April 22, 2019

Chair Carla Peterman
Commissioner Dave Jones
Commissioner Michael Kahn
Commissioner Pedro Nava
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Commission on Catastrophic Wildfire Cost and Recovery
Governor's Office of Planning and Research
1400 Tenth Street
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Submitted via Electronic Mail
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Re: Response Of The Institutional Equity Investors To The Commission's Request For Comment

Dear Commissioners:

The Institutional Equity Investors[1] appreciate the opportunity to provide comments supporting the forthcoming report of the Commission on Catastrophic Wildfire Cost and Recovery (the "Commission") to Governor Newsom and the California Legislature. We offer the perspective of institutional utility company shareholders who manage funds entrusted to us by pension funds, university endowments, charitable foundations, and individuals.

The Institutional Equity Investors, taken together, own a substantial portion of the common equity of PG&E Corporation, parent of Pacific Gas and Electric Company (collectively, "PG&E"), the utility facing the largest risks from past and prospective wildfires. Looking

[1] The Institutional Equity Investors are funds and accounts managed by: 683 Capital Partners L.P.; Anchorage Capital Group, L.L.C.; Attestor Capital, LLP; Caspian Capital LP; Centerbridge Partners, LP; First Pacific Advisors, LP; Latigo Partners, LP; Newtyn Management, LLC; Nut Tree Capital Management L.P.; Owl Creek Asset Management, L.P.; Pentwater Capital Management LP; Steadfast Capital Management LP; Stonehill Capital Management, LLC; Warlander Asset Management L.P.; and York Capital Management Global Advisors, LLC. The Institutional Equity Investors are acting in their individual capacities but authorized the filing of this single Response for the purpose of administrative efficiency. Each of the Institutional Equity Investors is expressing its independent views, and counsel does not have the actual or apparent authority to obligate any one entity to act in concert with any other entity with respect to PG&E equity securities. The Institutional Equity Investors have not agreed to act in concert with respect to their respective interests in PG&E equity securities.

forward, our firms and other investors like us will be an important source of the capital that PG&E and California's other investor owned utilities ("IOUs") need to make critical investments in safety and reliability, wildfire mitigation and grid hardening, and infrastructure to support the State's clean energy goals.

Like other stakeholders, we are deeply concerned about the future of California's IOUs, which currently bear a disproportionate share of liability for the State's increasingly catastrophic wildfires. If the wildfire liability framework is not fixed, the ongoing financial instability of the IOU sector across the State will have broad and far-reaching ramifications to wildfire victims, ratepayers, industry, and the environment.

We are encouraged by the significant efforts of this Commission, the California Public Utilities Commission ("CPUC"), and the Governor's Strike Force to understand and resolve these incredibly difficult and complex issues. We appreciate the substantial energy being put forth by all stakeholders to this collaborative process and look forward to providing our ideas and input. Below, we give the investor's perspective on the two Commission questions that directly relate to the investment decisions of those considering whether to extend financing to California IOUs. After a brief summary of the current crisis, we first address the misconstrued doctrine of inverse condemnation as it currently is applied and suggest legal and regulatory changes that would help bring low-cost capital back into the system (Question 1). Next, we respond to the concept of a fund or funds to help limit and fix IOU exposure to wildfire liability (Question 3).

I. The Current Crisis

California is in crisis. The confluence of record drought, excessive wind conditions, lack of deforestation, 100+ million newly dead standing trees, and continued development in the

wildland urban interface has led to unprecedented catastrophic wildfires in 2017 and 2018 and the prospect of future tragedies. This "new normal" driven by climate change, coupled with a unique inverse condemnation doctrine that imposes strict liability regardless of fault, has driven the State's largest IOU (PG&E) into bankruptcy and put the other two (Southern California Edison and San Diego Gas & Electric) on the verge of "junk issuer" status.

The Governor's Strike Force Report put it well:

> Under the status quo, all parties lose – wildfire victims, energy consumers, and Californians committed to addressing climate change. Victims face a great deal of uncertainty and diminished ability to be compensated for their losses and harm. Customers face rising rates and instability. California's ability to achieve its climate goals is frustrated. Utility vendors and employees face uncertainty and likely significant losses. The bottom line is that utilities either in or on the verge of bankruptcy are not good for Californians, for economic growth, or for the state's future.[2]

One root cause of this crisis is the combination of (1) the judicial application of inverse condemnation, where an IOU is held strictly liable, regardless of fault, for wildfire damages where IOU equipment is involved, and (2) the potential disallowance of rate recovery for such costs by the CPUC whenever it subjectively determines that the IOU did not act "prudently" in its conduct leading to the fire. This inconsistent regime separates inverse condemnation from its legal foundation and exposes IOUs to massive, unbounded liability that threatens their ability to raise enough capital to sustain safe and reliable operations and make necessary investments in the grid and wildfire mitigation.

