

# Appendix II: Wildfire Fund and/or Other Funding Mechanism(s) Workgroup Report

Chair Peterman and Commissioner Wara

Staff note: **The executive summary and the workgroup reports have not been reviewed or approved by the full commission prior to being released publicly.** The workgroup reports are the products of the workgroups established at the April 29th commission meeting, and represent consensus thinking of the members of a given workgroup. The executive summary, compiled by commission staff, is an attempt to reconcile the recommendations of the three workgroups into one cohesive set of proposed recommendations for discussion and consideration at the next commission meeting.

## I. Summary

The following findings, drawn from comments to the Commission, inform our conclusion that existing financial mechanisms and frameworks are insufficient to manage utility wildfire risk and liabilities. The legislature should further clarify the CPUC cost recovery process and establish a broadly sourced Wildfire Victims Fund to more quickly and equitably socialize wildfire costs. Ultimately, how such a fund is structured, and how effective it is, depends on what other reforms the legislature adopts. This workgroup has primarily focused our analysis, and discussion, to understand how a fund could best perform absent those reforms. However, the workgroup believes that a fund, to be most effective, should be coupled to greater investment in wildfire mitigation, and liability regime, cost recovery, and property insurance market reforms.

Establishing a Wildfire Victims Fund of sufficient size and with adequate contributions is a daunting task, and while this workgroup focused on a fund that would be designed to pay claims from wildfire victims, we believe that a smaller fund, designed to provide liquidity to utilities after large wildfires, could provide some but not all of the benefits of the larger claims-paying fund.

## II. Findings

**Finding 1. The financial mechanisms for paying wildfire liabilities associated with utility caused fires are strained and not sustainable for victims, ratepayers and utility shareholders.**

As the Strike Force Report notes and other commenters endorsed, “[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 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 wildfire 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.”<sup>1</sup>

Rating agency reports suggest that further credit rating downgrades are likely if the wildfire risk to utility shareholders remains unchanged.<sup>2</sup> In addition to ratepayer and shareholder impacts, financially distressed and/or insolvent utilities create much greater risks that victims will not be paid in full for their wildfire losses, and greater risk for all parties that do business with the utilities, including the renewable energy industry.

Investors and rating agencies assert that investors will be unwilling to invest in California utilities if the primary risk to solvency persists - the potential that fire liabilities will emerge that are larger than the utility’s assets. Unresolved, this market concern can create liquidity issues for utilities immediately following a fire. Specifically, after a fire, utilities are seeking to raise money to pay for claims at the same time their equity may be declining in value. Such liquidity issues can complicate the payment of wildfire victim claims and lead to utility bankruptcy filings. Absent solutions to what Institutional Equity Investors refers to as “massive, unbounded liability,” market confidence is unlikely to return to sufficient levels to affordably fund utility operations and ongoing capital investments.

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<sup>1</sup> “Wildfires and Climate Change: California’s Energy Future”, Governor Newsom’s Strike Force, p2-3

<sup>2</sup> Institutional Equity Investors. Written comments to the commission, April 22, 2019. p.8-9.

Historically, insurance markets have provided the necessary buffer to ensure liquidity and solvency. However, testimony received by the Commission indicated insurance markets for utility wildfire liability have contracted significantly, with few if any insurers being willing to offer coverage for these losses.<sup>3</sup>

**Finding 2. Wildfire risk is created by multiple parties who should all be incentivized to reduce risk and share in paying for wildfire damages.**

It is hard to parse responsibility across all stakeholders for wildfire. The demarcation between human factors and natural causes is less clear and more case specific than for other catastrophic perils. Each stakeholder contributes to the cumulative risk of catastrophic wildfire and no stakeholder can avoid all risk solely by their own action.

Socializing the costs of utility caused wildfires across a broader set of parties larger than utility shareholders and electricity customers is a more equitable apportionment of risk. It is equitable to allocate a share of costs to parties that have some control over causes that contribute to the overall utility wildfire problem in the state. At the same time, equity means insuring that the impacts on those least able to manage additional costs is not overwhelmingly large.

Significant efforts are underway by all parties to reduce wildfire risk. As the publicly owned utilities note in their comments, all utilities and communities have taken efforts over the last several years to implement wildfire mitigation measures and continue to work together to reduce risk. Nonetheless, parties can continue and expand efforts to manage risk:

- Utilities can better assess their wildfire risks, make investments to reduce wildfire risk, ensure proper maintenance of their systems, and demonstrate accountable spending of already approved investments.
- Utility boards and management, can identify, quantify, and create internal accountability and incentives for risk management. The Board has the responsibility to insure that compensation and other incentives align management's performance with shareholders and customer interest in safety.

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<sup>3</sup> As EEI notes, "In past decades, the traditional insurance market provided sufficient and affordable protection for wildfire liability for California's investor-owned utilities because wildfire liabilities were smaller. But due to the rise in frequency and severity of wildfires in California along with the current liability regime, this is no longer the case." (Institutional Equity Investors. Written comments to the commission, April 22, 2019, p.9). Further, utility insurance providers testified that "most traditional liability insurers have already decided to exclude wildfire liability insurance or discontinue writing liability insurance for California utilities going forward[...]If wildfire losses of the last few years continue for the California utilities, a collapse of the insurance market will follow." (Josh Jiang, Marsh Risk and Insurance Services. Public testimony. March 13, 2019)

- The PUC can further clarify a framework for cost recovery of reasonable utility investments.
- The CPUC can approve, and ratepayers can pay for, additional investments in wildfire hazard reduction associated with utility infrastructure.
- The state can invest in additional wildfire hazard reduction in communities and limit or prevent the development of new property at risk for wildfire damage.
- The state has a role to assist or require that communities adopt practices that limit wildfire risk to themselves and their neighbors.
- The state also has a role in ensuring that state (and federal) lands are managed in a way that minimizes risk of ignition and spread of wildfire.
- Property owners and communities can mitigate risk by hardening homes and infrastructure and maintaining defensible space.
- Local governments can enact and enforce defensible space ordinances that reduce the intensity of fire when it enters developed areas.

All stakeholders suffer if wildfires persist at the current scale. As the Strike Team report explains, “Under the status quo, all parties lose – wildfire victims, energy consumers, and Californians committed to addressing climate change.”<sup>4</sup>

All benefit if wildfires can be managed more effectively. Several commenters<sup>5</sup> to the Commission suggest that the requirement to contribute (in various ways), including via a wildfire catastrophe fund, creates incentives for all to more aggressively mitigate wildfire risk and damage and more equitably allocates wildfire costs.

**Finding 3. The time required for, and the uncertainty of, investor-owned utility wildfire cost recovery from ratepayers reduces investor confidence in utilities and limits utility access to capital after a major fire.**

When utility equipment contributed to a wildfire, the CPUC must determine that the utility prudently managed its system before IOUs can recover liability costs from their electric customers. This determination may be years after the fire has occurred due to the length of the

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<sup>4</sup> Governor Newsom’s Strike Force. “Wildfires and Climate Change: California’s Energy Future”, pp 1

<sup>5</sup> See Edison Electric Institute. Written letter to the commission April 22, 2019.

civil litigation process to determine liability (including settlement of wildfire claims)<sup>6</sup> and subsequent CPUC cost recovery proceeding, which begins only after the civil process is complete.

