". 74 Cal. App. 4th at 752 (emphasis added). The court cited to cases holding publicly owned utilities liable for inverse condemnation under similar circumstances, and found that a private utility was liable under inverse only after determining that no "significant differences exist regarding the operation of publicly versus privately owned utilities". *Id.* at 752-53 ("We are not convinced that any significant differences exist regarding the operation of publicly versus privately owned electric utilities . . . and find there is no rational basis upon which to found such a distinction. *We conclude, under the factual scenario here present, [the privately owned utility] may be liable in inverse condemnation as a public entity.*") (emphasis added)). Although the court subsequently considered whether the landowners' property was taken for a "public use", that analysis was secondary and was not the basis on which the court concluded that inverse condemnation could apply.

Similarly, in *Pacific Bell*, the court relied on *Barham* and imposed inverse only after finding that there was no "evidence to support its implication that the [CPUC] would not allow [the utility] adjustments to pass on damages liability during its periodic reviews". *Pacific Bell*, 208 Cal. App. 4th at 1404, 1407-08 (agreeing with *Barham* that no "significant differences exist" between a public and private utility). The CPUC now has provided evidence of the most critical difference between public and private utilities: "The California Public Utilities Code requires the Commission to subject application for recovery of cost by investor-owned utilities to a reasonableness review, which is not true for publicly owned utilities." (CPUC Concurrence at 5.) And it has announced that private utilities, unlike public utilities, can no longer assume that they will be entitled to automatic rate recovery of inverse condemnation losses. This new policy decision guts the rationale underlying *Pacific Bell* and *Barham*.[7] As Commissioner Rechtschaffen stated, the time has come for this court to do what neither *Barham* nor *Pacific Bell* did: "grappl[e] with the salient difference between public and private utilities, which is that there's no guaranty that private utilities can recover the cost from their ratepayers". (CPUC Hearing 21:48-22:00.)[8]

Further, neither *Barham* nor *Pacific Bell* considered whether a privately owned utility's inability to automatically spread the costs of inverse among its customers resulted in a violation of that utility's constitutional rights. As discussed below (*see* Section III), the effect of the CPUC's decision on PG&E constitutes a taking without just compensation or, in the alternative, a violation of PG&E's substantive

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[7] Plaintiffs also focus on *Barham*'s reliance on the California Supreme Court's opinion in *Gay Law Students Association v. Pacific Telephone and Telegraph Co.*, 24 Cal. 3d 458 (1979), to assert that "[t]here is no basis to differentiate between damage caused by public utilities and damage caused by privately owned utilities for the purposes of inverse condemnation". (Subrogation Pls.' Opp. 5; *see also* Individual Pls.' Opp. 6-7; Public Entity Pls.' Opp. 4.) As PG&E noted in its opening brief, quasi-public entities can be deemed public entities in certain contexts but not others. Thus, whether a court has held that a utility is bound by the equal protection clause has no bearing on whether it is subject to inverse condemnation. *See Pasillas v. Agric. Labor Relations Bd.*, 156 Cal. App. 3d 312, 348 (1984) (noting that private entities can take state action sufficient to trigger equal protection guarantees but not sufficient to trigger free speech and associational guarantees).

[8] Plaintiffs suggest that if PG&E acted reasonably—which it did—then the CPUC's new policy will not matter because PG&E will be able to satisfy the prudent manager standard and recover its costs. (Individual Pls.' Opp. 13.) This argument misses the point. Inverse condemnation is premised on the notion that the utility *will* be able to spread costs, not that it *might* be able to do so.

due process rights. On that basis alone, the prior cases are fairly distinguishable and are no longer controlling.

Third, Plaintiffs' final attempts to salvage their reliance on *Pacific Bell* and *Barham* miss the mark. While they devote extensive discussion to PG&E's quasi-monopolistic status as a regulated utility, (Individual Pls.' Opp. 3, 6-7; Public Entity Pls.' Opp. 6-7), their only citation as to why that issue might be relevant is *Pacific Bell*. But it was the fundamental assumption of cost-spreading that supported that ruling, not the so-called "quasi-monopolistic" status of a public utility. Plaintiffs also focus on dicta from *Pacific Bell* suggesting that the legislature could decide to place public utilities under the purview of the CPUC. Plaintiffs argue based on that dicta that a ruling that inverse is inapplicable to PG&E would bind future hypothetical courts addressing a hypothetical scenario in which public utilities also would not have automatic rate recovery guarantees. The court need not wade into those issues, as they are purely hypothetical and it would be up to the legislature to determine the full implications of taking steps to regulate public utilities that have never been taken before. No public utility has ever been placed under the rate-making authority of the CPUC, and there is no reason to expect they might be.

