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PACIFIC GAS AND ELECTRIC COMPANY and
PG&E CORPORATION

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN FRANCISCO

Coordination Proceeding
Special Title (Rule 3.550)

CALIFORNIA NORTH BAY FIRE CASES

JCCP No. 4955

PACIFIC GAS AND ELECTRIC COMPANY AND PG&E CORPORATION'S NOTICE OF HEARING ON DEMURRER; DEMURRER; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

Date: May 18, 2018
Time: 9:00 a.m.
Dept.: 304
Hon. Curtis E.A. Karnow, Dept. 304

NOTICE OF HEARING ON DEMURRER

TO THIS HONORABLE COURT, TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that on May 18, 2018, at 9:00 a.m. in Department 304 of the Superior Court of California, San Francisco, Defendants Pacific Gas and Electric Company and PG&E Corporation will move for an order sustaining their demurrer for failure to state a cause of action, without leave to amend, 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.

DEMURRER

TO ALL PARTIES AND THEIR ATTORNEYS OF RECORD:

PLEASE TAKE NOTICE that Defendants Pacific Gas and Electric Company and PG&E Corporation hereby demur 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 as follows:

1. The Inverse Condemnation Cause of Action fails to state facts sufficient to constitute a cause of action. Cal. Civ. Proc. Code § 430.10(e).

This Demurrer is made pursuant to California Civil Procedure Code § 430.10 and California Rules of Court Rule 3.1320, and is based on the Notice of Hearing of Demurrer and Demurrer, the Memorandum of Points and Authorities in Support Thereof, the Declaration of Keith E. Eggleton ("Eggleton Decl.") and accompanying exhibits, the Request for Judicial Notice, the pleadings and other papers on file in this action, and upon such other matters as may be relevant and which properly may be adduced at the hearing on this matter.

Dated: March 16, 2018

Respectfully submitted,

By: */s/ KEVIN J. ORSINI*

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Defendants Pacific Gas and Electric Company ("PG&E") and PG&E Corporation ("PG&E Corp.") (collectively, "PG&E") demur to the inverse condemnation causes of action in Plaintiffs' Complaints, and hereby move the Court to sustain their demurrer.

PRELIMINARY STATEMENT

On October 8 and 9, 2017, multiple wildfires began at different locations throughout Northern California. Fanned by extreme winds, these fires spread at a catastrophic pace and ultimately impacted at least a dozen counties (the "North Bay Fires"). These fires were the result of a confluence of unprecedented weather events, including five years of record breaking drought and bark beetle infestations that have led to an extreme tree mortality crisis; exceedingly heavy rainfall during the winter of 2016-2017, causing new vegetation growth; the hottest summer on record in 2017 for the Northern California area, killing and drying that new growth to create additional fuel; extremely low humidity throughout the Northern California area; and a high wind event on October 8 and 9, 2017, before the first rains had come through to soak the vegetation and ground. As a Cal Fire official recently explained, "[no one] could be prepared for the conditions that surfaced in California on . . . October 8th".[1]

While that observation was entirely accurate, PG&E has nonetheless poured hundreds of millions of dollars and tens of thousands of work hours into efforts to reduce the potential for wildfires. PG&E's overhead electrical system covers more than 100,000 miles, and there are more than 120 million trees within its service territory that could contact or fall into PG&E's overhead electric lines. With California in the midst of a tree mortality crisis, PG&E's investments in vegetation management have been unprecedented and have been specifically designed to mitigate the greatest wildfire risk to its system: contact between vegetation and electrified lines.