The Commission received testimony that the current standard for cost-recovery is unclear and protracted.<sup>7</sup> Furthermore, critics of the current prudency determination and cost recovery standard argue that the standard is out of line with reasonableness standards used by the Federal Energy Regulatory Commission (FERC) and civil law, which place the burden on the party objecting to cost recovery (FERC) or asserting negligence (civil law) to show that imprudence or negligence has occurred.<sup>8</sup>

Ratepayer advocates remind the Commission that the purpose of a reasonableness review is to “avoid outcomes that would have utility ratepayers bear costs arising from utility mismanagement.”<sup>9</sup> As such it is important to have a standard that clearly disallows cost recovery for liabilities stemming from utility imprudence.

SB901 acknowledged that although limiting cost recovery to only prudent expenses is important to protect ratepayers, so is having solvent utilities. The stress test adopted by SB901 sets a maximum limit to non-recoverable (disallowed) costs, but applies this limit only to 2017 fire liabilities.

SB901 also acknowledges the complex circumstances that may lead to a wildfire. For wildfires that occur in or after 2019, SB 901 directs the CPUC’s prudency evaluation to consider twelve factors that more directly relate to wildfire causes and assessment, including the role of climate change in exacerbating wildfires (UPUC section 451.1).

To date, there has been only one significant instance where an investor owned utility requested cost recovery for third-party wildfire damage in excess of general liability insurance.<sup>10</sup> Cost-recovery was not granted in this case, although this review occurred prior to

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<sup>6</sup> After the wildfires in 2007, SDG&E pursued settlement of its civil liability claims, and then in 2015 filed an application for cost recovery at the CPUC (Application 15-09010). The PUC adopted its decision denying cost recovery in 2017. CPUC (D.)17-11-033. November 30, 2017.

<sup>7</sup> See written testimony from Southern California Edison, Edison Electric Institute, Consumer Attorneys of California.

<sup>8</sup> See written comments from Pacific Gas & Electric, Southern California Edison, Edison Electric Institute

<sup>9</sup> The Utility Reform Network. Written letter to the commission, April 22, 2019.

<sup>10</sup> California Public Utilities Commission, ORDER DENYING REHEARING OF DECISION (D.) 17-11-033. July 12, 2018

passage of SB 901 and so did not explicitly reflect the twelve factors enumerated therein. CPUC's disallowance of SDG&E's WEMA cost recovery application and the scale of 2017 and 2018 wildfire liabilities have raised questions as to whether a more predictable standard of review for wildfire claims is warranted, and whether it should be more permissive given the nature of the risk, size of potential liabilities, and assumptions of cost socialization assumed in "no-fault" liability. Cost recovery standards were identified by several commenters to the Wildfire Commission as the key element in need of refinement in order to restore market confidence in California utilities.

**Finding 4. Californians' electric costs are increasing due to wildfire mitigation investments and other capital and regulatory requirements.**

The Strike team report and ratepayer advocates express concern that passing more wildfire costs to electric customers will further reduce electricity affordability.<sup>11</sup>

The CPUC May 2019 report pursuant to SB 695, "Actions to Limit Utility Cost and Rate Increases," affirms that electric rates and bills are going up. The report explains that rising rates and bills stem from declining utility sales, while revenue requirements continue to grow to meet statutory mandates and operational needs.

Mitigating wildfire risk is also increasing electric costs. The SB695 report details that the costs of proposed projects in utility Wildfire Mitigation Plans could result in increases of up to seven percent in monthly bills for residential customers, not accounting for any adverse change in the cost of capital for the utilities. Commenters indicated similar.<sup>12</sup>

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<sup>11</sup> TURN states that "California is in the midst of a utility bill affordability crisis. High energy bills resulted in 886,000 California households being shut off by PG&E, SCE, SDG&E and SoCal Gas in 2017, impacting more than 2.5 million people, most of whom are children." (The Utility Reform Network. Written comments to the commission, April 22, 2019,) CLECA and The California Farm Bureau note that California industrial and agricultural customers pay nearly twice the cost for power as their western neighbors. The Farm Bureau asserts that "a tipping point has been reached such that ratepayers can no longer be the sole funders." (The Farm Bureau. Written comments to the commission, April 22, 2019)

<sup>12</sup> TURN notes that, " Yet these figures represent only the initial impacts of what could well be years of higher utility spending to prevent wildfires, leading to increased rates that persist for decades into the future, not to mention impacts from any utility-caused wildfires in 2019 and beyond." (The Utility Reform Network. Written comments to the commission, April 22, 2019) Wildfire mitigations costs increase rates as well for publicly-owned utilities. SMUD notes that its wildfire mitigation spending has already increased rates 1.5%-2% (SMUD. Written comments to the commission, April 22, 2019).

CLECA highlights that commercial customers also face likely rising costs from the 2017 and 2018 fires. CLECA notes "the combined wildfire liability for PG&E for these two years would represent a 18% increase in rates for

The perceived financial risks of investing in California utilities create their own substantial costs. Because utilities must attract new capital - generally a 50/50 mix of debt and equity - in order to construct new infrastructure, with the interest (debt) and return (equity) paid for out of rates, increases in risk perception have direct implications for rates. Since the 2017 fires and the disallowance of SDG&E cost recovery for the 2007 fires (the decision on which occurred contemporaneously with the 2017 fires), the credit quality of California utilities has deteriorated precipitously. This impact has been felt even by Sempra, the parent company of SDG&E, despite the fact that there have been no utility caused fires in SDG&E's service territory since 2007, and the utility is widely recognized as a global leader on utility wildfire practices. Credit downgrades lead to increases in the cost of borrowing for utilities that ultimately will be reflected in customer rates. More recently, all three utilities proposed large increases in the allowed return on equity, which they believe will be required to attract new equity investment. While that proceeding is ongoing and its outcome is far from clear, what is clear is that a substantially higher return on equity (the "cost" of equity) - reflecting the same risks that have led to higher debt costs - will likely be required to attract new investment in California utilities.<sup>13</sup>

These correlated changes dramatically raise the costs of any future utility infrastructure projects for wildfire safety or other reasons. In comments, Institutional Equity Investors noted that current California IOU projects call for \$70 billion in capital expenditures in the next five years that will need investor financing and utility cost recovery.<sup>14</sup>

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PG&E bundled primary voltage industrial rates by 2023." "The combined wildfire liability for these two years would represent a 5% increase for SCE bundled primary voltage industrial rates by 2023." (CLECA. Written comments to the commission, April 22 2019. Appendix 1, p.1).

<sup>13</sup> Institutional Equity Investors estimate that "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 monthly bill of PG&E customers. Customers of Southern California Edison and San Diego Gas & Electric would suffer similarly." (Institutional Equity Investors. Written comments to the commission. p.10) The publicly-owned utilities note that even investment grade utilities face risks of higher costs, "Even with interest rates at historically low levels, a downgrade from AA to A would result in \$3-4 million of additional interest costs annually for every \$1 billion of borrowing, or \$100 million over the life of the bonds." (California Municipal Utilities Association et al. Written comments to the commission p.3)

<sup>14</sup> Institutional Equity Investors. Written comments to the commission, April 22, 2019, p.4.