The Strike Force Report warns that:

> [T]he current system for allocating costs associated with catastrophic wildfires – often caused by utility infrastructure, but exacerbated by drought, climate change, land-use policies, and a lack of forest management – is untenable both for utility customers and for our

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[2] *Wildfires And Climate Change: California's Energy Future, A Report From Governor Newsom's Strike Force*, April 12, 2019 ["Strike Force Rep."], at 3.

> economy. Multi-billion dollar wildfire liabilities over the last several years have crippled the financial health of our privately and publicly owned electric utilities. . . . Utilities rely on credit to finance ongoing infrastructure investments, including fire mitigation. As utilities' credit ratings deteriorate, their borrowing costs increase and those costs for capital necessary to make essential safety improvements are passed directly to customers. These downgrades, and the prospect of additional utility bankruptcy filings, directly impact Californians' access to safe, reliable and affordable electricity.[3]

This is no exaggeration. Current California IOU projections call for *$70 billion* in capital expenditures over the next five years.[4] Those expenditures are critical in several respects. In addition to normal (and substantial) ongoing investment in infrastructure, major capital is needed for wildfire prevention and mitigation through measures like vegetation management, pole strengthening, and fire detection. PG&E alone is projected to spend $5 billion on wildfire mitigation measures between 2019 and 2023. Independently, utilities must continue to invest in infrastructure to support clean and renewable energy. As the Strike Force Report notes, IOUs "play a critical role in the state's efforts to address climate change. To continue the state's progress in reducing greenhouse gas emissions in the energy sector, California needs investment-worthy IOUs" capable of raising the funds necessary to achieve the State's aggressive clean-energy goals.[5]

Absent a solution that makes capital more accessible to them, IOUs will be unable to make these investments. Without a solution, IOUs will have to make hard choices among competing imperatives – system reliability, wildfire mitigation, grid hardening, and clean energy

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[3] *Id*. at 2-3.

[4] *See* Exhibit A for a summary.

[5] Strike Force Rep. at 17.

– with devastating long-term consequences for California and its economy, which depends on reliable and ready access to IOU-delivered power.

II. Response To Question 1: Inverse Condemnation And The Wildfire Liability Regime

A. As Currently Applied To California IOUs, Inverse Condemnation Lacks A Legal Foundation Or Rationale

The inverse condemnation doctrine, as currently applied to IOUs, has been severed from its legal mooring of cost spreading. Instead of spreading costs among all who benefit from the services provided by IOUs, inverse condemnation as recently applied to private utilities *concentrates* the cost of wildfires on IOU investors due to the CPUC's determination that inverse condemnation liability is "not relevant" to rate recovery. As noted above, this concentrated cost has proven too much for IOUs to bear, with devastating consequences for California.

The premise of the inverse condemnation doctrine is "to distribute throughout the community the loss inflicted upon the individual by the making of the public improvements."[6] When applied to *public* utilities – utilities owned by municipalities or state instrumentalities (such as irrigation districts, city departments or rural cooperatives) – inverse condemnation permits cost-spreading because public utilities pay for liability by (1) raising rates (paid by ratepayers) and/or (2) relying on government funding (paid for by taxpayers). California's intermediate appellate courts extended the inverse condemnation doctrine to *private* utilities (those owned by private shareholders, *i.e.* IOUs) on the same premise – that the CPUC, which

[6] *Locklin v. City of Lafayette*, 7 Cal. 4th 327, 365 (1994) (citation and quotation omitted); *see, e.g.*, *Clement v. State Reclamation Bd.*, 35 Cal. 2d 628, 642 (1950) ("[t]he decisive consideration" under inverse condemnation "is whether the owner of the damaged property if uncompensated would contribute more than his proper share to the public undertaking"); *Holtz v. Superior Court*, 3 Cal. 3d 296, 303 (1970) ("the underlying purpose" of the doctrine is "to socialize the burden" by "afford[ing] relief to the landowner in cases in which it is unfair to ask him to bear a burden that should be assumed by society").

regulates IOUs and approves the rates that they charge customers, would allow private utilities to shift inverse-condemnation costs to the community at large by increasing rates.[7]

The CPUC, however, recently rejected the position that IOUs may pass on inverse condemnation damages to the public. Calling the cost-shifting assumption "unsound" and insisting that inverse condemnation liability is "not relevant" to rate recovery, the CPUC applied a "prudent manager" standard to deny San Diego Gas & Electric's application to recover from ratepayers $379 million in inverse condemnation liabilities based on wildfires.[8] The Fourth District Court of Appeal then summarily denied the petition for review, stating that "[t]he Commission's determination that the principals [*sic*] of inverse condemnation did not bar its prudent manager analysis under section 451 was not in excess of its powers [and] no[t] a violation of the law."[9]

