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Testimony for April 3, 2019 Meeting of the Commission on Catastrophic Wildfire Cost and Recovery

Madame Chair and Commissioners:

Thank you for inviting me to present to the Commission today. I appreciate this topic is a matter of life and death and much bigger than simply investor impact, but my expertise for this panel is providing an investor point of view. As I will describe in a minute, I believe there is great mutual interest in a better framework for addressing future utility fires.

As background, my name is Steve Fleishman. I am a sell-side analyst covering the utilities, power, renewables and midstream sectors for Wolfe Research. I have been analyzing utilities, including the California utilities, for 28 years. As a sell-side analyst, I do not own any stocks but I share my views and have conversations with most of the large investors that do own them. My company Wolfe Research is an independent research firm focused almost exclusively on top quality stock research.

In my experience, utility investors seek companies that provide stable income with modest growth. Utilities are able to earn a fair return on their investments but their return is essentially capped. As Warren Buffet once said, the utility business is a good business but should never be a great one. Investors are not seeking big upsides, but they also expect to have limited downside risks.

California has historically had a regulatory environment that allowed for this balance. While rate cases often take too long, the utilities have generally been given a chance to earn a fair return on investment with manageable risk. When utilities have had big issues, it has usually been self-imposed problems.

This time is different. The mix of 1) increased fire risk, 2) the unique application of inverse condemnation to utilities and 3) the lack of clear and timely recovery mechanisms creates an overwhelming downside risk for utilities. It is comparable to a utility having the risk of a failed multi-billion-dollar nuclear power plant every year even though the utility does not own any nuclear plants.

This high-risk and low-reward skew is not one that works for any utility investor. It's not just utility investors, we don't know any investor that would invest in a business with a capped return that faces the risk of multi-billion-dollar liabilities that they are not sure they can recover.

We believe the current framework is untenable. We have called the California utilities uninvestable. All the utilities could be junk credits with worst case risk of bankruptcy in the event of more catastrophic fires.

So why do any investors own stock in the CA utilities today? Because they think the current situation is so untenable and unsustainable that it must get fixed before the next fire season. The formation of this Blue Ribbon Panel and comments from Governor Newsom have been encouraging.

But it's not just about utility investors and their risk/returns. Utility shareholders also focus intently on the broader constituents that the utilities deal with and how content they are with the utilities, their rates and the regulatory environment overall. When most parties are happy and working together, when there is balance, then investors feel more confident that there is a sustainability to the utilities outlook.

That is clearly not the case in California right now. The extreme downside risks to utilities financials due to more fires, inverse condemnation and the lack of clear and timely recovery is hurting everyone. This framework is not just untenable for utility investors, it is untenable for most if not all the key constituents involved.

Wildfire victims need to be certain they can be paid for current and future fires, outside of a federal bankruptcy court

Renewable suppliers need to know they will be selling to utilities that are financially healthy or they won't invest in any more projects

Utility customers and businesses need to know there will not be risk of rate shocks due to financial instability

Utility employees and union members need to feel confident in their jobs since their work is critical to make California safer and to limit risk from future wildfires

Utility creditors and shareholders need to know they can lend and invest money to the utilities to support important programs – such as wildfire prevention and clean energy investments - with confidence they will get their principal back and earn a fair return.

The good news is solutions are not rocket science here. The money needs to be available upfront in the event of a future fire with clear certainty to all these parties that it will be there no matter the circumstances. Whether this is through a wildfire fund or some other mechanism, there must be confidence the money is there. All parties need to help in structuring this fund, and it will likely require state-backing or funding of some sort. Certainty can't come from the utilities on their own given the potential damage size of a catastrophic fire. The solution must be durable, sustainable, easy to understand and not subject to many conditions.

Utilities cannot be held to a perfection standard. So what if the utility did something wrong? The PUC or other bodies should have the ability to assess meaningful fines and penalties and/or even review whether board and management changes are required. However, the utility investor cannot be subject to paying for billions of dollars of fire damages every time there is a large fire with a violation. The simple fact is there won't be any utility investors left in the state. They have 49 other states to choose from where inverse and this current untenable risk/reward does not exist.

Thank you

