



Dan Skopec
Vice President
Regulatory Affairs

8330 Century Park Court
San Diego, CA 92123-1530

Tel: 858.650.4189
Fax: 858.650.6101

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VIA EMAIL

Commission on Catastrophic Wildfire Cost and Recovery
Governor's Office of Planning and Research
1400 Tenth Street
Sacramento, CA 95814

Re: San Diego Gas & Electric Company's Responses to Request for Comments

Dear Commissioners:

Enclosed are San Diego Gas & Electric Company's ("SDG&E") Responses to your April 8, 2019 Request for Comments. In Senate Bill 901, the Legislation tasked this Commission to develop recommendations on (1) options to socialize the costs associated with catastrophic wildfires in an equitable manner, and (2) the establishment of a fund to assist in the payment of costs associated with catastrophic wildfires.

Subsequent to the issuance of the Commission's Request for Comments, Governor Newsom's Strike Force issued its report entitled "Wildfires and Climate Change: California's Energy Future" on April 12, 2019 ("Strike Force Report"). With respect to the issues that this Commission is statutorily directed to consider, the Strike Force Report recognizes that "the most vexing public policy challenge ... is the equitable distribution of wildfire liability," and it advances three concepts to "address this central question – the imminent wildfire liability issues facing California's utilities." Those three concepts are: (1) a Liquidity Only Fund; (2) Changing Strict Liability to a Fault-Based Standard; and (3) a Wildfire Fund. SDG&E has included information and preliminary reactions to certain issues raised in the Strike Force Report in its Responses in recognition of the fact that the Strike Force Report "[r]equest[s] the SB 901 commission to review and analyze major liability concepts presented in [the Strike Force] report and solicit public comment regarding the different options."

As discussed further in the enclosed Responses, SDG&E highlights the following guiding principles for the Commission to consider as it develops its recommendations and report to the Legislature and Governor:

Cost Recovery: there must be a clear and predictable path to cost recovery for catastrophic wildfire liabilities that utilities incur, as well as accountability for utility actions with respect to wildfire risk mitigation. Cost recovery should be tied to substantial compliance with Wildfire Mitigation Plans. In an era of escalating wildfire costs, investor-owned utilities cannot

absorb unlimited wildfire liabilities, as recent events, including credit rating agency downgrades and PG&E's Chapter 11 reorganization, have illustrated. Furthermore, since state courts apply inverse condemnation to investor owned utilities, and since the purpose of inverse condemnation is cost spreading, cost recovery reform is necessary to effectuate that cost spreading purpose.

Catastrophic Wildfire Recovery Fund: we agree with the Strike Force Report that it is advisable and good policy to establish a fund to achieve broad risk and cost sharing that covers property damage resulting from wildfires if they are caused by electric utility equipment. Utilities should also be permitted to securitize losses in advance of and independent of a CPUC prudency review to protect against liquidity crises. Contributions to the fund must be risk adjusted to account for differences in each utility's service territory, and the level of risk mitigation each utility has undertaken to date.

SDG&E notes that it agrees with the Strike Force Report recommendations for CPUC reform, including (1) expanding safety expertise, (2) clarifying cost recovery standards; (3) improving decision-making; and (4) reviewing high-risk industry regulatory models. SDG&E also supports the CPUC's efforts with respect to the Senate Bill 901 Wildfire Mitigation Plans.

SDG&E appreciates the work this Commission has undertaken to date to understand these complex issues and to work towards solutions for all stakeholders in California. Please do not hesitate to contact me if you have any questions regarding these Responses.

Respectfully submitted,

/s/ Dan Skopec
Vice President – Regulatory Affairs

Enclosure

**SAN DIEGO GAS & ELECTRIC COMPANY RESPONSES TO COMMISSION ON
CATASTROPHIC WILDFIRE AND COST RECOVERY
REQUEST FOR COMMENTS**

1. WILDFIRE LIABILITY REGIME

a. *What, if any, issues exist with the application of the inverse condemnation doctrine? Do they limit the equitable distribution of wildfire costs, and if so, how?*

RESPONSE: California courts and the California Public Utilities Commission (“CPUC”) have issued inconsistent and conflicting rulings about how inverse condemnation should apply to investor-owned utilities (“IOUs”), and IOUs are being unjustly whipsawed by this conflict. Whereas California courts hold IOUs strictly liable for wildfire property damages, regardless of fault and even if one of several concurrent causes, on the theory that IOUs can spread the costs associated with those liabilities through rates,¹ the CPUC has denied such cost spreading.² Thus, the primary issue that exists with the application of the inverse condemnation doctrine is that IOUs are not being permitted to spread the costs even where they are not at fault for the events that gave rise to the costs.