B. The Severe Consequences Of Existing Inverse Condemnation Doctrine

Under existing law, as applied by the CPUC, IOUs are stuck between a rock and a hard place. On one hand, they are subject to strict liability for inverse condemnation under cases predicated on the idea that IOUs can spread the cost to all who benefit from utility operations. On the other hand, the CPUC has made it clear that IOUs may not recover the costs of inverse condemnation liabilities unless they satisfy the "prudent manager standard" (a standard not

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7 *Barham v. Southern California Edison Co.*, 74 Cal. App. 4th 744, 753 (1999) (noting no "significant differences . . . regarding the operation of public versus privately owned electrical utilities"); *Pacific Bell Telephone Co. v. Southern California Edison Co.*, 208 Cal. App. 4th 1400, 1407 (2012) (no evidence "that the commission would not allow [IOUs] to pass on [inverse condemnation] damages liability during its periodic reviews").

8 *Decision Denying Application Of San Diego Case & Electric Company (U902E) For Authorization To Recover Costs Related To The 2007 Southern California Wildfires Recorded In The Wildfire Expense Memorandum Account*, 2017 Cal. PUC LEXIS 513, at *94-95 (Cal. P.U.C. Nov. 30, 2017).

9 *San Diego Gas & Electric Co. v. Public Utilities Comm'n*, No. D074417, slip op. at 2 (Cal. Ct. App. Nov. 13, 2018).

required for publicly owned utilities). Thus, even though spreading costs is a fundamental basis of the inverse condemnation doctrine, private utilities are no longer assured that they can spread the costs of inverse condemnation liability across the community of ratepayers.

This situation is of significant concern to those who are considering whether to invest in California IOUs. The extent of potential inverse condemnation liabilities for wildfires is staggering. PG&E, for example, believes that its potential exposure with respect to the 2017 and 2018 wildfires alone could exceed *$30 billion*, exclusive of punitive damages, fines, and penalties.[10] Yet, for any given wildfire, the CPUC may or may not allow an IOU to pass on inverse condemnation damages to ratepayers. And even where the CPUC does ultimately permit a utility to raise its rates and socialize the damages, the utility must endure years of uncertainty between a wildfire event and a CPUC determination and allowance of ratepayer recovery. (CPUC's denial of the San Diego Gas & Electric's request for recovery of losses from the 2007 fire occurred a decade later, in 2017.) IOU shareholders bear the entire burden of wildfire liability during that period of uncertainty.

This lopsided dynamic cannot persist. Other businesses can adjust to changes in their risk profile by raising prices or exiting the market. IOUs can do neither – they are obligated to serve their territories no matter how high the wildfire risk and they are limited to CPUC-approved rates. The only recourse available to the IOU stakeholders called upon to provide critical ongoing financing is to demand substantially higher rates of return or to refuse to provide any financing whatsoever.

IOUs depend on capital markets to fund their operations, and they are facing increasing difficulty in attracting investment. One analyst has noted that, "to the average investor," inverse

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[10] PG&E (Form 8-K) (Jan. 13, 2019), at 4.

condemnation liability "seems a uniquely unpalatable proposition of socialized no-fault liability despite no assurance of presumed recovery in the CPUC rate-setting process."[11] Another observed that there were "too many unknowns and significant risk," making private utilities "uninvestable right now."[12] A third report likewise noted that, "unless the law is changed regarding application of inverse condemnation to investor-owned utilities or the CPUC changes its position on recovery under the law, the CA utilities will see this material increase in their cost of capital persist and amplify, stressing their ability to invest in CA infrastructure and help the state meet its aggressive clean agenda."[13]

These concerns are not hypothetical. California's IOUs already have seen their credit ratings severely downgraded. In February 2018, well before its bankruptcy filing in January 2019, PG&E's credit rating was downgraded from an A to BBB+ and it was placed on a negative ratings watch.[14] In June 2018, PG&E was downgraded further to BBB, with a continuing negative rating watch, because of "the company's exposure to the California wildfires and its ability to recover associated costs from ratepayers" under inverse condemnation.[15] The rating agencies warned that more credit downgrades could follow "[a]bsent a near-term resolution" of the "disconnect" between inverse condemnation's strict liability standard and CPUC's prudent

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[11] Jonathan Arnold, *CPUC Denies SDG&E Wildfire Recovery; Notes "Incorrect Premise" Of IC Doctrine*, at 3 (Nov. 30, 2017).

[12] Mike Yamamoto, *Market Notes: Tuesday, December 12, 2017* (Dec. 12, 2017), https://investitute.com/activity-news/market-notes-tuesday-december-12-2017/.

[13] Greg Gordon & Kevin Prior, *PCG Has Suspended Dividends, Citing Uncertainty Regarding Wildfire-related Liabilities*, at 2 (Dec. 21, 2017).

[14] Nephele Fabiola & S. Kirong, *S&P Downgrades PG&E Over Calif. Wildfire Risks*, S&P GLOBAL MARKET INTELLIGENCE (Feb. 26, 2018).