Several commenters suggested that given issues with electricity affordability, any changes to cost recovery should consider ratepayer impacts and any Wildfire Victims Fund should be capitalized more broadly than via ratepayers alone.<sup>15</sup>

**Finding 5. The liabilities associated with wildfire are challenging to model and not well understood.**

The science is clear that wildfire severity and the frequency of large fires are increasing due to climate change. However, specific liabilities are difficult to model.

The Commission heard substantial testimony by various parties (insurance industry, insurance brokers, and utility representatives) that rely on models to understand and price future wildfire risks. There are a variety of approaches to understanding wildfire risks including historic loss experience, more recent loss experience, highly complex Catastrophe Models, and expert judgment. None can, at this point, accurately specify the expected future wildfire losses in California from utility-caused wildfire. As AIR notes in its comments, “In the case of rare but severe catastrophic events, including wildfires, highly variable historical experience provides an insufficient basis to assess future loss potential.”

The challenges with estimating losses involve changes in the value at risk due to new housing development and increasing building and reconstruction costs, uncertainty about the degree to which mitigation measures will be implemented by communities and homeowners that lower risk, uncertainties about the effectiveness of utility Wildfire Mitigation Plans when fully implemented, and changes in the climate and weather environment, among others. There is no precise answer to basic questions about the risk of wildfires and the likely magnitude of future liabilities created by them.

There is, currently, no clear understanding of what a “worst case” wildfire in California might look like. This workgroup cannot exclude the possibility that the 2017 and 2018 wildfires were 1 in 250 year events or that they were 1 in 20 year events, and the workgroup does not know whether average losses over the past 20 years or the past 5 are an appropriate level to plan for over the next decade. The answers to these questions will depend on both what actions are taken to reduce risk as well as on the weather and climate that creates the conditions that can lead to catastrophic wildfires.

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<sup>15</sup> See written comments to the commission from The Utility Reform Network, Pacific Gas & Electric, and Southern California Edison.

### III. Considerations Objectives and Recommendations

**Summary Recommendation: Given the findings above, the workgroup recommends that the Legislature, in furtherance of a more equitable distribution of utility-caused wildfire costs, revise the CPUC cost recovery process and establish a Wildfire Victims Fund.**

This workgroup believes it is paramount that any such changes and new financing mechanisms be consistent with the objectives detailed below in order to avoid unintended consequences that result in more instability for wildfire victims and electricity ratepayers. The workgroup strongly recommends that legislation for cost recovery reform and a victims' fund only be pursued if there are clear, specific assurances and legal safeguards in place to ensure these objectives are achieved. In many cases, it is reasonable for legislation to delegate implementation details to responsible agencies for further development. However, given the need for certainty among the delicate and complex interactions of the Commission's broader set of recommendations, the workgroup recommends strong legislative clarity regarding the primary components and interaction of any changes to strict liability, cost recovery, and related financing mechanisms.

#### Cost Recovery Objectives

**Objective 1: Ensure ratepayers pay for just and reasonable investments, but do not pay for avoidable, negligent behavior.**

**Objective 2: Ensure cost recovery standards reflect the host of factors that contribute to the extent of wildfire damage and does not hold utility shareholders solely liable in cases where other factors contribute to the magnitude of the damages.**

**Objective 3: Be as predictable as possible to all stakeholders, given Objectives 1 and 2.**

#### Fund Objectives

**Objective 1- Broadly pooled risks, beyond electric ratepayers.**

Risk pooling creates state-wide economies of scale and addresses the overall perceived risk to all California utilities regardless of their ownership structure. The financial environment at all utilities has deteriorated in one form or another (IOU credit downgrades, challenges to POU's of accessing insurance) and all utilities are facing significant challenges in managing a risk as large as liability from catastrophic wildfires. One solution is to create an entity of sufficient scale for which even the largest foreseeable fire related liabilities are not destabilizing, and then to facilitate risk transfer from the threatened utilities to this entity. Complimentary to this

approach is the need to reduce the risks from wildfire, hence decreasing the magnitude of the liabilities.

Risk pooling, in order to be maximally cost-effective, should provide an opportunity for inclusion of POU's, and POU participation should be encouraged (especially for those with large service territories in high fire risk areas). This means creating a path for POU's to feasibly contribute to the fund commensurate with their risk. POU customers are also the owners of their systems, therefore playing the roles of both IOU shareholders and ratepayers. They could opt to make an initial contribution equivalent to an IOU's shareholder contribution plus an additional ratepayer contribution or could opt to make a higher ongoing contribution.

Given the diversity of stakeholders with some responsibility and ability to reduce wildfires, as noted in Finding 2, as well as the potential ratepayer affordability crisis noted in Finding 4, the fund should require contributions from utility ratepayers, utility shareholders, from property owners, and from the state. These parties all benefit from the risk pooling, greater certainty, and efficient claims process that a fund would provide.

**Objective 2: Contributions from utility shareholders and ratepayers reflect differential risk.**

Contributions should be actuarial – tied to risk. One approach to establishing contributions would be to look at recent losses, while another approach would be to identify key physical characteristics that are correlated with risk and to adjust utility contributions based on them, such as total overhead circuit miles versus undergrounded systems or the number or proportion of utility customers located in high risk areas. Over time, more sophisticated actuarial tests may inform utility and ratepayer contributions, or private markets using actuarial experience will develop utility specific pricing which can inform appropriate contributions.

**Objective 3: Limit risk pooling when the utility engages in negligent behavior.**

When the utility acts prudently, then the workgroup believes it is equitable, and practical, to have all parties pay some portion of the damage costs, and not require repayment of a fund. However, when a utility fails to act prudently, utility shareholders should repay some portion of the damages to the fund in addition to paying any penalties that might result from further investigations. A key attribute of insurance and risk pooling is financing loss even when a party has acted imprudently, the rationale for which is further apparent if an imprudent loss causer has effectively prepaid for that liability with higher premiums . However, an imprudent utility should not be fully shielded by the fund from the risk of being unable to recover cost from ratepayers. The degree to which the utility is shielded should depend significantly on the degree to which it contributed resources to the fund.

#### **Objective 4: Treat wildfire victims fairly.**

A fund should offer more certainty to wildfire victims regarding timely claims repayment and provide support for the under and uninsured.

#### **Objective 5: Improve utility solvency and liquidity.**

The best solutions to address solvency and liquidity require both reducing the overall liability and more widely socializing it, which is best addressed by a combination of mitigation, strict liability reform, cost recovery reform, and a fund. However, there are some particular fund attributes that can better support the objectives of liquidity and solvency. Such attributes include fund sizing and bond authority commensurate with probable wildfire risk, limits to third party claims, and contribution structures that enable access by utilities to lower cost financing.

#### **Objective 6: Maintain incentives for all parties to pursue wildfire mitigation efforts.**

Sustainability of a fund is highly dependent on all parties increasing efforts to reduce wildfire risk and reduce total costs. The easiest fire liabilities to manage are the ones that are never created because of wildfire prevention efforts. *The presence of a well-capitalized fund may reduce incentives for utilities, property owners and local governments to invest in mitigation and maintain adequate insurance. As such, any fund should be structured in a manner to reduce this moral hazard.* For example, relying on post event liability assessments, in addition to limiting upfront contributions from utilities, creates an incentive to avoid costly catastrophic fires. Moreover, a track record of vulnerability reduction will make re-insurance and cheaper capital more available, thus reducing the costs of managing the remaining wildfire risk.