Plaintiffs now seek to hold PG&E strictly liable through the doctrine of inverse condemnation for billions of dollars in property damages even though the events of October 8 and 9 were beyond any foreseeable or preventable scope and regardless of whether PG&E ever is found to

[1] George Avalos, "172 Wine Country infernos overwhelmed fire crews, probe of deadly blazes will take months more", The Mercury News (Jan. 26, 2018), *available at* https://www.mercurynews.com/2018/01/26/state-lawmakers-hunt-for-ways-to-prevent-lethal-wildfires/.

have acted negligently. In other words, Plaintiffs contend that PG&E should be liable even if there was nothing PG&E reasonably could have done to prevent the North Bay Fires (and even if the confluence of events leading to the fires was unforeseeable) as long as it is shown that PG&E's electrical lines were a substantial factor in causing those fires. Although PG&E is prepared to raise several defenses to the application of inverse condemnation on the facts presented in these cases, PG&E demurs to the inverse condemnation causes of action now based on the threshold legal issue that inverse condemnation is wholly inapplicable to a privately owned utility whose rates are set by a regulatory body, such as PG&E.

Under the California Constitution, the state is required to provide compensation to a private party when it takes or damages that party's property for the public use through eminent domain. Cal. Const., Art. I, § 19. The doctrine of inverse condemnation has been created by the courts of this state to give meaning to the provision requiring compensation for damaged property. As California courts have explained, 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". *Holtz v. Superior Court*, 3 Cal. 3d 296, 303 (1970) (internal citations and quotation marks omitted). Inverse condemnation serves as a form of social insurance, financed by the general public, based on the premise that the costs of damage from a public good "can better be absorbed, and with infinitely less hardship, by the taxpayers as a whole". *Albers v. Cty. of Los Angeles*, 62 Cal. 2d 250, 263 (1965). The doctrine thus originated by application to public agencies that had the inherent right to socialize losses suffered by the individual across the public through taxation or rate increases. This loss distribution framework is the constitutional "underpinning [of] inverse condemnation". *Gutierrez v Cty. of San Bernardino*, 198 Cal. App. 4th 831, 837 (2011).

That constitutional underpinning is wholly absent in the context of an privately owned utility such as PG&E. PG&E has no taxation authority and—unlike a public utility—does not have the authority to raise its rates and thereby engage in loss spreading. Instead, PG&E can only ask for an increase in rates and is entitled to one only if the increase is approved by the California Public Utilities Commission ("CPUC") after the request is adjudicated in an administrative proceeding.

Cal. Const., Art. XII, §§ 3, 6. Inverse condemnation liability, if it exceeds insurable amounts and cannot be recovered through the regulatory rate recovery process, has grave consequences for the economic health of privately owned utilities such as PG&E, as it may potentially increase the cost of insurance, decrease rates of return and discourage investors in the capital markets. These consequences in turn may lead to delivery interruptions and job losses that affect Californians more broadly and have ripple effects throughout the state economy.

Such consequences may soon be realized. In a recent decision denying a cost recovery application of another privately owned utility in connection with settlements it had paid relating to inverse condemnation claims, the CPUC announced for the first time that the cost-spreading rationale for inverse condemnation has *no bearing* on the CPUC's authority to set rates. Because the CPUC must approve private utility rate increases, the CPUC's declaration that it will not automatically allow such utilities to spread inverse losses through rate increases to the rate payers that benefit from the public improvement unambiguously establishes that the fundamental policy underlying the doctrine of inverse condemnation has no application to private utilities such as PG&E. Inverse condemnation is premised on automatic cost spreading. This articulation of CPUC policy refutes the assumption that a private utility can spread inverse costs in the same way that a public utility can. This incontestable fact compels two conclusions.