[15] Gabe Grosberg & Sloan Millman, *PG&E Corp. and Subsidiary Downgraded to 'BBB' on Initial Results of Wildfire Investigation; Still CreditWatch Negative*, RATINGSDIRECT (June 13, 2018).

manager standard.[16] Southern California Edison and San Diego Gas & Electric, the State's other IOUs, have been impacted similarly.[17]

Standard & Poor's recently questioned whether California even will have an investment grade IOU by the start of the 2019 wildfire season and stated that, absent a definitive legislative and regulatory solution, it will downgrade IOU ratings further:

> As we see it, there is a window of opportunity to bring clarity to the regulatory construct. However, that opening will start to close at the beginning of the 2019 wildfire season. From a ratings perspective, we would need to see clear evidence that concrete steps are being taken during this relatively short period to strengthen California's regulatory construct for electric utilities. Absent clear evidence of leadership to identify concrete and realistic steps to reduce wildfire liability risks, S&P Global Ratings would lower the ratings on Edison, SCE, and SDG&E by one or more notches.[18]

The loss of access to investment-grade capital (debt and equity), and accompanying higher financing costs of IOU capital, directly harms utility customers. For example, we estimate that just a 1% increase in the cost of debt occasioned by a ratings downgrade, coupled with an ensuing 3% increase in the cost of equity, would result in a 6.5% increase in the average

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16 *Id*.

17 *See, e.g.*, *San Diego Gas & Electric Co. Downgraded To 'BBB+', Outlook Remains Negative*, S&P GLOBAL RATINGS (Jan. 21, 2019) ("The outlook [for SDG&E] is negative, reflecting the unique and elevated credit risks that California's electric utilities face because of climate change, their susceptibility to frequent and devastating wildfires, and the legal doctrine of inverse condemnation. We could lower our rating on SDG&E by one or more notches if regulators and/or politicians do not take concrete steps to explicitly address these growing risks before the start of the 2019 wildfire season."); *Rating Action: Moody's Downgrades Edison International To Baa3 And Southern California Edison To Baa2; Outlooks Negative*, MOODY'S INVESTORS SERVICE (Mar. 5, 2019) (downgrade due in part to the doctrine of inverse condemnation, which "holds electric utilities to a strict liability standard on third-party property damages caused by the wildfire, regardless of fault," and the "significant amount of uncertainty associated with the cost recovery process because in 2017 the CPUC disallowed the entire $379 million wildfire cost request for wildfires that occurred on San Diego Gas & Electric's territory in 2007"), https://www.moodys.com/research/Moodys-downgrades-Edison-International-to-Baa3-and-Southern-California-Edison--PR_396014.

18 *Will California Still Have An Investment-Grade Investor-Owned Electric Utility?*, S&P GLOBAL RATINGS (Jan. 21, 2019).

monthly bill of PG&E customers. Customers of Southern California Edison and San Diego Gas & Electric would suffer similarly.[19]

To make matters worse, insurance costs have skyrocketed and coverage has restricted, directly increasing costs to ratepayers. As the Vice Chair of the California Assembly Utilities and Energy Committee noted at a recent hearing: "We've already heard about one [private utility] given a premium of $120 million for $300 million worth of coverage. That's not insurance."[20] Indeed, PG&E recently reported that when it renewed coverage during the third quarter of 2018 – *before* the November 2018 Camp Fire – it was only able to purchase an aggregate amount of $1.4 billion in coverage and only able to do so at a cost of $360 million.[21] This is both inadequate and extraordinarily expensive insurance, and it is expected that coverage for future periods, if available at all, will be even more expensive.

At the same time, wildfires are getting more frequent and more severe due to climate change and other factors outside of IOU control (such as governmental forest and land management and increasing development in the wildland urban interface). Each degree of increased temperature is linked with exponential growth in the number and severity of wildfires, and temperatures are expected to rise over six degrees Fahrenheit over the next century.[22] The Strike Force Report observed that "[w]ildfires are not only more frequent but far more devastating. Fifteen of the 20 most destructive wildfires in the state's history have occurred

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[19] *See* Exhibit B for a summary.

[20] Informational Hearing: California Public Utilities Commission: 2017 Fires, Cal. Assembly Comm. on Utils. & Energy (Feb. 26, 2018), at 1:14:45-1:15:45 (testimony of CPUC President Michael Picker), http://assembly.ca.gov/media/assembly-utilities-energy-committee-20180226/video.

[21] PG&E Quarterly Report (Form 10-Q) (Nov. 5, 2018), at 49.