The legal whipsaw imposed on IOUs effectively eliminates the equitable distribution of wildfire costs by forcing an IOU to potentially bear 100% of the state-jurisdictional portion³ of the costs of wildfire liabilities (as SDG&E did), even where the IOU was not at fault or was merely one of several concurrent causes.⁴ Although the rationale for application of inverse condemnation is cost spreading – with the aim of ensuring that no single property owner disproportionately bears the burden of a public improvement – that rationale is turned upside down in the current regime where the costs are instead borne by a single entity – the IOU.

¹ California courts have consistently explained that the “underlying purpose of [inverse condemnation] is to distribute throughout the community the loss inflicted upon the individual by the making of public improvements: to socialize the burden ... that should be assumed by society.” *Holtz v. Superior Court* (1970) 3 Cal.3d 296, 303 (internal citations and quotation marks omitted). *See also Barham v. S. Cal. Edison Co.* (1999) 74 Cal.App.4th 744, 752-53; *Pac. Bell Tel. Co. v. S. Cal. Edison Co.* (2012) 208 Cal. App.4th 1400, 1407. The *Barham* court extended application of inverse condemnation to privately-owned public utilities – deeming them comparable to publicly-owned utilities – in 1999. That extended application might have made sense from a legal and policy perspective at that time, prior to the current era of catastrophic wildfires and liabilities that exceed insurance, but it certainly makes no sense today given the changed circumstances.

² *See* CPUC Decision 17-11-033.

³ The Federal Energy Regulatory Commission, unlike the CPUC, permitted SDG&E to recover costs associated with 2007 wildfire liabilities.

⁴ *See e.g., Marshall v. Dept. of Water & Power* (1990) 219 Cal.App.3d, 1124, 1138

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Governor Newsom’s Strike Force report – entitled “Wildfires and Climate Change: California’s Energy Future” issued on April 12, 2019 (“Strike Force Report”) – aptly described these problems as follows:

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.⁵

As alluded to in this statement, Pacific Gas and Electric Company’s (“PG&E”) Chapter 11 reorganization filing dramatically illustrates the consequences of the conflict in California law.⁶ But the investment grade credit ratings of the state’s other IOUs, including SDG&E, are also under threat. In February 2019, Standard & Poor’s Global Ratings indicated that further downgrades could occur for SDG&E and Southern California Edison Company (“SCE”) if California does not strengthen its “regulatory construct” by June 2019. Access to capital markets on reasonable terms is critical for funding not only routine investments and operations but also for the enhanced wildfire mitigation investments and practices that must be undertaken.

As discussed in the response to subpart c. below, SDG&E strongly urges this Commission to recommend a clear, upfront cost recovery mechanism to fulfill the cost spreading rationale of inverse condemnation.

b. What benefits, if any, are provided by the current application of the inverse condemnation doctrine?

RESPONSE: There are no benefits provided by the current application of the inverse condemnation doctrine because of the conflict between the applicability of strict liability under inverse condemnation and the lack of cost recovery. Inverse condemnation thus disproportionately burdens IOUs, and it may also burden ratepayers to the extent utilities (1) require a higher cost of capital (which is passed on through rates), or (2) become insolvent or unable to continue to provide safe and reliable service.

⁵ Strike Force Report, p. 27.

⁶ In its January 13, 2019 SEC Form 8-K, in which PG&E announced that it (and its parent corporation) would file for bankruptcy reorganization, PG&E explained that its potential liabilities arise from the application of inverse condemnation and the fact that the CPUC may deny cost recovery.

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c. *What, if any, changes to the utility wildfire liability regime do you recommend, and what are the consequences of these changes?*

RESPONSE: To effectuate the cost spreading rationale of inverse condemnation, and to put IOUs on the same footing as government entities and publicly-owned utilities, the current regime must be changed to permit IOUs to recover the costs associated with wildfire liabilities. SDG&E supports legislative measures that couple cost recovery with enhanced wildfire prevention and mitigation efforts.