## **IV. Detailed Recommendations on Cost Recovery and a Fund**

### **Cost Recovery Recommendations**

Given the limited experience California has with cost recovery for catastrophic fires, it is difficult to identify with certainty what constitutes reasonable pre- or post-event behavior, though. Although ratepayers should not pay for imprudent conduct or negligence, they should pay for wildfire costs when a utility acts in a reasonable manner - our collective understanding of this increases with experience. The workgroup believes there are several modifications of the current approach to determining prudence that better acknowledge the intent of inverse condemnation to socialize costs and the evolving understanding of reasonable utility practices, while still holding utilities responsible for imprudent conduct or negligence.

**The workgroup recommends Options 1 and 2 if no action is taken to further socialize costs or if a liquidity fund is created and Option 3 if a Wildfire Victims Fund is simultaneously created *and* utility shareholders make a substantial upfront contribution to the fund.**

**Cost Recovery Option 1:** Burden of proof shifting. The CPUC review process for utility wildfires could be modified to allow for a presumption of prudence for a utility wildfire expense given a prima facie showing, but still allow for a challenger to attempt to prove, by a preponderance of the evidence, that an expense was imprudently incurred. This change should not impact other cost-recovery processes at the CPUC.

Current CPUC cost recovery review process, as described above, requires that the utility prove, by a preponderance of the evidence, that the expense was prudently incurred. In order to increase the certainty that prudently incurred costs will be allowed to be recovered in rates, the CPUC process could be modified to allow for a presumption of prudence for a utility wildfire expense given a prima facie showing, but still allow for a challenger to attempt to prove, by a preponderance of the evidence, that an expense was imprudently incurred. The difference between these legal philosophies is apparent in the case of the SDG&E 2007 wildfire cost recovery request: the request to recover federally regulated expenses was deemed prudent and approved by FERC (where the burden of proof was on the party challenging the utility's prudence) while the request to recover state regulated expenses was denied by the CPUC (where the burden of proof was on the utility to show their expenses were prudently incurred).

**Cost Recovery Option 2:** Further refinement of the SB901 factors the CPUC should consider when assessing disallowances.

SB901 (Dodd, 2018), section 451.1 lists 12 factors the CPUC may consider when evaluating applications for catastrophic wildfire cost recovery. The workgroup believes could be further enhanced by mandating the CPUC to give a higher weighting to the SB901 factors that acknowledge the unique, exogenous circumstances possibly present in a catastrophic wildfire. This might be accomplished via a statutory modification to PUC 451.1 that requires the CPUC to make a determination of the degree to which related factors (PUC 451.1(a)(7)-(11)) reduce the percentage of liability from a wildfire that utility shareholders should be accountable for, even if utility operations were the cause of a wildfire and other factors (PUC 451.1(a)(1)-(6)) would counsel against the recovery of costs in rates. Thus if a utility negligently caused a fire, shareholders would bear full responsibility if exogenous factors did not contribute to the liability, but might only face partial responsibility if exogenous factors were important in generating the liability.

**Cost Recovery Option 3:** Limits on utility shareholder liability—only if shareholders make substantial upfront contributions to a fund.

If shareholders make a substantial upfront contribution to a Wildfire Victims Fund, one option for cost recovery is to have a predetermined maximum liability that shareholders may be subject to under the existing, or a revised, prudency framework. One option might be to apply a version of the SB901 stress test<sup>16</sup> to all wildfire cost recovery claims. Another is to limit liability to a percentage of the market capitalization of an electric utility on the day prior to the ignition of a wildfire. For example, if a utility had a market capitalization of \$50 billion the day before a wildfire, it might be limited to paying a maximum of \$10 billion in losses for any single incident if found to be imprudent. Any costs above that limit would be recoverable from ratepayers or through a fund. By making upfront contributions to a fund, a utility would in effect be pre-funding any future rate recovery denials and so is reasonably entitled to expect some limitation on risks. Any such cap would need to be set at such a level as to continue to avoid a moral hazard. In general, the workgroup favors incorporating functionally identical features into the recapitalization procedure of an adequately sized Wildfire Victims Fund rather than making changes of this type to the CPUC cost recovery standards.

#### **Additional Options:**

The workgroup notes that another option, proposed in one form in Senate Bill 1088 (Dodd, 2018) and subsequently by utilities in other fora is to create explicit criteria for operation, maintenance, and investment by a utility. Under this proposal, a utility would be deemed prudent if it met the required criteria in pre-wildfire reviews. This approach makes sense in theory in that it would allow for all parties to create an objective and measurable set of criteria that could be met by the utility as a whole and would thus avoid the perception of an after-the-fact “perfection in practice” standard for prudency review. The challenge with this approach is developing a set of criteria that are an adequate pre-event proxy for prudent management of safety in the wildfire context. While the utilities have performed significant analysis of these issues in the Safety Model Assessment Proceeding, Risk Assessment Model Proceeding, and Wildfire Mitigation Plan processes, there is still no consensus on a set of standards or practices that would allow for a pre-event prudence determination.

There does appear to be consensus by many parties other than the investor owned utilities that current Wildfire Mitigation Plans do not provide a set of criteria that would allow for implementation of this approach. At this time the workgroup does not recommend such an approach for cost recovery. Such an approach may be reasonable in the future once there is

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<sup>16</sup> SB 901 established authority within the CPUC to develop a mechanism (the “stress test”) to determine when the denial of cost recovery would put the utility in financial jeopardy, and to allow cost recovery in such cases.

more collective experience with the mitigation plans and generally what constitutes reasonable action.

Finally, the workgroup recommends reviewing the CPUC fine authority to issues fines for any violations. Revisions could include increasing the \$8 million cap on fines for citations related to wildfire mitigation, statutorily increasing the maximum fines allowed under PUC section 2107, and altering the disposition of fine revenue to the Wildfire Victims Fund or towards mitigation measures.

While cost recovery is a critical issue in the absence of a Wildfire Victims Fund, the presence of a claims paying fund fundamentally alters the situation so far as ratepayers are concerned. To the degree that a fund acts as an insurer of wildfire liabilities - similar to a larger version of the utility's general liability insurance policy, there will be fewer or perhaps no cost recovery applications to the CPUC because all wildfire expenses will be recovered from the fund, not as expenses in rates.

Ratepayers don't get something for nothing with this arrangement - rather than managing large fire liabilities as expenses in rates that may cause unprecedented bill volatility<sup>17</sup> ratepayers would pay a non-bypassable charge that, in conjunction with contributions from other parties, serves to insulate them from the costs of future fires via a Wildfire Victims Fund.

From the utility shareholder perspective, the magnitude of their pre-event contributions to the fund is logically connected to the certainty of post-event cost recovery process from the fund or at the CPUC. To the degree that utilities contribute to a Wildfire Victims Fund, they are in some sense pre-paying for avoiding future disallowance perceived unlimited risk from the cost-recovery process. They should be willing to contribute more to a fund to the degree that they receive certainty regarding the maximum value of a repayment to the fund or of a disallowed expense that they would most likely fail to recover from ratepayers.