[22] Robinson Meyer, *Has Climate Change Intensified 2017's Western Wildfires?*, THE ATLANTIC (Sept. 7, 2017), https://www.theatlantic.com/science/archive/2017/09/why-is-2017-so-bad-for-wildfires-climate-change/539130/.

since 2000; ten of the most destructive fires have occurred since 2015."[23] Former Governor Brown stated that massive and destructive wildfires are the "new normal" in California.[24] And officials from Cal Fire noted that recent trends "reflect a major shift in wildfires," namely, that "[w]ildfires are becoming more damaging and destructive."[25]

IOUs thus are trapped in the worst of all worlds. With ever-increasing wildfire danger and risk, they are held strictly liable for wildfires caused, even in part, by their equipment (regardless of fault and regardless of measures taken to prevent and reduce harm), yet they cannot be assured of recovering damages paid to wildfire victims through the rate setting mechanism. They cannot obtain adequate insurance, nor can they raise capital at reasonable, investment-grade rates. In short, contrary to the fundamental principle animating the inverse condemnation doctrine, IOUs have been forced to "bear a burden that should be assumed by society."[26]

C. Potential Solutions

Given this dynamic, IOU shareholders face acutely "asymmetric" risk. On one hand, the investment in an IOU is subject to extreme devaluation, and possibly destruction, in cases where the IOU bears the brunt of inverse condemnation liability without the ability to socialize losses through rate increases or other mechanisms. On the other hand, due to the strictly regulated IOU

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[23] Strike Force Rep. at 1.

[24] *Brown on Wildfires Outbreak: 'We Are in for a Rough Ride',* CBS SF Bay Area (Aug. 1, 2018), https://sanfrancisco.cbslocal.com/2018/08/01/brown-on-wildfires-outbreak-were-in-a-new-normal/.

[25] Melissa Palmer & Elizabeth Espinosa, *'We Don't Even Call It Fire Season Anymore . . . It's Year Round': Cal Fire*, KTLA 5 News (Dec. 11, 2017).

[26] *Holtz*, 3 Cal. 3d at 303; *see also* Strike Force Rep. at 27 ("This regime – strict liability for wildfire damage coupled with uncertain ability to recover those damages in rates – increases the risk of bankrupt utilities, which in turn drives up costs for consumers, threatens fair recoveries for fire victims, undermines the state's ability to mitigate and adapt to climate change, and creates uncertainty for utility employees and contractors.").

return on equity, they have no offsetting opportunity for gains in times when wildfire liabilities do not materialize. This is an unpalatable "tails I lose, heads I break even" situation and a clear breach of the "regulatory compact" that, for privately owned utilities, promises a "return to the equity owner . . . commensurate with returns on investments in other enterprises having corresponding risks."[27] That compact is meaningless unless IOUs are able to recoup the extraordinary liabilities arising from wildfires they have only a limited ability to control in the time and with the resources available to them.

As the Governor's Strike Force recognized, the only viable path forward and out of the current crisis is a system that fairly distributes the burdens of wildfire damages. Strike Force Rep. at 28 ("The burdens of wildfire damages brought on by climate change are too great to be borne by any one stakeholder. A fair distribution of the burden requires utilities (ratepayers and investors), insurance companies, local governments, and attorneys representing victims to contribute."). Investors – including those who desire to invest in utilities – have many investment opportunities available to them. Faced with the disproportionate risk currently associated with investments in California IOUs, many have chosen, and will continue to choose, to deploy capital elsewhere. For all the reasons described above, this threatens to undermine the State's economy and its critical energy objectives.

So what should be done to fix this problem? We see several plausible solutions, each of which would be implemented in conjunction with the "wildfire fund" discussed in Section III, below. First and foremost, the Legislature can and should enact a statute requiring the CPUC to allow private utilities to pass along inverse condemnation damages to ratepayers. Such a statute

[27] *Fed. Power Comm'n v. Hope Gas Co.*, 320 U.S. 591, 603 (1944); *see also Bluefield Water Works Co. v. Public Serv. Comm'n*, 262 U.S. 679, 692-93 (1923).

would undo the solvency-threatening uncertainty currently crippling California IOUs and restore the premise underlying the cases that have applied inverse condemnation to private utilities, namely, that there are no "significant differences . . . regarding the operation of publicly versus privately owned electric utilities" that affect the application of inverse condemnation.[28]

Second, failing that permanent and definitive solution, the Legislature could direct the CPUC to allow private utilities to pass along inverse condemnation damages to ratepayers so long as they substantially comply with CPUC-approved wildfire mitigation plans.[29] This would restore a level of objectivity to the CPUC rate-setting process and lessen the unbounded risk to IOU shareholders, who currently are subject to the CPUC's unclear, uncertain, and after-the-fact "prudency" standard for cost recovery from ratepayers.

Third, the Legislature could enact a statute limiting inverse condemnation to public entities. Multiple members of the CPUC have suggested this approach, which would enable IOUs (and their shareholders) to assess the risk of negligence-based liability like any other privately operated business.[30] However, given the constitutional roots of the inverse

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[28] *Barham*, 74 Cal. App. 4th at 753; *see Bacich v. Board of Control of California*, 23 Cal. 2d 343, 350 (1943) (inverse condemnation applies to entities that can spread costs "throughout the community").