First, because California law establishes that the entire basis for inverse condemnation is to permit loss spreading, the doctrine is facially inapplicable to private entities such as PG&E who cannot engage in such automatic loss spreading. Although there have been a handful of cases that have applied inverse condemnation to privately owned utilities, they have done so based on the mistaken assumption that there is no meaningful difference between private and public utilities. In the most recent such case decided by an appellate court, the court said that evidence of the privately owned utility's "implication that the [CPUC] would not allow [the utility] adjustments to pass on damages liability" was lacking. *Pac. Bell Tel. Co. v. S. Cal. Edison Co.*, 208 Cal. App. 4th 1400, 1407 (2012). That evidence has now been supplied by the CPUC itself. As one commissioner noted in approving the CPUC decision discussed above, those courts that have extended inverse condemnation from public entities to private utilities such as PG&E 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 rate payers". (Eggleton Decl. Ex. A ("CPUC Hearing") 21:45-22:00.)[2]

Second, the application of inverse condemnation to PG&E is unconstitutional. Because PG&E has "no guaranty" that it can spread any losses it is forced to pay as a result of inverse condemnation claims, the application of inverse condemnation to PG&E is nothing more than the transfer of private property from one private entity (PG&E) to another (the inverse plaintiff) without any compensation.[3] This uncompensated taking of PG&E's property would violate the Fifth Amendment of the United States Constitution (as incorporated against the states by the Fourteenth Amendment) and the California Constitution. In the alternative, the application of inverse condemnation to PG&E would be arbitrary and irrational and violates PG&E's substantive due process rights protected by the Fourteenth Amendment and the California Constitution.

STATEMENT OF FACTS

Plaintiffs allege that their damages were "legally and substantially caused by the actions of [PG&E] . . . in their installation, ownership, operation, use, control, management, and/or maintenance of the power lines and other electrical equipment for a public use". (*See, e.g.*, Individual Pls.' Master Compl. ¶ 224.) Among other claims, Plaintiffs have all asserted claims for inverse condemnation. (*See, e.g.*, *id.* ¶¶ 220-227.)

A decade before the Northern California wildfires at issue in this litigation, several wildfires spread throughout portions of Southern California. (Eggleton Decl. Ex. B ("WEMA Decision") at 2.) After the fires, Cal Fire and the CPUC's Consumer Protection and Safety Division attributed the ignition of three of these fires (the "2007 Wildfires") to electrical facilities owned and operated by San Diego Gas & Electric ("SDG&E"). (*Id.*) SDG&E established a Wildfire Expense Memorandum Account ("WEMA") to track costs associated with the three fires.[4] (*Id.* at 2-3.) The

[2] The Court may take judicial notice of official acts and statements of state agencies. Evid. Code § 452(c); *Pratt v. Coast Trucking, Inc.*, 228 Cal. App. 2d 139, 143-44 (1964).

[3] (*See* Individual Pls. Master Compl. ¶ 224 (PG&E is "privately owned"); Eggleton Decl. Ex. E.)

[4] A WEMA is a tracking mechanism used by a regulated utility to segregate costs that it may later seek to recover through rates in an application to the CPUC.

WEMA account grew to $2.4 billion in costs and legal fees incurred by SDG&E to resolve third-party damage claims arising from the 2007 Wildfires. (*Id.* at 3.) These costs arose primarily from the application of inverse condemnation against SDG&E, for which the Superior Court held SDG&E could be liable. (*Id.* at 65.)

In September 2015, SDG&E applied to the CPUC to recover, through rates, $379 million of the WEMA account for unreimbursed costs that SDG&E paid due to inverse condemnation. (*Id.* at 2-3.) On August 22, 2017, the CPUC Administrative Law Judges ("ALJs") issued a proposed decision (the "PD") denying SDG&E's application. (Eggleton Decl. Ex. C.) Without addressing inverse condemnation, the ALJs concluded that SDG&E did not reasonably manage and operate its facilities, and therefore was not authorized to recover costs from the 2007 Wildfires through its rates. (*Id.* at 62.)

SDG&E filed comments on the PD in September 2017. (WEMA Decision at 64.) PG&E and Southern California Edison ("SCE") also filed comments on the PD. (*Id.*) SDG&E, PG&E and SCE argued that the ALJs committed legal error by failing to address inverse condemnation. (*Id.*) Given the fundamental basis of inverse condemnation proceedings—the notion that any damages awarded against the utility can and will be spread among the entire public that benefits from the utility regardless of fault or prudence—the parties all argued that the CPUC was required to permit rate increases premised on damages paid for inverse condemnation claims. (*Id.*) The ALJs subsequently revised the PD to, among other things, confirm their view that inverse condemnation principles were irrelevant to the CPUC. (*Id.* at 65.)