III. APPLICATION OF INVERSE CONDEMNATION WOULD BE UNCONSTITUTIONAL IN LIGHT OF THE CPUC'S NOVEMBER 30, 2017, DECISION

The CPUC's decision set a new policy, disrupting long-standing beliefs that the CPUC would consider the cost-spreading rationale of inverse condemnation when setting rates. Without a guarantee that PG&E can recover inverse condemnation costs, the imposition of such liability effects a taking without just compensation. Moreover, because inverse condemnation rests on the premise that losses from public improvements should be spread throughout the community, application of inverse condemnation to PG&E when it cannot engage in such loss spreading is arbitrary and irrational.

A. In Light of the New CPUC Policy, the Application of Inverse Condemnation to Privately Owned Utilities Violates the Takings Clause of the Fifth Amendment.

Plaintiffs' arguments that application of inverse condemnation to PG&E will not constitute a taking are without merit.

First, Plaintiffs contend that whether inverse condemnation costs can be recovered "will be determined upon application to the CPUC, which has already made clear that inverse condemnation is not relevant to such determinations". (Individual Pls.' Opp. 13.) What Plaintiffs fail to grapple with is the fact that it is this very policy statement that renders inverse condemnation (as applied to a private utility) unconstitutional. There is now no guarantee that privately owned utilities can recover the costs of inverse condemnation that the courts have long assumed they could pass along to their customers. Without that guarantee, there is no assurance that PG&E will receive just compensation for the taking of its property (*i.e.,* PG&E funds) in the event that the court awards damages under the strict liability inverse condemnation regime. Indeed, according to Plaintiffs, the entire policy underlying inverse is to take property (money) from one entity that has a better ability to absorb the losses caused by a public improvement (PG&E) and give it to someone else with less ability to absorb those losses (the individual property owner). As described above, Plaintiffs have the policy justification for inverse wrong but they have the effect exactly right. Application of inverse condemnation following the November 30, 2017, CPUC decision is nothing more than a transfer of property from one private entity to another by the state, with no just compensation. That is an unconstitutional taking.

Second, Plaintiffs argue that inverse condemnation liability has no bearing on PG&E's investment-backed expectations, because "state appellate decisions dating back to 1999 have held that the doctrine applies to privately owned public utilities". (Individual Pls.' Opp. 15.) Plaintiffs miss the point. The key assumption underlying those cases was that privately owned utilities can automatically spread costs through the ratemaking process. That is no longer true in light of the new CPUC policy. As noted by the United States Supreme Court in *Duquesne Light Co. v. Barasch*, "the impact of certain rates can only be evaluated in the context of the system under which they are imposed". 488 U.S. 299, 314 (1989).[9] Nowhere does the "long-standing case law" cited by Plaintiffs articulate that PG&E could

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[9] Plaintiffs incorrectly contend that because the facts of *Dusquesne* and *Ponderosa Telephone Co. v. Public Utilities Commission*, 197 Cal. App. 4th 48 (2011), are distinguishable, the constitutional principle underlying them should not be applied to PG&E. In *Duquesne*, a privately owned utility requested a rate increase to cover the costs of an unfinished project, and in *Ponderosa*, a privately owned utility objected to the allocation of its share proceeds to ratepayers as "retroactive rulemaking". Plaintiffs attempt to distinguish those cases by contending that here the "alleged 'takings'" are

be held liable for inverse condemnation without a guarantee of cost recovery. Under such circumstances, holding PG&E liable for inverse condemnation costs—imposed in the first place solely because courts assumed privately owned utilities could spread the costs among the community—implicates fundamental principles of fairness. *See id.* at 307 (noting that "the Constitution protects utilities from being limited to a charge for their property serving the public which is so "unjust" as to be confiscatory".. This argument is not "speculative" now that the CPUC has articulated its new policy that inverse condemnation will not be considered when it sets rates.[10] (*See supra* Part I.A.)

