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California Water Association

April 22, 2019

The Honorable Gavin Newsom
Governor, State of California
Governor's Office, State Capitol
Sacramento, CA 95814

Honorable Commissioners
Commission on Catastrophic Wildfire Cost and Recovery
Office of Planning and Research
1400 10th Street
Sacramento, CA 95814

Transmitted via email: wildfirecommission@opr.ca.gov

Dear Governor Newsom and Commissioners:

On behalf of the California Water Association (CWA), I am writing in response to the request by the Commission on Catastrophic Wildfire Cost and Recovery (Commission) for comments on the various issues related to catastrophic wildfire cost and recovery. CWA is a statewide trade association representing the interests of public water suppliers subject to the jurisdiction of the California Public Utilities Commission (CPUC). As regulated public utilities that serve 6 million Californians with safe, reliable drinking water, CWA's members have a particular interest in the topical areas for comment outlined in the request for public input.

CWA concurs with many of the conclusions and recommendations reached by Governor Newsom's Strike Force in its April 12, 2019 report, "Wildfires and Climate Change: California's Energy Future" (Strike Force Report) especially with respect to preventing and responding to catastrophic wildfires, reform of wildfire liability risks, and allocating responsibility for wildfire costs. In particular, CWA is very concerned about the implications and risks for its members and their customers that are associated with California law on inverse condemnation and strict liability.

While the Strike Force Report properly focuses on energy utilities and their customers, it is imperative that the Commission (and the State) consider the relationship between wildfires, the 3,000-plus community water systems[1] in California, and the unique challenges facing them in the aftermath of a catastrophic wildfire whereby they are victims twice over. This phenomenon occurs when the fire damages or destroys their customers' homes and businesses, as well as their own property and equipment, and then again when their water systems are subjected to inverse condemnation/strict liability claims for damages, despite the fact that these water systems were not the cause, were not at fault and had no responsibility in starting the fires.

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[1] Community water systems are city, county, regulated utilities, regional water systems and even small water companies and districts where people live. As defined in Sec. 116275 of the California Health & Safety Code, a community water system means a public water system that serves at least 15 service connections used by yearlong residents or regularly serves at least 25 yearlong residents of the area served by the system.
https://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?lawCode=HSC&sectionNum=116275.

CWA respectfully requests that the Commission consider these water systems among the fire victims when considering recommendations on wildfire liability reform, innovative insurance initiatives, or wildfire cost assignment and financing options.

1. Wildfire Liability Regime

There are no "true" benefits provided by the current application of the inverse condemnation doctrine against water systems in California; there are only negative consequences. Not surprisingly, only one other state, Alabama, has this doctrine in place. It is a dubious distinction for California to share this public policy deficiency with just this one other state.

The Strike Force Report does an admirable and objective job of identifying the issues that exist with inverse condemnation. It explains that California's inverse condemnation law holds an electric utility strictly liable for wildfire damages if the utility's equipment ignites a wildfire, *even if the utility's design and maintenance of infrastructure were not unreasonable or negligent* (emphasis added).[2] The Report makes it clear that losers abound from the doctrine:

> *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. Bottom line --- utilities in or on the verge of bankruptcy are not good for Californians, for economic growth or for the state's future.*[3]

One might argue that insurance companies benefit from inverse condemnation because their payouts to insured victims are less than would otherwise be the case, absent the law. However, this is a specious argument. Insurance policies were created to identify risk, establish coverage and compensate for loss of life and property, often without regard to whether the victim was at fault. Many decades of experience have enabled the insurance industry to price its policies with a high degree of sophistication and precision.

Transferring compensation from these policies to more nebulous payouts from the utility's ratepayers through the vagaries of a litigated proceeding is inefficient at best and unduly punitive at worst. The drawbacks and unintended adverse consequences of the inverse condemnation doctrine far outweigh any misperceived benefits.

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[2] *Wildfires and Climate Change: California's Energy Future*, A Report from Governor Newsom's Strike Force, April 12, 2019, p. 27.
[3] Id.

Application of Inverse Condemnation to Community Water Systems

A major issue for concern is the application of the inverse condemnation doctrine to community water systems. Even though they are one step removed from the responsibility of electric utilities (their equipment does not start a wildfire), they are still subject to the same inverse condemnation/strict liability exposure and risk. So long as they comply with applicable standards and requirements, their system design, operation, and maintenance are reasonable by any measure.