On November 30, 2017, the CPUC adopted the revised PD and issued a final decision denying in full SDG&E's application for the recovery of costs related to the 2007 Wildfires.[5] (*See generally id.*) The CPUC applied its administratively created "prudent manager" standard, under which it examines whether costs incurred are "reasonable," to deny cost recovery to SDG&E. (*Id.* at 10.) In doing so, the CPUC announced that the inverse condemnation principles of cost-spreading are irrelevant to rate setting because the CPUC has exclusive jurisdiction over cost recovery:

[5] On January 2, 2018, SDG&E applied for rehearing of the CPUC decision. PG&E and SCE jointly filed a separate application for rehearing.

"Inverse Condemnation principles are not relevant to a Commission reasonableness review under the prudent manager standard. . . . Even if SDG&E were strictly liable, we see nothing in the cited case law that would supersede this Commission's exclusive jurisdiction over cost recovery/cost allocation issues involving Commission regulated utilities." (*Id.* at 65.) Concurrently with the SDG&E decision, the CPUC Commissioners held a hearing in which they affirmed the CPUC's policy but recognized that courts should revisit the continued application of inverse condemnation to private utilities that, unlike public utilities, cannot automatically spread inverse condemnation costs. Indeed, Commissioner Rechtschaffen stated:

> [I]t is worth noting that the doctrine of inverse condemnation as it's 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 rate payers**. 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. But having said that, it doesn't change our obligation to rule that the utility can't recover unless they acted prudently.

(CPUC Hearing 21:29-22:15 (emphasis added).) Other Commissioners agreed. For example, Commissioner Peterman remarked: "I also appreciate the revisions to the proposed decision, clarifying that the legal doctrine of inverse condemnation does not displace the Commission's reasonableness review of whether SDG&E was a prudent manager in this case." (*Id.* 9:10-19:26.)

On December 26, 2017, President and Commissioner Picker and Commissioner Gusman-Aceves filed a joint concurrence. (Eggleton Decl. Ex. D ("CPUC Concurrence").) These Commissioners 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." (*Id.* at 1, 5.) The Commissioners also stated that "the application of inverse condemnation to utilities in all events of private property loss [fails] to recognize important distinctions between public and private utilities and that the financial pressure on utilities from the application of inverse condemnation may lead to higher rates" resulting from "increase[s] in the cost of capital and the expense associated with insurance". (*Id.* at 6.)

STANDARD OF DECISION

Under Code of Civil Procedure section 430.10(e), a demurrer should be sustained when the facts pleaded in the complaint fail to state a cause of action. *C&H Foods Co. v. Hartford Ins. Co.*, 163 Cal. App. 3d 1055, 1062 (1984). While the Court must accept as true material facts alleged in the complaint and may consider matters which may be judicially noticed, *Tilton v. Reclamation Dist. No. 800*, 142 Cal. App. 4th 848, 853 (2006), "contentions, deductions or conclusions of fact or law alleged in the complaint are not considered in judging its sufficiency," *C&H Foods*, 163 Cal. App. 3d at 1062. "Doubt in the complaint may be resolved against plaintiff[s]." *Id.*