Plaintiffs also direct the Court to a 2012 CPUC decision denying SDG&E's and SCE's applications for balancing accounts to recover *all* wildfire costs (not just costs associated with inverse condemnation) from ratepayers. (Public Entity Pls.' Opp. 12-13.) This decision, however, has no bearing on whether PG&E reasonably would have expected to recover inverse condemnation costs. The only reference to inverse condemnation in the entire 19-page decision is one sentence acknowledging the utilities' argument that the "doctrine of inverse condemnation presupposes that costs allocated to the public entity will be shared by all users served by that entity". (Fiske Decl. Ex. 4 at 7.) The CPUC based its decision that SDG&E and SCE had failed to demonstrate the need for the balancing accounts in part on the fact that SDG&E had "demonstrate[d] conclusively that [it] has available options for seeking Commission authorization to allocate uninsured wildfire costs to ratepayers". (*Id.* at 17.) The CPUC's decision said nothing about the recoverability of inverse losses before the CPUC.

Third, Plaintiffs contend that PG&E's position begs the logical conclusion that "any lawsuit seeking damages by one party from another would constitute a 'taking'". (Public Entity Pls.' Opp. 9.) This argument is grounded in the misguided assumption that the liability borne by privately owned

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"payments for [PG&E's] liability under the law" and therefore cannot constitute a constitutional violation. (Public Entity Pls.' Opp. 10-11.) This conclusion incorrectly rests on the assumption that it is appropriate for PG&E to bear the costs of inverse condemnation liability even where cost recovery is not guaranteed. In this case, where applying inverse condemnation to PG&E may result in an inability to recover any costs, rates cannot be said to "afford sufficient compensation so as not to create a taking". (*See* Public Entity Pls.' Opp. 10 (citing *Duquesne*, 488 U.S. at 307).)

[10] Moreover, the fact that PG&E can pursue "administrative proceedings" if it is subject to inverse condemnation liability is not sufficient to guard its constitutional rights since those proceedings plainly do not guarantee recovery of the damages subject to the taking.

utilities under inverse condemnation is rightfully attributed to them. As PG&E has explained, liability under inverse condemnation has been imposed based on the rationale that privately owned utilities are in a position—like public entities—to pass on the costs. (*See supra* I.A.) The application of inverse requires *no* finding of wrongdoing, no breach of duty and no other traditional limitations of even tort-based strict liability doctrines. It is, instead, a state government policy decision to shift losses from one private party to the public at large via a utility with taxation or rate powers. But, under the new CPUC policy, courts may no longer assume that privately owned utilities can pass on inverse condemnation costs to the communities that benefit from public improvements. This destroys the foundation of inverse condemnation as it applies to privately owned utilities, and belies the comparison Plaintiffs attempt to make between damages awarded under inverse condemnation and damages awarded in other actions.

B. In light of the New CPUC Policy, the Application of Inverse Condemnation to Privately Owned Utilities Violates PG&E's Substantive Due Process Rights

Plaintiffs' response to PG&E's substantive due process argument fails for similar reasons: It relies on assumptions—namely, the assumptions made by the court in *Pacific Bell* regarding the "interpretation of what 'cost-spreading'" means in the context of inverse condemnation" (Public Entity Pls.' Opp. 14-15)—that, as made clear by the CPUC's November 30, 2017, decision, no longer hold true. Where, as here, a change in the CPUC's policy so clearly forecloses the opportunity to automatically spread costs among the public, it is arbitrary and irrational to impose the costs of all damages on PG&E without consideration of fault.

CONCLUSION

For the foregoing reasons, PG&E respectfully requests that the Court sustain its demurrer to the Fourth Cause of Action of the Individual Plaintiffs' Master Complaint, the Second Cause of Action of the Public Entity Plaintiffs' Master Complaint and the Fourth Cause of Action of the Subrogation Plaintiffs' Master Complaint. Should the Court be inclined to overrule PG&E's demurrer, PG&E respectfully requests that the Court indicate its belief that this "is a controlling question of law as to which there are substantial grounds for difference of opinion, appellate resolution of which may materially advance the conclusion of the litigation." *See* Cal. Civ. Proc. Code § 166.1.

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By 

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