## Wildfire Victims Fund Recommendations

Catastrophe funds, such as a Wildfire Victims Fund, can be useful tools when rapid changes in perception of risk from a particular peril (wildfire, hurricane, earthquake) lead to disruptions in

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<sup>17</sup> “[PG&E] estimates \$30 billion in damages for 2017 and 2018 fires. But the operating revenue of their electricity business is less than \$13 billion a year...If future fires continue to create liabilities similar to those over the last two years and PG&E can't cover the new losses by selling bonds, rates would have to double in the first year and continue to continue to grow at an unsustainable rate year after year.” Steve Weissman to Ana Matosantos <https://gspp.berkeley.edu/news/news-center/the-massive-cost-of-the-new-normal-in-wildfires-climate-change-era>

insurance markets or to a risk that traditional insurers are either unable or unwilling to manage through the normal underwriting process. The purpose of catastrophe funds in these cases is to pool risk at sufficient scale to cost-effectively manage it. The catastrophe fund agrees to a transfer of liability for a particular type of claim from another party (a homeowner or an insurance company that writes homeowner policies) to itself. Assuming the catastrophe fund can be structured to more efficiently manage the risk, it may be able to manage the peril at more affordable cost. This can be critical to allowing continued access to home insurance for customers that are exposed to the peril in question.

### **Fund scope:**

#### **a. The Wildfire Victims Fund should pay claims for only electric utility caused wildfires.**

Based on testimony received at public hearings, the workgroup recommends a Wildfire Victims Fund created at this point in time should focus on utility caused wildfires rather than all causes of wildfire or on additional perils. While there are signs of strain in the home insurance market in California—and this will likely worsen unless there is a significant reduction in wildfire losses—at this point there is not a property insurance crisis. In order to limit a Fund’s costs, and therefore impacts on all stakeholders, it should be limited to covering only utility wildfire liabilities. Similarly, although the workgroup appreciates the concerns raised by water utilities regarding the potential inverse condemnation liabilities they face from fires, we think the challenge facing water utilities is unique from electric utilities. Any reforms to the strict liability standard should consider reforms for water utilities as well. The CPUC and legislature should continue to monitor exposure faced by water utilities and consider in the future whether any additional financing mechanisms are needed to transfer risk and recover costs in that sector.

The workgroup recommends that participation in the fund be voluntary, but that only participating utilities should be allowed to benefit either from Wildfire Victims Fund claims paying resources, as well as from any changes in prudency review that are enacted concurrently with creation of the fund. In this construct, the workgroup believes that all investor owned utilities will opt to participate in a well-designed Wildfire Victims Fund and many Publicly Owned Utilities may opt in as well, so long as contributions required from their ratepayers are fair. An alternative participation scheme would require participation by all utilities above a certain size (load served or overhead circuit miles) and allow optional participation by smaller utilities.

The workgroup recommends that payments from the fund occur only for catastrophic fires. One approach to define “catastrophic” is an event that exceeds the maximum coverage reasonably available to utilities via their privately obtained general liability and wildfire specific insurance. For IOUs, this is currently between \$1 and \$1.5 billion. POUs have a broader range of

available insurance due to the broader size range of POUs in the state. An alternative approach would be to pay for wildfires that exceed a fixed threshold – i.e., \$1 billion - and to require all utilities to obtain coverage equal to that amount or to participate in private risk pooling arrangements that are equal to that amount.

Given the desire to more broadly socialize costs, the workgroup recommends a claims paying fund rather than a liquidity only fund. While a liquidity fund can provide greater access to capital following a wildfire, testimony indicated that other tools, such as allowing investor-owned utilities to securitize debt to raise capital in the aftermath of a fire, can also achieve the same objective without requiring an upfront ratepayer investment. However, the cost to utilities to raise capital post event may be greater if equity value has diminished post-event or if the scale of the event raises solvency concerns. If wildfire costs are more broadly socialized via changes to the strict liability standard, then a complementing liquidity fund may provide additional benefits to utilities and ratepayers, including access to lower cost capital.

In the event that other barriers prevent creation of a claims paying fund but would allow for creation of a smaller liquidity only fund, primarily funded by ratepayers, the workgroup recommends that only modest changes to cost recovery be considered (Cost Recovery Options 1 and 2).

**b. The Wildfire Victims Fund should pay insured, underinsured, and uninsured property losses from utility caused wildfires at values approximating their settlement value.**

In recent utility caused wildfires (2007, 2015, 2017, 2018) there have been significant liabilities beyond those covered by insurance. Insurance coverage has proven insufficient to fully compensate victims, some homes destroyed in the fire carried no insurance whatsoever, many renters lacked coverage, and construction costs increased dramatically due to shortages of skilled labor after the fires, and local governments lacked sufficient coverage for infrastructure loss. While estimates vary, there can be no question that underinsurance of liabilities is a significant fraction of total liabilities in recent catastrophic events. As a result, resolving the crisis for utility ratepayers, insuring that fire victims get paid for their losses, and stabilizing financial conditions for electric utilities requires steps to reduce the magnitude of under- and uninsured property [staff note: see further discussion in Insurance Workgroup Report] and also developing a Wildfire Victims Fund that can pay claims beyond those that are covered by current utility liability insurance.

At the same time, if a Wildfire Victims Fund covers insured, underinsured, and uninsured claims, the fund must avoid creating incentives not to purchase insurance. The fund should be designed to avoid these incentives by paying the settlement value of claims, or a range of predetermined values, rather than their full value. Insured claims for catastrophic loss,

depending on the facts, settle at values far below 100 cents on the dollar. Underinsured claims, both because they can be subject to greater uncertainty and because they are not vetted by a claims adjustment process, tend to settle at even greater discounts. The workgroup believe that while compensation for both insured, underinsured, and uninsured losses should be compensable from a fund, Wildfire Victims Fund payments for insured losses should reflect the approximate settlement value of a claim. Most parties recommend that insured claims should be subject to automatic reduction, within the range of which such claims historically settle. Although several parties suggested claims settle at 50% of insured loss, no party suggested a clear legal mechanism for requiring such a reduction. Details on how the reductions would be calculated should be further explored and are a critical part of any authorizing legislation. If insured claims cannot be guaranteed an automatic reduction, this would put significant upwards pressure on the needed fund size.

Underinsured claims against the fund should be covered at a substantially lower level and claimants must agree not to litigate their claim. Wildfire Victims Fund payments for underinsured fractions of property claims should reflect the differential settlement value between insured and underinsured losses. Faster claims resolution and increased certainty could be important incentives for underinsured claimants to participate in a Wildfire Victims Fund.

The workgroup recommends that local governments receive compensation for settlement value of infrastructure destroyed by fire. Local governments should be encouraged to adequately insure critical infrastructure and those that do should receive a higher settlement value for insured losses.

The workgroup recommends that private parties that were totally uninsured but can substantiate their loss - either renters that carried no insurance for their personal property or homeowners that chose not to obtain homeowners coverage or participate in the FAIR Plan - could receive an offer of a flat settlement from the Wildfire Victims Fund at a low value - perhaps \$10,000 per household. This would assist these parties in reestablishing their lives while disincentivizing the choice not to obtain insurance coverage before a disaster strikes. Bodily injury and other tort claims should not be covered by the fund.