ARGUMENT

I. IN LIGHT OF THE CPUC'S POLICY, APPLICATION OF INVERSE CONDEMNATION TO PG&E IS INCONSISTENT WITH STATE LAW.

Under California law, only a "public entity" is subject to inverse condemnation. *See Barham v. S. Cal. Edison Co.*, 74 Cal. App. 4th 744, 752 (1999) (holding that a plaintiff seeking to prevail on inverse condemnation "must prove that a public entity has taken or damaged their property for a public use"). The California Supreme Court has never held that a private utility such as PG&E is a public entity for purposes of an inverse condemnation claim. Because the CPUC's policy restricts the ability of private utilities to spread inverse condemnation costs among its rate payers, PG&E should not be treated as a public entity for purposes of inverse condemnation. Although prior Court of Appeal decisions have held privately owned public utilities liable in inverse condemnation, *see, e.g.*, *id.* at 752-53, those courts did not have the benefit of the CPUC's recent confirmation that it would not allow automatic recovery of the costs associated with inverse claims. As a result, these cases are distinguishable and this Court need not follow them. *See Cuccia v. Superior Court*, 153 Cal. App. 4th 347, 354 (2007).

As described above, the core purpose 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". *Pac. Bell v. City of San Diego*, 81 Cal. App. 4th 596, 602 (2000); *see also Holtz*, 3 Cal. 3d at 303 (noting fundamental policy is to distribute losses throughout the community and thereby "socialize the burden" (citation omitted)); *Gutierrez*, 198

Cal. App. 4th at 837.[6] That is why inverse condemnation liability is imposed without fault: Losses caused by a public improvement are "capable of more equitable absorption by the beneficiaries of the project (ordinarily either taxpayers or consumers of service paid for by fees or charges) than by the injured owner". *McMahan's of Santa Monica v. City of Santa Monica*, 146 Cal. App. 3d 683, 697 (1983) (citation omitted). The policy underlying inverse condemnation is not merely to shift losses from one private party (here, Plaintiffs) to another (here, PG&E) under strict liability.

True public entities may have immunity or other protections from tort liability such as those afforded by California's Tort Claims Act, Gov't Code §§ 810 *et seq.*, and they have the taxing authority to spread costs. As a result, the doctrine of inverse condemnation has been developed to ensure that citizens who suffer losses as a result of a public improvement constructed by a public entity have a means of redress that results in the spreading of such losses across the benefiting community. Private utilities, on the other hand, lack tort immunity, have no taxing authority and cannot automatically spread costs since their rates are subject to CPUC approval (as has now been crystallized). *See Moreland Inv. Co. v. Superior Court*, 106 Cal. App. 3d 1017, 1022 (1980) (holding private utility is not governmental agency under Code of Civil Procedure section 397 in part because it cannot directly pass on eminent domain costs to rate payers).

Only two Court of Appeal decisions (and no Supreme Court decisions) have extended inverse condemnation to a private utility such as PG&E where there was not joint action with a public entity: *Barham* and *Pacific Bell*. The CPUC policy set forth in the SDG&E decision undermines the validity of those decisions and, because those decisions are fairly distinguishable, this Court need not follow them. *See, e.g.*, *Cuccia*, 153 Cal. App. 4th at 354; *People v. Linkenauger*, 32 Cal. App. 4th 1603, 1613 (1995); *cf. Montandon v. Triangle Publ'ns, Inc.*, 45 Cal. App. 3d 938,

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[6] *See also 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)); *Barham*, 74 Cal. App. 4th at 752 (same); *Magnuson-Hoyt v. Cty. of Contra Costa*, 228 Cal. App. 3d 139, 144 (1991) (same); Arvo Van Alstyne, *Statutory Modification of Inverse Condemnation: The Scope of Legislative Power*, 19 Stan. L. Rev. 727, 738 (1967) (explaining that the purpose of inverse is to ensure that losses are "distributed over the taxpayers at large rather than . . . borne by the injured individual").

950-52 (1975) (distinguishing case where Supreme Court had not considered facts present in pending case).