[29] San Diego Gas & Electric previously made a similar recommendation to the Commission. *See* Dan Skopec, *Existing Wildfire Legal Liability Regime Presentation by Dan Skopec, Vice President of Regulatory Affairs, San Diego Gas & Electric Company to the Commission on Catastrophic Wildfire Cost and Recovery* (Mar. 13, 2019), http://opr.ca.gov/docs/20190313-wildfire_comments_3-12-2019_San_Diego_Gas_and_Electric.pdf.

[30] Commissioner Rechtschaffen stated that "the legislature and the courts may wish to examine" the doctrine of inverse condemnation because "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." CPUC Hearing (Nov. 30, 2017), at 1:14:45-1:15:45, http://adminmonitor.com/ca/cpuc/voting_meeting at 21:34-22:00. President Picker and Commissioner Guzman-Aceves also urged reconsideration of the application of inverse condemnation to private utilities. *Decision Regarding Application of San Diego Gas & Electric Company for Authorization to Recover Costs Related to the 2007 Southern California Wildfires Recorded in the Wildfire Expense Memorandum Account*, No. 17-11-033, slip op. at 5 (Cal. P.U.C. Dec. 21, 2017) (Concurrence of President and Commissioner Michael Picker and Commissioner Martha Guzman Aceves on Item 40).

condemnation doctrine, such legislation likely would provoke legal challenge, making this a suboptimal solution in light of the critical need for a robust solution prior to the upcoming wildfire season.[31]

Fourth, the Legislature could adjust the degree of culpability required for inverse condemnation, such that liability is imposed only if a private utility is found to have acted negligently in causing a wildfire. This would have the same effect as limiting inverse condemnation to truly public entities, as it would restore a negligence-based liability regime to IOUs.[32] Here again, however, such a statute may be subject to constitutional challenge and thus is not an ideal legislative fix to address the near term crisis.

III. Response To Question 3: Financing Mechanisms

We agree with the Governor's Strike Force Report that a statewide liability "wildfire fund" is a promising concept.[33] A wildfire fund should be structured to provide certainty to IOU investors respecting the maximum liability threshold an IOU may be expected to bear without contribution from ratepayers or other sources. The goal is to remove IOUs from their current status as *de facto* "insurers of last resort" for wildfire harm, thereby restoring the traditional regulatory compact providing for regulated (and limited) rates to be charged by IOUs in

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[31] *Cf. Methodist Hospital of Sacramento v. Saylor*, 5 Cal. 3d 685, 692 (1971) (noting "strong presumption in favor of the Legislature's interpretation of a provision of the Constitution").

[32] *See* Strike Force Rep. at 36 (suggesting "[m]oving to a fault-based standard" where a utility is liable only where it "acted negligently, recklessly, or with intentional misconduct").

[33] We also support the Strike Force's concept of a "liquidity" fund, but only to the extent used in conjunction with the broader wildfire fund and change in liability standards discussed in this Response. A liquidity fund may be helpful to ameliorate liquidity issues that arise when IOUs must pay wildfire claims but wait for reimbursement from a liability-based fund, ratepayers, or other sources. Standing alone, however, a "liquidity-only" fund would do nothing to address the existing disconnect between IOU wildfire exposure and the sources of payment for that exposure.

exchange for a reasonable return on IOU equity commensurate with the returns available on alternative investments of comparable risk.

There are several potential fund structures that could accomplish this objective. One option is a "utility-only" fund that would address only catastrophic wildfires resulting from utility infrastructure. The other is an "all-fire" fund that would address catastrophic wildfires of all sort, regardless of causation. We do not take a position on the best structure at this time. Instead, we suggest below a few important components for a fund of either type. Because diligence respecting current and future fire liabilities and funding sources is ongoing, we speak in generalities rather than specifics. We look forward to working with the Commission over the coming weeks and months to develop specific parameters for a wildfire fund.

As we envision it, the statewide wildfire fund would serve as the sole source of recovery, after recoveries from insurance (if any), for entities asserting claims relating to a wildfire determined to qualify as catastrophic. In effect, the fund would extend the limited commercial liability insurance now available to IOUs in this time of great wildfire risk and uncertainty. As efforts to reduce wildfire risk bear fruit over time, the fund could be downsized or replaced with commercial insurance if and when it becomes available on reasonable terms.

Under our construct, a "utility only" fund would operate as follows:[34]

- Following a determination (by litigation, settlement, or other mechanism[35]) of IOU liability, the fund would (1) reimburse uninsured and underinsured wildfire victims for

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[34] A statewide "all fire" fund would operate similarly, with revisions to address the expanded universe of potentially liable entities.