Senate Bill (“SB”) 901 amended the Public Utilities Code by, *inter alia*, establishing Wildfire Mitigation Plans⁷ and requiring the CPUC to take into account certain factors in cost recovery reasonableness reviews arising from catastrophic wildfires.⁸ Further legislation should be enacted that would make clear that if the IOU has substantially complied with its approved Wildfire Mitigation Plan, the Commission shall deem the company prudent for cost recovery purposes. Many of the prudency factors in Section 451.1 of SB 901 can be linked to substantial compliance with a utility’s approved Wildfire Mitigation Plan. Substantial compliance is an appropriate standard by which to judge a utility’s wildfire mitigation operations, since prudency cannot equate to perfect operations, regardless of the industry in question. When the utility engages in willful misconduct, acts with reckless disregard of consequences, or engages in a persistent pattern of misconduct, its conduct will not fall within the meaning of substantial compliance. The CPUC also has authority to impose fines or penalties for violations of Wildfire Mitigation Plans. Utilities need clear and predictable standards to which they should be held accountable.

The Strike Force Report recommended changing the strict liability standard under inverse condemnation to a fault-based standard.⁹ The Strike Force Report indicated that “[a]pplying a fault-based standard – utilities pay for damage if caused by their misconduct – would balance the need for public improvements (i.e., an electrical distribution system) with the private harm to individuals occasioned by those improvements.”

California courts have rejected strict liability, and have instead applied a standard of reasonableness, in inverse condemnation actions involving public flood control projects. Inverse condemnation claims involving wildfires should likewise be subject to a reasonableness standard for similar reasons. As in the flood control context, the placement, design, and operation of utility facilities “inherently involve a complex balancing of interests and risks.”¹⁰ The liability from damage caused by wildfires is “potentially enormous” and “deserve[s] compensation.”¹¹

⁷ See SB 901, Sec. 38, amending Section 8386 of the Public Utilities Code.

⁸ See SB 901, Sec. 26, adding Section 451.1 to the Public Utilities Code.

⁹ Strike Force Report, pp. 34-35.

¹⁰ *Bunch v. Coachella Valley Water Dist.* (1997) 15 Cal.4th 432, 450.

¹¹ *Id.*

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At the same time, “strict and open-ended liability” for “a project whose overall design, construction, operation and maintenance was ‘reasonable’” threatens to unduly skew the development and operation of utility facilities, which are essential public works.¹²

An appropriate reasonableness standard would weigh various factors in an assessment of the utility’s fault, such as whether the utility facilities served a public purpose, whether the property damage was offset in any way, whether the utility could have feasibly engaged in alternatives with lower risks, and whether the damage was a risk of land ownership at the relevant location.

¹²

Id.

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2. INSURANCE

a. What actions can improve utility access to affordable wildfire liability insurance?

RESPONSE: The most effective way to resolve issues related to the affordability of wildfire liability insurance is to reduce the occurrence and magnitude of catastrophic wildfires. Wildfire mitigation and prevention is a state-wide problem that involves not only utilities but also fire agencies, forest and land management agencies, property owners and governmental entities. Important steps were taken in SB 901 to address mitigation of utility-caused wildfires, statewide fuel issues (*e.g.*, dead and dying trees), funding for fire prevention activities, and other related issues. Another insurance-related issue is the diminished availability and affordability of insurance for tree trimming contractors. Legislation enacted in 2019 must continue to build on these reform efforts, as called for in the Strike Force Report.¹³

If insurance companies continue to experience losses of the frequency and magnitude of 2017 and 2018, affordability of insurance will not be the only problem – availability at any price will be the issue.

b. What actions can ensure that local governments, homeowners, and businesses are adequately insured for wildfire loss? What actions can improve availability and affordability of homeowners' and commercial insurance?

RESPONSE: Legislative and policy solutions must avoid creating the wrong incentives with respect to insurance. In that regard, SDG&E opposes measures that would reduce the incentive of local governments, homeowners, and business to obtain adequate insurance. For example, a fund concept that directly pays uninsured or underinsured property owners could create such a perverse incentive and should thus not be entertained as a solution.

¹³ Strike Force Report, pp. 5-16 (“Part 1: Catastrophic Wildfire Prevention and Response”).