Indeed, the CPUC acknowledged that those prior rulings extended inverse condemnation to private utilities "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 rate payers". (CPUC Hearing 21:48-22:00.) The court in *Barham* simply asserted that no "significant differences exist regarding the operation of publicly versus privately owned utilities", 74 Cal. App. 4th at 753, without considering that unlike public entities, private utilities cannot automatically spread inverse losses across the community.[7] Likewise, the *Pacific Bell* court found that inverse condemnation applied to SCE, a private utility, in light of SCE's "quasi-monopolistic" authority. 208 Cal. App. 4th at 1406. But in doing so, the court did not consider whether SCE could in fact spread losses to the community because SCE "ha[d] not pointed to any evidence to support its implication that the [CPUC] would not allow [SCE] adjustments to pass on damages liability during its periodic reviews". *Id.* at 1407.[8]

Such evidence now exists. Even if a private utility is held strictly liable in inverse condemnation, the CPUC will not automatically permit the private utility to spread the costs associated with its public improvement throughout the benefiting community. This incompatibility between inverse condemnation principles and CPUC policy compels the conclusion that the prior Court of Appeal decisions applying inverse condemnation are distinguishable and have no bearing

[7] In reaching its decision, the *Barham* court relied on a decision about whether private utilities were bound by the equal protection clause when making employment decisions. *See* 74 Cal. App. 4th at 753 (citing *Gay Law Students Ass'n v. Pac. Tel. & Tel. Co.*, 24 Cal. 3d 458, 469-70 (1979)). But quasi-public entities can be deemed public entities in certain contexts and not others, and 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. For example, in contrast with *Barham*, the Court of Appeal stated in *Pasillas v. Agricultural Labor Relations Board* that private entities can take state action sufficient to trigger equal protection guarantees but not sufficient to trigger free speech and associational guarantees. 156 Cal. App. 3d 312, 348 (1984).

[8] Although the court in *Pacific Bell* suggested in a footnote that, if municipally owned utilities were regulated by the CPUC, such regulation would not "immunize municipal utilities from inverse condemnation liability under the theory that they were no longer able to spread the cost of public improvements", 208 Cal. App. 4th at 1407 n.6, that statement was dicta and is inconsistent with the Supreme Court's express articulation of the policy underlying inverse condemnation. It was also made before the CPUC had expressed its position that it would not permit automatic cost recovery for privately owned utilities that incurred inverse condemnation costs.

on this decision. (*See* CPUC Hearing 22:00-22:07 ("[T]his is an issue that the legislature and the courts may wish to examine and may be called on to examine in the future."); *see also* CPUC Concurrence at 6-7 (urging the court "to carefully consider the rationale for applying inverse condemnation in these types of cases").

For these reasons, Defendants respectfully request that this Court address the salient difference between PG&E and public entities—namely, PG&E's inability to unilaterally and automatically recover inverse condemnation costs—and sustain their demurrer on the ground that inverse condemnation does not apply to PG&E.[9]

II. IN LIGHT OF THE CPUC'S POLICY, APPLICATION OF INVERSE CONDEMNATION TO PG&E IS UNCONSTITUTIONAL.

The application of inverse condemnation to PG&E in light of the CPUC's WEMA Decision would also violate PG&E's constitutional rights. Assuming that inverse condemnation serves a legitimate government purpose, the combination of inverse condemnation and the CPUC's refusal to allow automatic pass-through of inverse condemnation costs exacts an uncompensated taking of PG&E's property in violation of the Takings Clause of the Fifth Amendment of the United States Constitution as incorporated against the States through the Fourteenth Amendment and Article I, Section 19 of the California Constitution. Alternatively, the application of inverse condemnation to PG&E is arbitrary and irrational and violates PG&E's substantive due process rights under the Fourteenth Amendment and the California Constitution.

