



## MAPLE-BROWN ABBOTT

INVESTMENT MANAGERS SINCE 1984

April 22, 2019

Governor's Office of Planning and Research  
By email: [wildfirecommission@opr.ca.gov](mailto:wildfirecommission@opr.ca.gov)

Commissioner Carla Peterman, Chair  
Commissioner Dave Jones  
Commissioner Michael Wara

Commissioner Michael Kahn  
Commissioner Pedro Nava

### **RE: Request for Comments – April 2019**

Dear Commissioners,

Thank you for the opportunity to provide input to your process.

By way of background we are an Australian based long-only equity investor who invests globally in listed infrastructure securities. Nearly half of our investments in this strategy are in the securities of regulated electric, gas or water utilities – including currently in regulated businesses located across the US, Canada, the UK, Australia, Japan, Brazil and Chile. Our clients are similarly global in nature, including approximately a third of our funds under management being sub-advisory mandates to North American mutual funds.

I would first like to acknowledge the incredible hardships and challenges that these wildfires have brought to multiple stakeholders, and most particularly the fire victims. We are acutely aware of the various perspectives that the Commission needs to consider across the broad range of issues that resulted from these wildfires. Our hope in making this submission is that we may add further color to the discussion, including from our perspective in analysing the regulatory constructs applicable to electric utilities across multiple global jurisdictions.

We have structured our comments in two parts; being firstly what we believe to be the key issue for long-term orientated investors such as us, and our views on possible means this could be addressed, and secondly our thoughts on how a broader solution could be structured so to fairly balance the interests of the stakeholders whilst maintaining a safe, reliable and affordable electric system.

#### **(a) Key Area of Concern**

As listed infrastructure investors we seek assets that possess certain characteristics; including a lower cashflow volatility and higher dividend yield, each relative to broader equity markets. Regulated utilities typically well exhibit these characteristics, and in exchange for these attributes utility investors understand that the return that the utility can earn is effectively capped at a level set by the regulator.

Californian regulated electric utilities and their customers currently face a heightened risk profile due to the wildfire risk. This is both due to (a) the higher risk of fires in the State, which makes it more likely that a utility caused ignition could lead to a catastrophic wildfire, and (b) uncertainty in relation to the allocation of costs in the event of such a wildfire.

Equity investors, including ourselves, are concerned about these risks for a number of reasons. One factor is the time required to determine any costs that are to be allocated to the utility, and the liquidity challenges that this can then present.

We believe though that the key fundamental question faced by investors is whether the capped equity return that is available to investors sufficiently compensates for the potential downside exposure from Californian wildfires. In our opinion the current framework clearly does not provide this balance, and without this condition we do not believe that investors will be willing to meaningfully contribute further capital to the Californian electric utility sector, especially when such risks are not evident in utilities outside of California.

We are aware of several concepts that have been raised by participants in the current processes, which seek to address this mismatch. A workable solution, we believe, may involve a combination of these concepts, but following are our views on them individually:

1. Inverse Condemnation: in our opinion the fairest means to bring a balance to the risks and rewards faced by debt and equity investors would be through a change to the Inverse Condemnation laws, so that Californian utilities would operate under a comparable risk allocation to virtually all other US and global jurisdictions (being a negligence standard that is determined through a traditional court process). We would note that even with this change the risk to Californian utilities would be higher than other jurisdictions due to the greater ongoing risk of wildfires, but believe that a sufficient subset of investors would likely be able to accept and price that incremental risk.
2. Wildfire Fund: there has been discussion of a possible Wildfire Fund, including by Governor Newsom's Strike Force in their paper titled "Wildfires and Climate Change: California's Energy Future". That paper considered a fund that would be available to pay claims of utility-caused catastrophic wildfire liabilities. As we understand it, a utility would have automatic access to this fund regardless of the determination of prudence, whilst penalties would be applied to create disincentives for negligent and unreasonable behaviour by fund participants. In our opinion, this could be an effective solution provided that a) the fund is of a sufficient size to provide market participants confidence that the solution is durable, b) that any upfront contribution asked from utility investors is of a scale that enables investors to retain confidence in the balance of the Californian regulatory construct and fairly reflects the multiple causes of increased wildfire risk in the state and the utilities' role in this increase, and c) that any future penalty applied to a utility for negligent or unreasonable behaviour is capped at an affordable and reasonable level.
3. "Substantially complied" provision: an alternative that has been discussed would be a new provision that if utilities have "substantially complied" with their wildfire risk mitigation plans then they are deemed to have acted prudently, and so able to recover wildfire costs through rates. If this approach is pursued then we believe that it will be critical for investors that the measure is sufficiently clear as to what circumstances a utility will be determined to have "substantially complied". If there is material subjectiveness in the evaluation, and especially if the evaluation is not conducted until after a catastrophic wildfire has occurred, then investors will continue to be concerned that utilities could be held to an unreasonable - or worse still "perfection" - standard.
4. Utility "Stress Test": there have been suggestions that the legislature should consider extending the "Stress Test", which was introduced in SB901, to fires in future years. From this perspective we believe the initial proposal from the CPUC of the methodology to be used provides the Commission with a strong solution for consideration. Two areas that we would suggest be further considered are (a) we would recommend that the stress test can and should be calculated earlier than the initial proposal suggests, for as it is currently structured the delay in calculation introduces additional uncertainty for investors for little to no benefit to ratepayers (especially if a Ratepayer Protection Measure is included), and (b) whilst we understand the logic of the Ratepayer Protection Measures,

we believe that if this concept is adopted then the current proposed sizing would be at the very upper end of what investors would view as a workable range (and the total amount payable at any time under the Ratepayer Protection Measure should be capped). In concept though, we believe that the “Stress Test” could be an important component of a successful solution.

**(b) Broader Market Solution**

As long-term orientated utility investors we also have a strong interest in wanting to see a robust state-wide solution to the wildfires issue, including one that is viewed as fair to all constituents. This is important so to provide us confidence that the system is stable and that the solution is sustainable.

In our opinion the wildfire risks in California have increased in recent years for multiple reasons, many of which are beyond the control of utilities. For this reason the costs involved should be spread further than just shareholders and ratepayers, and indeed the magnitude of these costs are far too great for these parties alone to assume. We were very pleased to read similar thoughts from Governor Newsom’s Strike Force.

In order to provide a sustainable solution we believe that it is critical that the costs are broadly shared across the various constituents. This needs to include the insurance sector, and so we were pleased to see a proposal to cap subrogation claims related to catastrophic wildfires. We also believe that the solution needs to include the Attorneys, as the level of potential legal fees needs to be contained so to deliver a durable outcome. Shareholders will continue to face a wildfire risk that is greater than in comparable regulatory jurisdictions, but as discussed in “a” above this risk needs to reflect their level of potential benefit from their investment in the system. Ratepayers’ future tariffs will also necessarily be impacted by the increased wildfire risk within the system, but it is critical that rates remain affordable for multiple reasons.

In our opinion other groups, or funding mechanisms, will also need to share in the wildfire costs, so to achieve a sustainable solution that can deliver safe, reliable and affordable electricity, and which supports the policy objectives of the State.

Yours sincerely,



Andrew Maple-Brown

Head of Global Listed Infrastructure