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3. FINANCING MECHANISMS

a. What specific problems related to wildfire cost assignment and recovery should a dedicated wildfire fund or other financial mechanism address?

RESPONSE:

SDG&E generally supports the Wildfire Fund (Concept 3) set forth in the Strike Force Report. Such a Wildfire Fund should be established to achieve broad risk and cost sharing that covers property damage resulting from catastrophic wildfires caused by electric utility equipment. This Wildfire Fund would benefit property owners by providing relief more quickly and with more certainty. In the event the Wildfire Fund exists but cannot respond, securitization of losses not covered by the Wildfire Fund should be an available option to mitigate the rate impact of wildfire costs.¹⁴

Even if such a Wildfire Fund is established, SDG&E believes that a clear path to cost recovery, as discussed in the response to 1.c. above, must nevertheless be established. If a Wildfire Fund is established, a post-loss contribution by an IOU should be determined through the assessment of substantial compliance with the Wildfire Mitigation Plan. For example, to the extent a utility did not substantially comply with its Wildfire Mitigation Plan, and that failure caused a fire, the utility would be required to make an increased annual contribution (between 10-30% of the post-claim increase in the annual contribution) to the Wildfire Fund.

b. What financial mechanism(s) best address the problems you identify within the current liability and insurance regimes? Please provide as much detail as possible regarding proposals (e.g. What liabilities would be covered? Who are the involved parties? What is the administrative structure? How is it capitalized and funded? What level of capitalization is needed? How would subrogation and damage claims be handled? Is it scalable and how? What are the consumer impacts? What are the risks to the proposed approach?)

RESPONSE: The Wildfire Fund should cover property damage resulting from wildfires caused by electric utility ignitions. All utilities in the state – IOUs and publicly-owned utilities – should participate in the Wildfire Fund.

Governance: A governing board should be appointed and include representation from the participating utilities; this governing body would make decisions on utility contributions, reinsurance, and other means to reduce the ratepayer impact of wildfire events.

Insurance requirement: Electric utilities (IOUs and POUs) should be required to continue purchasing commercial insurance; the governing body will require the electric utilities

¹⁴ The Department of Water Resources charge implemented following the California Electricity Crisis – as referenced in the Liquidity-Only Fund (Option 1) of the Strike Force Report – could be another option to consider.

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continue to procure economically feasible amounts of commercial insurance and continue to aggressively mitigate wildfire risks.

Fund pays out after utility insurance: The fund should respond and pay claims for property damage once individual electric utility's insurance is exhausted. Given the varying levels of insurance among electric utilities, an attachment point should be established, and utilities that are unable to commercially procure insurance up to the attachment point should be required to self-insure.

Required risk mitigation: Electric utilities should continue to aggressively implement wildfire risk mitigation measures.

Avoid moral hazard: (1) The CPUC continues to have penalty authority – the Commission should retain authority to fine/penalize IOUs for conduct or regulatory violations related to a fire; (2) for wildfires covered by the Fund, IOU shareholders would be responsible to pay a portion of the post-loss increased premium to the Wildfire Fund that corresponds with the extent an IOU acted imprudently; and (3) willful misconduct and punitive damages are not covered by the Wildfire Fund.

Need for pre-loss upfront and annual contributions: The Wildfire Fund should be funded by electric utilities' initial and ongoing, annual premium contributions:

Premiums should be based on: (1) risk (*e.g.*, miles of overhead lines or number of metered customers in high fire risk areas); (2) geographic differences; and (3) modeling/actuarial analysis that includes a factor for implemented risk mitigation.

Premiums covered in rates: Initial and ongoing, annual premium contributions to the Wildfire Fund should be covered in rates (like insurance premiums).

Securitization: Electric utilities should be able to securitize, with a dedicated rate component, the initial and ongoing, annual premium contributions, and post-loss, as needed.

Increased premiums for loss-causer after an event funded by shareholders in proportion to the extent an IOU is found imprudent in the cause of a fire: If an electric utility suffers a loss paid by the Wildfire Fund, the Fund will require the loss-causer to pay an increased additional premium per underwriting guidelines; an IOUs' increased additional contributions would be subject to a CPUC review, and a portion may be allocated to shareholders proportional to the IOU's misconduct, to the extent such misconduct was a proximate cause of the wildfire.