[9] Plaintiffs' claim for inverse condemnation is brought against "All Defendants". (*See, e.g.*, Individual Pls. Master Compl. ¶¶ 220-227.) The claim against PG&E Corp. must fail for an additional reason: It is the holding company of Pacific Gas and Electric Company, the utility. (Eggleton Decl. Ex. E at 7 ("Utility" is Pacific Gas and Electric Company) and 8 ("PG&E Corporation . . . is a holding company whose primary operating subsidiary is Pacific Gas and Electric Company, a public utility operating in northern and central California.").) PG&E Corp. therefore cannot be liable for inverse condemnation. *See Barham*, 74 Cal. App. 4th at 752. Even if, however, PG&E Corp. was a utility, it is still a *privately owned utility*, and therefore inverse condemnation should not apply. *See, e.g.*, *Bach v. Cty. of Butte*, 215 Cal. App. 3d 294, 307 (1989) ("[I]t is elementary that an inverse condemnation action . . . cannot be asserted against private parties.").

A. Application of Inverse Condemnation to PG&E Violates the Takings Clause of the Fifth Amendment.

The Takings Clause of the Fifth Amendment provides: "[N]or shall private property be taken for public use, without just compensation." U.S. Const. amend. V, § 5. The Supreme Court has explained that this clause "prevent[s] the government from forcing some people alone to bear the public burdens which, in all fairness and justice, should be borne by the public as a whole". *E. Enters. v. Apfel*, 524 U.S. 498, 522 (1998) (internal quotation marks omitted). Article I, Section 19 of the California Constitution provides: "Private property may be taken or damaged for a public use . . . only when just compensation" had been paid.

Because private utilities cannot automatically recover their inverse condemnation costs, the application of inverse condemnation to a private utility such as PG&E is a taking of private property from one private party (PG&E) to give it to another (the inverse plaintiff) without just compensation. As explained above, the purpose of inverse condemnation is to spread the losses sustained by one class of people that have been harmed by a public improvement to all who benefit from that improvement. That is the whole point behind the strict liability scheme. When applied to a public utility, which can spread costs simply by increasing its rates with no requirement for regulatory approval, there is no uncompensated taking: All rate payers bear the costs of the strict liability regime that has been developed for their common good. By contrast, given the CPUC's policy of denying automatic rate recovery by a private utility, the application of strict liability under inverse condemnation would "forc[e] [PG&E] alone to bear the public burdens" of inverse condemnation losses that were meant to be "borne by the public as a whole". *E. Enters.*, 524 U.S. at 522. That uncompensated taking for public use is unconstitutional.

First, the application of the inverse condemnation doctrine here will force a considerable financial burden on PG&E. PG&E's potential liability under inverse condemnation is substantial, and PG&E is "clearly deprived of the amounts it must pay" to the injured landowners. *See id.* at 529-32 (finding considerable financial burden was imposed where the Coal Act required plaintiff to make considerable payments and where the Act did not guarantee a right to reimbursement). Courts have recognized that limiting a utility's rate-setting ability can, in some circumstances, constitute a

taking. *See Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308 (1989) ("If the rate does not afford sufficient compensation, the State has taken the use of utility property without paying just compensation and so violated the Fifth and Fourteenth Amendments."); *Ponderosa Tel. Co. v. Pub. Utils. Comm'n*, 197 Cal. App. 4th 48, 59 (2011) (holding that CPUC had engaged in impermissible appropriation by failing to permit rate increase). Where, as here, PG&E is forced to absorb those inverse costs without any guarantee of rate recovery, its financial burden is sufficient to demonstrate a constitutional taking.

Second, the application of inverse condemnation interferes with PG&E's reasonable investment-backed expectations. *E. Enters.*, 524 U.S. at 524-25, 532. As a privately owned entity, PG&E does not expect, on the one hand, to be held strictly liable by courts for inverse condemnation costs, but unable, on the other hand, to recover those costs through its rates. Further, as noted in the CPUC Concurrence, "[i]nvestor owned utilities are partially dependent on the capital markets to raise money and the insurance market to mitigate financial risk". (CPUC Concurrence at 6.) Prior to the CPUC's policy statements, the investment-backed expectation of the capital markets was aligned with PG&E's expectations that it would not be subjected to strict liability but also precluded from cost spreading. Now, the taking of PG&E's property without just compensation through the application of inverse condemnation could change "the risk profile of investor-owned utility[ies]," (*id.*), and thereby increase PG&E's cost of obtaining the capital that it needs to continue to provide its customers with safe and reliable energy service.