Unfortunately, the judicial system in California has reached a different conclusion. In 2008, a vehicle's faulty catalytic converter ignited roadside vegetation and caused a wildfire in Orange County that ultimately destroyed 314 homes. The Freeway Complex Fire burned a pressure monitoring wire at Yorba Linda Water District's (YLWD) Santiago Booster Pump Station, which then caused a short in the electrical panel and shut down the electrical pumps, as well as communication with the SCADA center at YLWD's offices. This damage prevented YLWD from being able to pump water to the fire hydrants in one neighborhood. Tragically, 12 homes were lost in this neighborhood.

Despite the fact that the Orange County Superior Court found that YLWD, or any YLWD public improvement, did not cause the Freeway Complex Fire, and despite the fact that YLWD was itself a victim in this fire, the utility found itself a defendant in an inverse condemnation claim simply because its equipment failed after being damaged by the fire. While no one knows whether those homes would have been lost or damaged had YLWD's equipment remained operable, YLWD was not able to demonstrate that other forces would have produced the same level of damage had water been available. Ultimately, the Court found in favor of the plaintiffs. It ordered YLWD to pay nearly $70 million in damages to these 12 homeowners.[4]

There are multiple problems with this lower court judgment. YLWD did not cause the fire, nor was it responsible for the spread of the fire. The Superior Court determined that "neither the Plaintiffs nor the YLWD (or any YLWD public improvement) caused the Freeway Complex Fire."[5]

YLWD was not negligent. The Superior Court determined that the "… interruption of water service ... was an accident that was not desired or intended by anyone. The service interruption was not caused by a decision of YLWD's Board of Directors."[6] Despite these facts, YLWD was subject to "full liability to the prevailing plaintiffs," with the Superior Court determining that "the fact that other circumstances or forces combined to cause the damage does not relieve the public entity of full liability."[7]

[4] *Itani v. Yorba Linda Water Dist.*, Case No. 30-2009-00124906 (Sup. Ct. Orange County, July 13, 2012).
[5] Id.
[6] Id.
[7] Id.

Similar logic is being applied in several cases[8] related to the 2017 Thomas Fire[9], including one against the City of Ventura, which claims the City should have been able to operate the entirety of its water system, much of which is dependent on electricity, even when the electric utility was unable to provide its customers with power.[10] As was the case with YLWD, the City of Ventura was a victim, not a perpetrator; yet, it is being subjected to an inverse condemnation claim simply because it installed, constructed, owned, operated, used, controlled and provided maintenance for a water delivery system designed for public use.

As one insurance expert recently observed, the current application of the inverse condemnation doctrine threatens the existence of California's water suppliers:

> *Inverse condemnation is an evolving exposure that may intensify in frequency, gravity, and consequence. The impact on public water systems is notably adverse because their water delivery systems align well with the liability standards imposed by this legal theory. With overwhelming financial ramifications, inverse condemnation represents an existential threat to public water systems. The situation will exacerbate should the standard of strict liability, as opposed to reasonableness, be imposed for failure of fire suppression systems during wildfires.*[11]

With the climate change-fueled proliferation of wildfires, community water systems facing unrestrained wildfire liabilities will, no doubt, find it increasingly difficult to make needed improvements to the State's drinking water infrastructure. The Governor's Strike Force explains in the quoted passage below that the absence of a fault-based wildfire liability standard will negatively affect the the ability of energy utilities to provide customers with safe and affordable electricity. The same is true for community water systems, only more so because their customer totals, invested plant and equipment, and sources of investment capital are orders of magnitude smaller than those of electric utilities.

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[8] *See, e.g., Wilkinson v. Southern California Edison Co.*, Case No. 19GDCV00322 (filed in Sup. Ct. Los Angeles County on March 12, 2019) (alleging inverse condemnation claims against the City of Ventura); *Ojai Village Pharmacy v. Southern California Edison Co.*, Case No. 56-2018-00511478-CU-EI-VTA (filed in Sup. Ct. Ventura County on May 7, 2018) (alleging inverse condemnation claims against the City of Ventura and Casitas Municipal Water District).