Tax-exempt contributions: The Wildfire Fund should include a state tax-exempt feature and authorized to seek a federal tax exemption. This would allow tax free accumulation of pre-event loss reserves.

Accessing reinsurance and other risk financing: The Wildfire Fund may purchase reinsurance and other risk financing instruments.

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State contribution: Due to statewide impact of catastrophic wildfire, the State should consider making regular contributions to the fund; to provide immediate confidence for the capital markets, the State should consider acting as a backstop.

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4. COMMUNITY AND WILDFIRE VICTIM IMPACTS

a. What are the specific needs of communities and wildfire victims in considering how costs are socialized?

RESPONSE: With respect to costs, communities and wildfire victims need prompt and efficient resolution of damage claims. The establishment of a Wildfire Fund, as outlined above, would promote such a resolution.

One aspect of this issue that merits consideration is the potential for subsidization among communities or utility service territories. SDG&E’s wildfire mitigation efforts began over a decade ago, following the October 2007 wildfires in Southern California. Underscoring our obligation to operate a safe and reliable system, SDG&E embarked upon a series of measures to reduce the risk that electrical equipment would be a source of wildfire ignitions. SDG&E invested in a meteorology team and a sophisticated weather monitoring network and has more recently invested in building a network of mountaintop cameras – all of which enhance situational awareness. Additionally, SDG&E has worked to fire harden our infrastructure. For instance, SDG&E has replaced wood poles with more durable and weather resistant steel poles, upgraded to large conductor and larger spacing, and has increased the design standards of facilities in the highest risk fire areas. SDG&E has also adopted new safety protocols for operating the power grid during the fire season and on days when the Fire Potential Index shows extreme risk. Complimenting these activities, SDG&E strives to communicate and collaborate with our community, particularly with respect to de-energizations for safety, and has developed practices to do so. SDG&E has invested over \$1 billion in wildfire mitigation efforts since 2007. This is an ongoing effort and will require ongoing investments.

The Strike Force Report recognized SDG&E’s efforts: “SDG&E engaged in a robust fire mitigation and safety program after experiencing devastating fires in its service territory in 2007 and has become a recognized leader in wildfire safety.”¹⁵

Other utilities in California have not yet fully implemented all of these investments or operational changes. Thus, it would be unequitable to ratepayers and communities in SDG&E’s service territory, who have contributed to SDG&E’s wildfire mitigation, to subsidize communities elsewhere in the state where comparable investments have not yet been made. This is a critical dimension that state decisionmakers must consider and resolve as they decide how to scale premiums or contributions to a catastrophic wildfire fund. Ultimately, Wildfire Fund premiums should take risk into account, using factors such as miles of overhead lines in high risk fire areas, geographic differences, as well as an analysis of each utility’s wildfire mitigation efforts to date.

¹⁵ Wildfire Strike Report, p. 11.

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b. What are the specific needs of communities and wildfire victims in considering a potential wildfire fund or other financial mechanism?

RESPONSE: As noted in the response to subpart a., prompt and efficient resolution of property damage claims is a critical need that a Wildfire Fund would address. Given the legal whipsaw created by the legal status quo of inverse condemnation strict liability coupled with uncertain rate recovery, communities and wildfire victims “face a great deal of uncertainty and diminished ability to be compensated for their losses and harm.”¹⁶ That is precisely why a Wildfire Fund is so important to California.

¹⁶ See Strike Force Report, p. 27.

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5. MISCELLANEOUS

a. Do you have other recommendations for ways to reduce wildfire damage and costs that the Commission should consider?

RESPONSE: Improved measures for overall risk reduction (forest management, land use, emergency response, utility and home hardening, and inspections/enforcement) must continue to be a focus for all stakeholders. Mitigation should be enabled by public funding and, if funding is prescribed, the ability to recover costs in utility rates is critical.

Additionally, legal fees can add significantly to the overall expense (and timing) of resolving property damage claims. Thus, costs can be reduced by developing expedited procedures for subrogated insurer claims, as well as claims by uninsured or underinsured property owners, in relation to the Wildfire Fund.

b. Do you have other recommendations to ensure a more equitable distribution of wildfire costs and liabilities that the Commission should consider?

RESPONSE: Linking cost recovery to substantial compliance with the Wildfire Mitigation Plans, and establishing a Wildfire Fund – as described above – are the best options for improving the equitable distribution of wildfire costs and liabilities.