**c. The Wildfire Victims Fund should be created as soon as possible to cover the 2020 fire season and beyond, and ideally would include coverage for 2019 fires.**

The problem of utility wildfire liability is urgent. Current lack of a solution creates imminent risk for all utilities in the state. There is a very real risk that a fire in a non-bankrupt utility's service territory would precipitate a rapid deterioration of financial status leading to a bankruptcy. A bankruptcy filing will significantly reduce the ultimate payment that wildfire

victims of prior fires receive. For the bankrupt PG&E, a fire in its service territory would, due to the operation of federal bankruptcy law, create an “administrative claim” on the firm which takes priority over all pre-bankruptcy claims, including those of 2015, 2017, and 2018 fire victims. A large fire in PG&E’s service territory in 2019 could potentially threaten payment of the bankruptcy settlement value of 2018 and earlier wildfire victims.

The lesson of SB901 and the fall 2018 fires is that the State cannot afford to wait to put in place a long-term solution for utility caused wildfire even as it implements mitigation strategies that in the long run will reduce the risks. Therefore, we recommend that a Wildfire Victims Fund should cover liabilities in the 2019 and later fire seasons. This should be possible since the legislation will be enacted prior to the most dangerous part of the season while payments to victims will not occur until after the claims process, which typically takes at least one to two years. Thus liabilities from a fire that occurs even in the 2019 wildfire season would not necessarily need to be paid by a Wildfire Victims Fund structure that pays claims after insurance companies, plaintiffs for uninsured parties, and others have negotiated to a settlement of claims. Delayed implementation of the fund or delayed claims coverage by the fund will only raise the risk that in the interval between action by the State and the beginning of coverage, a catastrophic wildfire will further degrade the likelihood that current and future victims get fair compensation. Given enactment during the 2019 legislative session, the risks to current fire victims in the absence of a long-term fix, and the time required to adjudicate claims, we see no reason why a Wildfire Victims Fund if established, should not pay claims for the 2019 fire season.

Some challenging implementation issues are raised by the bankruptcy of PG&E. Whether and how a bankrupt entity could raise funds during the reorganization process without impairing the priority of other creditors is uncertain. There is enormous potential benefit to participating in a Wildfire Victims Fund for all unsecured creditors in terms of avoiding potentially massive administrative claims due to additional wildfires. These questions can only be answered by the parties to the PG&E bankruptcy and perhaps even then only via a plan of reorganization. If PG&E cannot participate in a Wildfire Victims Fund until it exits the bankruptcy process, this would significantly increase the value to PG&E bankruptcy stakeholders of an expeditious resolution to the bankruptcy and reorganization process.

#### **Fund Administrative Structure:**

A Wildfire Victims Fund administrative structure must be effective, transparent, and maximize the fund’s resources to pay claims. The relatively simple administrative structure established for the California Earthquake Authority (CEA) is a good model for a Wildfire Victims Fund. The Earthquake Authority is run by a three-member board appointed by state government to

which CEA executive leadership reports. The board serving a Wildfire Victims Fund should be appropriately compensated and include subject matter experts, including expertise on utility financing and operations, insurance claims and actuary assessments, and catastrophic fire modeling.

**a. Tax Exempt Status. Any administrative structure must be designed to create tax exempt status for the fund.** Tax exempt status will facilitate greater effectiveness of investor owned utility contributions to the fund, since they will not be subject to taxation. It will also facilitate more efficient use of earnings created from the funds reserves or principal. If the principal is subject to taxation, far less of it will be available to reinvest, pay claims, purchase reinsurance or invest in mitigation efforts.

In order to be tax exempt while also remaining distinct from the State (in order to avoid placing state finances at risk from wildfire liabilities), a fund must be clearly designed to provide a public benefit to the state. A Wildfire Victims Fund clearly provides a public benefit given the threat posed by wildfires to provision of an essential service to the citizens of the state. Efforts should be made to articulate this benefit and to seek favorable IRS treatment of fund contributions and earnings as soon as a fund structure is created.

**b. Use of funds. Money contributed to or earned by a Wildfire Victims Fund should be used for a variety of purposes to further its goals.** First and foremost, resources of the fund would be available to pay wildfire related liabilities that exceed the attachment point to the fund for any participating utilities. In addition, fund resources could be used to purchase reinsurance or other risk transfer to the degree that they are available and cost effective.

The workgroup recommends that the state authorize the fund to spend a small fraction of its resources on developing a better understanding of and recommendations for risk based approaches to wildfire mitigation. This research could serve as an important independent arbiter of best practices in reducing wildfire vulnerability. Any analyses conducted by the fund should be shared with all stakeholders to increase knowledge about effective approaches to reduce overall risk of catastrophic fire.

The workgroup also recommends that the state authorize the fund to expend a small fraction of its resources on educating the public more effectively about the risk of wildfire and the actions that it can take to avoid or reduce vulnerability. The CEA has done very effective work educating the public about the value of simple mitigation strategies and has created significant risk reduction by doing so. A Wildfire Victims Fund should be authorized to take similar cost effective steps for the State. Indeed, the case is even stronger for a Wildfire Victims Fund because many interventions that homeowners, communities, and utilities can take have spillover effects. That is, reducing fuel loads on a property or in a community provides benefits

to neighbors. The Wildfire Victims Fund should be enabled to educate all stakeholders about cost-effective actions they can and should be taking to reduce risk.

### Fund Financial Structure:

**a. The claims paying capacity of the fund should be structured as a “layer-cake” or “tower” of different forms of claims paying capacity.** Fundamentally, the goal of the fund’s financial structure would be to maximize the ability of the Wildfire Victims Fund, given available resources, to pay claims over time. To a significant degree, the structure is dependent on both the amount of money available to the fund, expected future cashflows, and the willingness of reinsurers or other risk transferees to accept wildfire risk in exchange for reasonable compensation. Legislation creating a fund would need to establish both a clear set of rules for what increment of wildfire liability would be retained by utilities and clear authority for the fund to take appropriate actions to develop an efficient claims paying structure.

There is wide variation in the use of pre-event funding versus post-event assessment authority on the part of catastrophe funds. Post-event assessment authority can be used when the risk is not fully understood or when effectiveness of risk mitigation measures is poorly characterized. Both are important concerns for the case of wildfire: committing pre-event capital when risks and risk-mitigation are poorly constrained can unnecessarily raise costs.

- The workgroup recommends that legislation creating a fund should require that participating utilities maintain a commercial wildfire liability or general liability policy equal to at least 10% of their gross earnings or 1 billion dollars for investor owned utilities.<sup>18</sup> The state should require the deductible for the policy be equal to at least 5% of their earnings or \$500 million for investor owned utilities. Utilities would be free to structure lower deductibles for other types of liability that might occur in the general course of business.
- The workgroup recommends that the Wildfire Victims Fund pay, for utilities that pay into the fund, any claims in excess of 10% of gross earnings for public utilities or \$1.5 billion for investor owned utilities or the maximum level of reasonably available commercial wildfire insurance, whichever is greater.
- The workgroup recommends that the Wildfire Victims Fund pay a maximum amount per fire incident and a maximum amount per utility in a given year. Any excess liability

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<sup>18</sup> Others have proposed higher retention. See Consumer Attorneys of California. Written comments to the Commission, April 22, 2019.

incurred by a utility would remain with that utility and be subject to CPUC prudency review and follow through cost allocation.