[9] Between December 4, 2017 and December 22, 2017, the Thomas Fire burned 282,000 acres in Ventura and Santa Barbara Counties. Two lives were lost in Ventura and the City lost 686 structures.

[10] *Wilkinson v. Southern California Edison Co.*, Case No. 19GDCV00322 (filed in Sup. Ct. Los Angeles County on March 12, 2019). Here, plaintiffs allege that defendant Ventura Water's "despicable" conduct in not spending hundreds of thousands of ratepayer dollars on backup generators to maintain water pressure when the primary source of electricity was lost evidences a conscious disregard for safety because the loss pressure prevented firefighters from extinguishing flames and saving Plaintiffs' home.

[11] "Inverse Condemnation and Public Water Systems: A Legal Nexus of Complexity, Exposure, and Uncertainty," Paul Fuller, *Public Law Journal*, Volume 41, Nos. 3 & 4, 2019 (emphasis added).

> *At the same time, the current system for allocating costs associated with catastrophic wildfires – often caused by [electric] 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 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.*[12]

All these conditions apply to community water systems (again, magnified by the lack of scale in the water utility industry). The absence of inverse condemnation/strict liability reform and the lack of a fault-based standard for wildfire liability will directly affect Californians' access to safe, reliable, and affordable drinking water.

Water infrastructure needs in California are significant and relevant to this issue. For example, data released by the State Water Resources Control Board shows that more than 1.5 million Californians have drinking water that violates public health standards.[13] The U.S. Environmental Protection Agency estimates that more than $50 billion needs to be invested in California's drinking water systems over the next 20 years to ensure their continued safety and reliability.[14] These essential investments will simply not be possible if the state's community water systems face unlimited liabilities for damage caused by wildfires that they had no responsibility for starting.

<u>Change the Inverse Condemnation/Strict Liability Doctrine to a Fault-Based Standard</u>
California courts have concluded that "the nature of the California regulatory scheme demonstrates that the state generally expects a public utility to conduct its affairs more like a governmental entity than a private corporation."[15] Because the courts have used this reasoning to apply the inverse condemnation doctrine to corporations regulated by the CPUC, CWA agrees with the Strike Force Report's Concept 2,[16] which proposes to change the strict liability standard under the inverse condemnation doctrine to a fault-based standard that balances the need for public improvements with private harm to individuals.

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[12] *Wildfires and Climate Change: California's Energy Future*, A Report from Governor Newsom's Strike Force, Introduction, pp. 2-3, April 12, 2019.
[13] State Water Resources Control Board, Division of Drinking Water, "Annual Compliance Report: 2015."
[14] U.S. Environmental Protection Agency, "Drinking Water Infrastructure Needs Survey and Assessment: Sixth Report to Congress," March 2018.
[15] *Barham v. Southern California Edison Company*, 74 Cal. App. 4th 744, 753 (1999).
[16] *Wildfires and Climate Change: California's Energy Future,* A Report from Governor Newsom's Strike Force, April 12, 2019, pp. 35-37.

A fault-based standard whereby utilities pay for damage caused by their misconduct,[17] as the Strike Force Report states, would shift the risk of property loss to insurance carriers and to uninsured or underinsured property owners in those cases where the utility did not engage in misconduct. As noted earlier, insurance companies are better able to manage and price these risks. Also, a fault-based standard would avoid the moral hazard that arises when property owners fail to purchase insurance commensurate with their property risks simply because they know that any damages they incur will be absorbed by someone else (e.g., utility ratepayers). In other words, the "free-rider" problem is avoided.

The establishment of a fault-based standard for wildfire liability under which community water systems whose public improvements do not start a fire means that they are not subject to strict liability for damages or loss of life arising from that same fire. It also means that community water systems are not the "substantial cause" of those damages.

Indeed, it is absurd to hold a community water system responsible for destruction caused by a wildfire when the water system itself was damaged and/or disabled by that very same fire, simply because it may have been unable to prevent the fire from spreading to nearby neighborhoods. When a fire is burning the equivalent of a football field every second, as was the case with the 2018 Camp Fire, there is no community water system in the world that can combat a wildfire of that magnitude.

The fault-based standard suggested in Concept 2 would address the injustices described above pertaining to community water systems. At the same time, it would be narrow enough not to unduly constrain the rights of homeowners and other wildfire victims in other circumstances. This change in policy to a fault-based standard is an essential part of the state's response to the new wildfire normal, especially given the fact that the current strict liability standard threatens the financial existence of hundreds, if not thousands, of community water suppliers.