Third, application of inverse condemnation to PG&E does not "adjust[] the benefits and burdens of economic life to promote the common good". *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 539 (2005). Under inverse condemnation, PG&E has to pay landowners for damage to their property caused (without fault) by PG&E's power lines. In this circumstance, PG&E—and not the rate payers who benefit from power lines—is left to bear the costs alone.

B. Application of Inverse Condemnation to PG&E Violates PG&E's Substantive Due Process Rights.

The Fourteenth Amendment protects against government deprivations of life, liberty or property that are arbitrary and irrational. *See State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S.

408, 416-17 (2003) ("The Due Process Clause of the Fourteenth Amendment prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor."); *Action Apartment Ass'n v. Santa Monica Rent Control Bd.*, 509 F.3d 1020, 1025-26 (9th Cir. 2007) ("[A]n arbitrary and irrational deprivation of real property . . . might be 'so arbitrary or irrational that it runs afoul of the Due Process Clause." (citing *Lingle*, 544 U.S. at 542)).[10]

As a threshold matter, inverse condemnation liability plainly deprives PG&E of its property, as PG&E is required to pay money damages. *Cf. Bd. of Regents v. Roth*, 408 U.S. 564, 571-72 (1972) ("property interests protected by . . . due process extend well beyond actual ownership of real estate, chattels, or money"). Contrary to the typical eminent domain or inverse condemnation case, PG&E is not actually entitled to retain the "condemned" property, and thus receives no benefit in exchange for compensating the landowner. The only question, therefore, is whether this deprivation is arbitrary and irrational. *Action Apartment*, 509 F.3d at 1025-26. It is, for at least two reasons.

First, taking PG&E's property without a showing of fault and without automatic rate recovery is not substantially related to the stated cost-spreading justification for inverse condemnation. *Cf. Sinaloa Lake Owners Ass'n v. City of Simi Valley*, 864 F.2d 1475, 1484-87 (9th Cir. 1989) ("To establish a violation of substantive due process, the plaintiffs must prove that the government's action was 'clearly arbitrary and unreasonable, having no substantial relation to the public health, safety, morals, or general welfare.'"). As explained above in Part I, under the CPUC's policy, PG&E cannot spread its costs without satisfying the CPUC's "prudent manager" standard through an extra-judicial administrative proceeding. It is arbitrary and irrational for a court, on one hand, to hold PG&E strictly liable for inverse condemnation on the theory that it can recover such costs and for the CPUC, on the other, to require PG&E to meet an administratively created standard to recover the same.[11]

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[10] A Superior Court's ruling on inverse condemnation constitutes state action. *See N.Y. Times Co. v. Sullivan*, 376 U.S. 254, 265 (1964); *Shelley v. Kraemer*, 334 U.S. 1, 14-18 (1948).

[11] It is significant that the regulator entrusted by the California Constitution with overseeing utilities, the CPUC, has expressed concerns with the application of inverse condemnation to private utilities for exactly this reason.

Second, inverse condemnation is irrational as applied to PG&E. Government entities are protected against private claims by sovereign immunity or California's Tort Claims Act, Gov't Code §§ 810 *et seq.* Inverse condemnation therefore allows private property owners an opportunity to recover damages from government entities when otherwise no remedy may be available. PG&E, however, is a private corporation and is subject to general tort liability. Private individuals do not need inverse condemnation to recover for harm allegedly caused by PG&E. *See* C.C.P. § 3333.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that the Court sustain their demurrer to Plaintiffs' inverse condemnation causes of action.[12]

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[12] To the extent the Court overrules Defendants' demurrer, Defendants respectfully request that the Court recommend that this question be certified for interlocutory appellate review, pursuant to C.C.P. § 166.1 because "there 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".