- The fund should be authorized to utilize risk transfer mechanisms - reinsurance, insurance linked securities, or others - to maximize the claims paying capacity of the fund. Current market conditions are such that reinsurance would likely be unavailable to the fund except to cover losses at a very high level - perhaps above the level of liabilities from recent catastrophic wildfires.

Once settlement values are clarified, claims are paid by the fund if they are above the attachment point for a utility. If a utility is found to be imprudent, or partially imprudent with respect to a wildfire, the fund would pay claims up to a specified amount, directly tied to shareholder contributions to a fund.

Especially in early years when the fund is smaller, many catastrophe funds rely on post-assessment bonding authority. This is a pre-arranged legal authority to levy an assessment on insurance policies that can then be used to finance borrowing used to pay claims.

The fund should be permitted, if in its management's opinion it lacks sufficient pre-event capacity to fund likely wildfire liabilities, to arrange for contingent post-event bonding authority via post-event assessments on electricity customers and home insurance policyholders.

**b. The fund should be designed to last so long as necessary but no longer.**

The workgroup recommends that the Wildfire Victims Fund be designed to last only so long as needed and that its need be subject to regular, periodic reassessment and reauthorization by the legislative and executive branches on a 5- or 10-year basis.<sup>19</sup> As mitigation becomes more effective either on the part of utilities or communities, the Wildfire Victims Fund may cease to be necessary because utility caused wildfires will either become less frequent or decrease in intensity and destructiveness. If the fund becomes unnecessary in future, and so the fund is not reauthorized for further claims-paying capacity, there should be a pre-planned mechanism to

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<sup>19</sup> Often after a major catastrophe, there is temporary uncertainty about how to price a risk. This uncertainty can lead to withdrawal of normal property and casualty insurance. But once primary insurers and their reinsurers better understand the risk, or it is better mitigated by, for example, structure hardening, they may return to a market. For this reason, some catastrophe funds have been designed to sunset once a "normal" insurance market redevelops. Hurricane Iniki necessitated the creation of the Hawaii Hurricane Relief Fund, which was then mothballed after ten years once private insurers reentered the market. Funds need not exist in perpetuity.

wind down fund operations, pay outstanding bonds, and return unused capital to all contributors in an equitable fashion.

### **c. The appropriate size of a Wildfire Victims Fund.**

A key question raised by the Strike Team Report is the necessary size of a Wildfire Victims Fund. The workgroup recommends a fund be sized to survive anticipated third-party damages, with a high probability (95% or greater) for a period of time sufficient to ensure that utility mitigation specified in Wildfire Mitigation Plans is deployed and is effective. Based on recently filed Wildfire Mitigation Plans, and allowing for possible delays, 10 years should be sufficient.

The workgroup further believes that a Wildfire Victims Fund should be sufficiently sized to have claims paying capacity - either through pre-event funding or post-event assessments - sufficient to cover a higher wildfire risk scenario that reflects the belief that loss experience over the past two years is an element of the “new normal” rather than a once-in-a-century (or two century) statistical aberration.

The legislature and the Governor must engage with catastrophe risk modelling experts to determine an appropriate claims paying capacity for this higher risk scenario using the best available catastrophe models, appropriately modified to reflect the recent change in risk perceptions, the time duration of the fund, and the fact that the fund is intended to pay all third-party property (not tort) related claims from utility-caused (as opposed to all) wildfires.

Based on recent Senate testimony from consultants employed by the Governor’s team to evaluate fund size and electricity rate impacts, an appropriate claims paying capacity may be approximately \$40 billion, but further analysis is justified to increase confidence in this estimate.

Such analysis should begin with commercially available catastrophe models. These models are the best tools available to estimate the potential for large but very infrequent losses due to wildfire. These models are far from perfect however and so work done to estimate appropriate size of a Wildfire Victims Fund must also consider expert judgment regarding the degree to which currently available models realistically predict the likelihood of recent loss experience.

A Catastrophe modelling-based analysis of fund size should also consider a variety of other context-specific factors. These include the fraction of all wildfire losses that are likely to be utility caused. Such an analysis should be designed to estimate 10-year losses rather than 1-year losses, as is typical for commercial catastrophe models. Fund size estimation should also take into account the degree to which mitigation may reduce risk and the degree to which total value at risk may increase over the relevant time frame. Given that these models are

designed to simulate insured loss, estimates will also have to be modified to reflect both underinsured and uninsured losses, if covered, as well as any settlement discount. Finally, an analysis of required fund size should consider the attachment point for the fund.

Given the unknown likelihood of the unprecedented loss experience of the past three years, pre-event funding (including reinsurance capacity) might be scaled to reflect a more optimistic assessment of likely requirements for claims paying capacity while post-event assessment might be used to cover the difference between an optimistic and a more pessimistic view and so higher level of needed claims paying capacity.

#### **d. Equitable Sources of Contribution to a Wildfire Victims Fund.**

As many parties as possible that have some ability to control the risk of wildfire should be asked to contribute to a Wildfire Victims Fund. Different pre- and post- event funding structures, including a stream of contribution payments or post event bonding authority, may allow for access to lower cost capital. The legislature and Governor should further explore, and allow for, funding mechanisms that reduce the cost of capital while ensuring the fund is adequately capitalized. This report details below how pre-event contributions could be structured , however the workgroup recommends the legislature consider post-event funding options as well in order to manage overall initial capital commitment.

**Investor owned utility ratepayers** could contribute to the fund via a 20-year bond charge, similar in size to the DWR bond charge, as well as via payment in rates for utility general liability insurance coverage. For example, authorization for a new ratepayer charge equal to the \$812 million annual DWR bond charge scheduled to end late-2020, can provide cumulative net present value contribution of \$11.5-13.5 billion. This contribution acknowledges the role that electric customers have to socialize liability for utility caused fires. A fund also limits the rate variability and potential shock that arises from relying only on post-event funding to pay liabilities. Moreover, by sizing the charge to be the same as the outgoing DWR bond charge, this approach reduces incremental bill impacts to ratepayers for fund capitalization. However, under the status quo, the DWR bond charge sunset would result in incremental bill reductions. As such, the ultimate size of any new bond charge should support the equitable sharing of costs across electric customers, shareholders, and property owners, and may be less than the DWR bond charge if a smaller fund is created.

**Investor owned utility shareholders** could contribute to the fund via a one-time cash contribution or a stream of payments equal to the net present value of the ratepayer contribution. The contribution shares of individual investor owned utilities should be sized to reflect actuarial risks of each utility depending on a variety of factors including recent loss experience, fire risk in their service territory, value at risk in the high wildfire risk areas of their

service territory, and others. This contribution acknowledges the value of the fund, (and associated reforms), in establishing a more stable damage payout and cost recovery environment, which has positive benefits for utility shareholders and continue utility solvency. The workgroup recognizes that ensuring voluntary contributions from shareholders is difficult to require via legislation. The legislature and Governor’s office should consult with utilities and financial market experts regarding how to best incentivize shareholder contributions. A requirement to recapitalize the fund in the event of utility negligence should be smaller the greater the upfront utility contribution. Likewise, the scope of changes to cost recovery, and the degree of pre-event certainty of recovering costs, should depend on the degree to which a utility contributes to initial capitalization of a fund.

**Publicly owned utilities** could contribute an equivalent up-front (equivalent to shareholder) and ongoing (equivalent to ratepayer) contribution, with both sized to reflect the size of their customer base. Thus a POU ratepayer would pay an additional charge equivalent to the extension of the DWR bond charge plus an incremental charge needed to finance the upfront contribution.