[35] The need for rapid determination and resolution of wildfire claims is paramount so that wildfire victims may be compensated, insurers may be reimbursed, and IOUs may seek rate recovery as quickly as possible. One important aspect of fund structure would be the establishment of a claims resolution process that enables some or all claims to be resolved without lengthy litigation.

compensable established damages and (2) reimburse insurance subrogation claimants (*i.e.*, insurers who had paid policyholders for damages determined to have been caused by an IOU) at a fixed discount amount.

- If it is determined (by litigation, settlement, or other mechanism) that an IOU failed to meet a specified standard of care (for example, failure to substantially comply with its CPUC-approved wildfire mitigation plan), the IOU would be responsible to pay the fund a per-occurrence penalty within a defined range (which penalty would not be subject to recovery from ratepayers). In order to eliminate concerns about "moral hazard," the IOU penalty would increase with every occurrence up to a specified maximum. But IOU penalties also would be subject to a "stress test" (similar to that envisioned by the Legislature in S.B. 901) to ensure that the IOUs achieve and maintain investment grade credit ratings, ensuring an ongoing source of low-cost capital.

- Consistent with the need to socialize the costs of harm from utility operations (a public good), the fund would be capitalized from a variety of sources:

  - Utilities (IOUs and publicly owned utilities) would contribute fixed premiums over time; IOUs would be able to recover those premiums from ratepayers (just as they would be able to recover standard commercial insurance premiums) and securitize their contributions to the extent appropriate;

  - IOUs failing the required standard of conduct would make penalty payments as described above;

  - The existing DWR bond charge would be extended and securitized, for the benefit of the fund; and

- The State would make contributions from, for example, the Greenhouse Gas Reduction Fund and/or *Wayfair* sales taxes.[36]

The fund would be authorized to securitize these revenue sources, giving it immediate access to extraordinary amounts of capital at very low rates.

The fund should be governed by a diverse board with representatives appointed by interested stakeholders, including utilities, the Legislature, the Governor, the CPUC, and ratepayer advocates. In addition to securitization, the board would have the authority to purchase reinsurance and order utilities to obtain economically reasonable amounts of primary liability insurance.

Taken together, this fund structure would encourage "best practices" in wildfire prevention and mitigation and penalize "bad behavior" without subjecting IOU shareholders to indefinite and unbounded liability, thus making it possible for prospective investors to assess risk and make informed decisions about the allocation of capital to California IOUs. Properly sized, the fund would free up the flow of capital that IOUs – and the State – desperately need.

IV. Conclusion

The asymmetric risk posed by the current application of inverse condemnation to IOUs, without a guaranteed recovery of associated liabilities, is an issue that must be addressed to ensure continued investment in California's electrical grid and clean energy goals. A legislative "fix" to the inverse condemnation doctrine as currently applied is critical. So too is a properly sized and structured wildfire fund. These solutions must be aimed at restoring financial stability

[36] For an "all-fire" fund, property insurers would make contributions as a condition to doing business in the State and in recognition of the reduced risk resulting from utility and State capital investments in fire mitigation and prevention.

to IOUs while socializing the cost of wildfire liabilities among all who benefit from the provision of clean and reliable power by the State's utilities.

Regardless of the chosen path forward, immediate action is critical. We submit that, as the Commission looks at solutions, it must identify meaningful action to address the crisis in the very near term. While we recognize that some solutions may take longer to implement, the precarious financial position of California's IOUs and the magnitude of potential harm that could result from further IOU downgrades or bankruptcies mean that near term measures are essential.

We look forward to working together with the Commission, the Legislature, and the Governor to find constructive and fair solutions. We welcome questions and comments through our counsel as identified below.