2. Insurance

Because insurance availability is inversely related to risk (when wildfire risks increase, insurance availability declines) and because risk correlates with insurance pricing (insurance costs rise as wildfire risk rises), utilities must be vigilant in engaging in risk management and mitigation. This will not be easy, as insurance carriers have submitted applications for more than 100 rate increases in insurance premiums for homeowner's insurance to the California Department of Insurance in the past two years.[18]

[17] Misconduct means deliberate and willful non-compliance with federal and state regulations and permit conditions. Not encasing wires and control panels in concrete or not spending thousands or millions of dollars on backup portable generators when mobile units from another utility's service area may be available does not rise to the level of misconduct.
[18] *Wildfires and Climate Change: California's Energy Future,* A Report from Governor Newsom's Strike Force, April 12, 2019, pp. 33-34.

Nonetheless, there are actions utilities can take. One is to ensure that inverse condemnation liability is included in the utility's general insurance policies – either General Liability or Public Officials Liability.[19] Because a General Liability policy is triggered by a tort (negligence) liability claim, not a strict liability claim, a Public Officials Liability policy is better equipped to handle this risk. If the latter policy is not available, then the utility will need to work with its broker for strict liability protection. Essential to this concept is that the utility be permitted to recover the costs of this insurance in its rates for service.

Another possibility is to participate in industry-wide or state-wide utility insurance pools. If a statewide insurance fund is created to compensate victims for loss of life or property, then CWA recommends that community water systems, as victims themselves, be included in a statewide insurance program. Another consideration for community water systems is participation in industry-wide or pooled insurance programs.

3. Financing mechanisms

CWA notes that most of the financing options considered in the Strike Force Report under Concepts 1 and 3 pertain to electric utilities and the claims against them. It is noteworthy that community water systems would be precluded from both the Liquidity-Only Fund and the Wildfire Fund because they are limited to CPUC-regulated electric utilities who have a role in the cause of a catastrophic fire. Additionally, they would be subject to a cost-recovery determination in the former and to overall CPUC jurisdictional control in the latter.

Since Concepts 1 and 3 are not applicable to community water systems, the change to a fault-based liability standard is clearly the long-term solution for them. A shorter-term solution for community water systems who are victims of catastrophic wildfires may well be a smaller Catastrophic Wildfire Fund devoted to compensating them when they are victims of property damage and loss, or utilized by them when they are subject to an inverse condemnation claim. Such a water-only fund could be established as a trust initially financed through the California budget process.

4. Community and wildfire victim impacts

The principal concern with cost allocation is an over-reliance on ratepayers (utility customers) as a source of funding for compensating victims for property loss and liability claims. Catastrophic losses from wildfires go well beyond the norm in traditional cost recovery principles for typical and even atypical utility operations. Wildfire costs should be socialized across a large a base as possible, i.e., the taxpayer, in order to take advantage of economies-of-scale benefits.

[19] See "Inverse Condemnation and Public Water Systems: A Legal Nexus of Complexity, Exposure, and Uncertainty," Paul Fuller, *Public Law Journal*, Volume 41, Nos. 3 & 4, 2019.

Already, utility customers are facing the increased costs associated with future insurance coverage, wildfire mitigation plans, climate change adaptation plans, physical security and emergency preparedness and response plans, disaster relief plans, de-energization plans and protocols, and disaster relief programs. Under any financing mechanism adopted, the ratepayer will already have been paying his or her fair share.

Thank you for the opportunity to provide these comments. Feel free to contact me at jhawks@calwaterassn.com.

Sincerely,

Jack Hawks
Executive Director

Cc: The Honorable Toni Atkins, Senate President Pro Tempore
The Honorable Anthony Rendon, Speaker of the Assembly
The Honorable Ben Hueso, Chair, Senate Energy Utilities & Communications Committee
The Honorable Chris Holden, Chair, Assembly Utilities & Energy Committee
The Honorable Hannah-Beth Jackson, Chair, Senate Judiciary Committee
The Honorable Henry Stern, Chair, Senate Natural Resources & Water Committee
The Honorable Mark Stone, Chair, Assembly Judiciary Committee
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