These contributions ensure policy fairness both between ratepayers and shareholders and between participating investor owned and publicly owned utilities.

**Property Insurance Policy Holders in California** would be subject to a surcharge on their insurance policies sufficient to raise funds equivalent to electric customer contributions. This charge would amount to approximately on average \$80 per year.<sup>20</sup> The purpose of such a surcharge is different than existing surcharges collected from property owners and more research is needed regarding how to best structure to ensure there are direct benefits to property owners and how any such surcharge interacts with Prop 26 and Prop 13. The legislature may consider limiting such a surcharge only to properties in Tier 2 or Tier 3 fire zones, even though broader socialization better supports the risk pooling objective. It is important to note the independence of the Wildfire Victims Fund from the State of California may be a factor in distinguishing such a surcharge on insurance policies from a tax requiring supermajority approval.<sup>21</sup>

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<sup>20</sup> The intention is to have similar collections from property owners as from ratepayers and IOU shareholders, and that the fees would be levied for 10 years or the length of the fund. As such, this fee may be smaller or greater per property if the fund size is different than the assumed \$40 billion, and may decline over time if a smaller capitalization is needed.

<sup>21</sup> *Schmeer v. County of Los Angeles* (2013) 213 Cal.App.4th 131, 1326–1327.

The **State of California** contributes to the fund via foregone tax revenue due to the fund's tax-advantaged status and via investment in wildfire mitigation that, if effective, will reduce the size of the fund and lowers the probability that post-event assessments will be triggered. The Wildfire Victims Fund does not require direct taxpayer contributions, although the workgroup strongly recommends that taxpayers substantially increase wildfire mitigation targeted to reducing wildfire risks for individual homes and in communities at highest risk for wildfires. This is above and beyond the current funding from the Greenhouse Gas Reduction Fund of \$200 million per year; the workgroup recommends an additional \$3 billion in annual near-term (next 5 years) mitigation funding designed to limit draws on the fund via risk-targeted investment, with a particular focus on areas at highest risk for utility caused fires.

#### **e. Wildfire Victims Fund post-event contributions**

Ideally, post-event assessment will not be required because mitigation efforts will reduce utility caused wildfire risks sufficiently that the higher levels of claims paying capacity will not be required. If initial capitalization does prove insufficient, a Wildfire Victims Fund should have authority to levy post-event assessments on parties sufficient to pay claims up to the \$40 billion level, or another level established by further analysis of a high-risk wildfire scenario. Contingent, post-event assessment provides incentives for mitigation (and adequate ongoing mitigation funding) by the utilities and the state. Post-event bonding authority also accounts for the possible need to upsize the fund if liabilities prove greater than expected.

Several parties, including The Utility Reform Network (TURN) and the California Large Energy Consumers Association (CLECA), argue that utilities should be required to repay the fund for any payments associated with fires where utility negligence was later found. The utilities suggest that alternatively, the loss causer should pay a higher contribution to rates recovered through ratepayers. It is important to assign some additional financial responsibility to the loss causer to limit the funds coverage of any claims associated with negligence, but also necessary to maintain solvent utilities.

To achieve this balance, the workgroup recommends utility shareholders be required to repay fund payments associated with an imprudent utility fire up to a certain threshold amount. This utility repayment can be subject to a pre-established cap, for example a certain percentage of market capitalization the day before a fire or a stress-test designed to maintain utility credit quality. The level of this cap should be higher if utilities do not contribute substantial up front contributions to the Wildfire Victims Fund and lower if they choose to make such contributions. Utilities should also be subject to fines and penalties from the CPUC for negligence, which can be remitted to the fund.

## **Observations regarding feasibility of a fund**

Establishing a Wildfire Victims Fund of sufficient size and with adequate contributions is a daunting task.

It is made more challenging by the fact that a key potential contributor, PG&E, is currently undergoing Chapter 11 reorganization, but exit from the Chapter 11 process may only be possible with liability reform. The creation of a fund and cost recovery reform that is calibrated to utility shareholder Fund contributions is the best path forward.

It is made more challenging by the fact that all shareholders of IOUs may object to sizeable initial contributions to the fund, even though they will benefit from the risk pooling a fund creates as well as from associated cost recovery reform.

It is made more challenging by the fact that maintaining payouts at current settlement values both for subrogation claims from insurers and for payments to underinsured homeowners present legal and implementation challenges. But not limiting these payouts would dramatically increase the cost of the fund and so compromise its usefulness.

It is made more challenging by the affordability challenges the state faces in electric utility rates. However, the workgroup believes this proposal renders a future of escalating and unpredictable electricity bills somewhat less costly and much more predictable.

It is made more challenging by the affordability challenges currently being experienced by homeowners in the WUI seeking to purchase fire or homeowners insurance. But it will help to stabilize California's homeowner's insurance market whereas modification of inverse condemnation doctrine may be a fundamentally force.

The solution we propose - a Wildfire Victims Fund coupled to significant cost recovery reform - is not an easy path. Further work is needed to identify the costs, consequences, and feasibility, of parts of the proposal as presented here. The workgroup believes that this combination of reforms will best protect victims, ratepayers, homeowners, and ultimately the health and wellbeing of the citizens of the state of California.

The workgroup believes that a smaller, liquidity only fund could provide some but not all of the benefits of a larger claims paying fund. The workgroup recommends that no or only modest cost recovery changes should be made if such liquidity only fund is created primarily using electricity customer resources with little utility shareholder contribution.

Other elements of this report discuss reform to the liability framework for utility caused wildfires in California as well as potential associated modification to CPUC cost recovery

process for these catastrophes. The workgroup emphasize that such change would have implications for what we have recommended here: possible changes in cost recovery as well as creation of Wildfire Victims Fund to pre-fund liabilities associated with utility caused catastrophic wildfires.

Modification of the current strict liability framework to a fault-based liability framework would reduce but not eliminate the need for a utility-focused Wildfire Victims Fund by limiting instances in which a utility is liable for wildfire to those in which it acted negligently.

Presumably, a negligent utility would be unable to prove to the CPUC that costs associated with its negligence were prudent, and thusly utility shareholders rather than ratepayers would be liable for any liabilities still the responsibility of electric utilities. Non-negligent utility-caused wildfire liabilities would be the responsibility of homeowners and their insurance companies. In both such cases a Wildfire Victims fund could assist with timely claims payment.

The workgroup emphasizes the degree to which change in the liability regime would alter utility liability for wildfire is uncertain. It might be that most wildfire liability would shift to home insurers under this approach. On the other hand, it is also possible that victims would be successful in proving in court that utilities conduct in setting fires was negligent. If so, then a change in liability regime could be destabilizing to utilities because it would predictably lower the odds of cost recovery for wildfire expenses while not reducing the underlying expense. Shareholders and ratepayers might end up needing to create a Wildfire Victims Fund or take major reforms to cost recovery because of the benefits of stable utilities with good access to capital markets. Any changes to inverse condemnation, cost recovery, or creation of a Wildfire Victims Fund must be considered and undertaken in a coordinated fashion. Interactions between the three frameworks are so direct and so strong that modification of one or more without close coordination is likely to lead to failure of policy effectiveness and severe unintended consequences.