Respectfully submitted,

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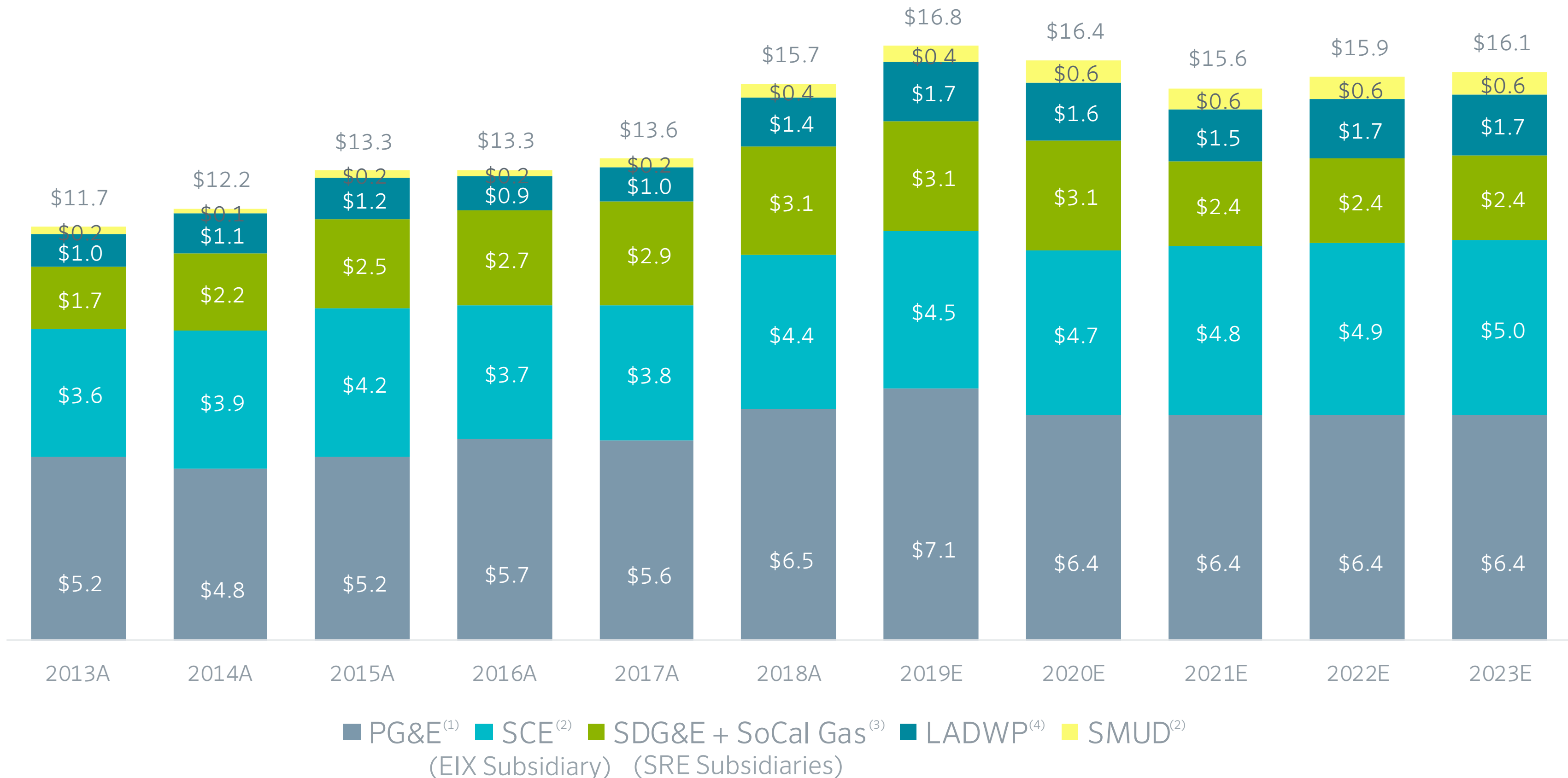
EXHIBIT A

Significant Upcoming Capital Expenditures

CALIFORNIA UTILITIES CAPITAL EXPENDITURES ("CAPEX") 2013A-2023E

($ in billions)

PG&E alone will cumulatively spend $5 billion in capital expenditures on wildfire mitigation measures from 2019 to 2023



Source: Company presentations, EIA, SNL.

Note: Graph only reflects the utilities shown in the legend and does not include the other Publicly Owned and Investor Owned utilities in California.

(1) Assumes average of guidance range for PG&E for years 2020-2023.
(2) Assumes Capex growth at inflation (2%) from 2021 to 2023.
(3) Assumes average of guidance range for SDG&E and SoCal Gas for years 2020 – 2023.
(4) Includes Capex from power segment only. Capex grown at inflation for 2023

EXHIBIT B

Higher Capital Costs Directly Harm Ratepayers

($) CHANGE IN AVERAGE RESIDENTIAL MONTHLY BILL[1]

	1% Increase in Cost of Debt	3% Increase in Cost of Equity	Total
PG&E	$1.28	$5.90	$7.18
EIX	0.88	4.12	5.00
SDG&E	1.32	6.32	7.65

(%) CHANGE IN AVERAGE RESIDENTIAL MONTHLY BILL[1]

	1% Increase in Cost of Debt	3% Increase in Cost of Equity	Total
PG&E	1.2%	5.3%	6.5%
EIX	1.0%	4.5%	5.4%
SDG&E	1.4%	6.7%	8.1%
Average	**1.2%**	**5.5%**	**6.7%**

Edison International:

The "increasingly dire risk profile has already increased customers' costs, mainly the interest obligations arising from recent debt issuances to be recovered in future rates. Last month, SCE issued $1.1 billion of debt at ~0.85% higher interest rates than non-California peer utilities, which translates to nearly $200 million of additional interest over the life of the bonds to be paid for by customers"

April 1, 2019
Senior Vice President, Corporate Affairs, Edison International

(1) Increases based on 2020E rate base and 2017 total MWhrs; Assumes 500 kWh / month residential usage and uses latest available EIA data for average bundled residential rates.