



March 11, 2019

Governor's Office of Planning and Research
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Commissioner Carla Peterman, Chair
Commissioner Dave Jones
Commissioner Michael Wara

Commissioner Michael Kahn
Commissioner Pedro Nava
Executive Officer Evan Johnson

RE: March 13th Meeting of the Commission on Catastrophic Wildfire Cost and Recovery

Dear Commissioners:

The work this Commission will undertake is extremely important, and we value the commitment you have shown by agreeing to serve. Southern California Edison (SCE) thanks the Commission for the discussion of the existing wildfire liability regime, utility insurance availability and community needs following wildfire that is scheduled at your upcoming meeting.

You understand electric utilities play a key role – which is expected to grow – in helping the State meet its ambitious climate change and other environmental goals, while meeting their mission of providing safe, reliable, and affordable electric service to customers. The state's three investor-owned utilities (IOUs) collectively employ more than 40,000 Californians, providing good jobs and benefits. Given the essential role electric utilities play in the lives of our communities and the State's economy, it is critical that IOUs remain financially healthy to attract the capital needed to meet the State's objectives.

Critical to the financial health of utilities – and our ongoing wildfire risk mitigation efforts – is the ability to access low-cost debt and equity capital for infrastructure investment and utility operations. Due to recent (and potentially future) downgrades of our credit rating, the cost of capital is increasing and these higher costs have a direct impact on utility customers. The health of California's IOUs is dependent on California's regulatory compact. In return for an obligation to serve all customers, regardless of risk, IOUs are supposed to recover their costs of service in rates. That regulatory compact is broken. The strict liability framework in California coupled with an unpredictable and drawn-out process for cost recovery at the California Public Utilities Commission (CPUC) has damaged the IOUs' financial health. These conditions strike at the heart of the State's longstanding regulatory framework for IOUs, and they pose a real challenge for our future. We believe this was made clear in the recent downgrades Edison and SDG&E received by the rating agencies.

As the State works to mitigate and adapt to climate change, this Commission will make important recommendations, and there is an urgent need for them. In the following sections, we offer information for your consideration on the agenda items for your March 13 Commission meeting.

Existing Wildfire Liability Regime - Inverse Condemnation

The California Constitution requires the government to pay just compensation when it takes or damages private property for a public purpose. State and local governments are required to pay fair compensation when property is damaged by facilities providing a public service, such as providing water. Fault is generally irrelevant. California courts have ruled that “the cost of such damage can be better absorbed, and with infinitely less hardship, by the taxpayers as a whole than by the owners of the individual parcels damaged.” The framework is based on a shared “socialization” of the costs that flow from the operation of infrastructure that benefits the public.

California courts have extended this concept to privately owned utilities, even though these companies are not governmental entities. This means that those utilities are responsible for all property damage if their facilities dedicated to a public purpose cause a wildfire, even when the utility has done nothing wrong and has followed the rules regarding safety and compliance. For example, if a tree falls into a power line and causes it to fall and start a fire, the application of inverse condemnation means the utility is responsible for all of the property damage and attorneys’ fees, even if the utility maintained proper clearances between the tree and its line and had no reason to know the tree would fall.

Courts have ruled that inverse condemnation should apply to IOUs because they assume these utilities have the same ability as governmental entities to spread costs to their customers by raising rates. This simply is not true, as demonstrated by the CPUC’s 2017 decision denying SDG&E recovery of costs above insurance paid to settle property damage claims from 2007 wildfires (~\$380 million).

As noted earlier, holding electric utilities liable for all property damage caused by their facilities without regard to fault, and without a predictable, objective process for timely cost recovery at the CPUC has damaged the IOUs’ financial health. If the Commission determines that a utility cannot include such costs in its rates, then the utility is on the hook for all damages. Allowing what is essentially unlimited liability undermines the financial health of the state’s utilities, as investors and bond holders put their money elsewhere. Thus, inverse condemnation may seem obscure, but it has huge negative implications for the State’s environment, economy, and communities. In light of a changing climate, California needs to determine a path forward that addresses the disproportionate liability that IOUs bear for catastrophic wildfires by providing greater certainty around cost recovery.

Ultimately, until impactful policy changes occur to assist with the difficult climate change circumstances that exist, the financial health of utilities will continue to be felt by our customers when they pay their bills.

Current Conditions of Utility Insurance Market

Wildfires are a growing hazard across California, as the state continues to experience decades-long drought conditions, the significant buildup of hazardous fuels, strong seasonal winds, higher temperatures, lower humidity, and expanded residential and commercial development in remote, high fuel, high wildfire risk areas. Thirty-five percent of the SCE service territory is deemed to be high wild fire risk. Since the risk of wildfires in California is high and the amount of potential damage is large, obtaining insurance for wildfire risk is becoming difficult and increasingly expensive for utilities and their customers.

SCE’s experience is that insurance companies are continuing to reduce or eliminate their wildfire liability coverage for IOUs and premiums are increasing sharply. Stated differently, both the insurance and reinsurance markets for wildfire liability are “hardening.” This hardening of the wildfire liability coverage market is due to three key factors: 1) the increased risk that is driven by building in fire areas, increased

densities and property values, drought, lack of fuels management, and climate change; 2) the increased frequency and severity of wildfire events throughout California; and 3) the unique application of inverse condemnation in California to IOUs. With respect to the second factor, insurance companies (like all businesses) need to be able to earn a profit on the product they sell. As insurers have incurred greater and increasing losses on the California wildfire liability insurance policies they have issued, they need to increase premiums substantially to recover a portion of their past losses and attempt to earn a profit in the future.

With respect to the third factor (inverse condemnation), insurers face a risk in California that is different from virtually any other state in the country. The inverse condemnation doctrine in California exposes insurers to much greater risk than they face in other states, where utilities are held strictly liable without regard to fault.

Some insurance companies have dropped out of the California utility wildfire insurance market, others are reducing the amount of wildfire insurance they are willing to sell in California and still others are indicating they may drop out of California if there is another large wildfire. For SCE, in 2017, the Wildfire insurance cost was approximately \$75 million. For 2018, the Wildfire insurance cost increased to approximately \$235 million. SCE goes to the market each year for insurance, and we expect the premium to increase for continued coverage. Given the magnitude of risk in California due to drought and climate issues, wildfire risk is increasing just as wildfire insurance is becoming increasingly scarce and expensive.

Furthermore, as the magnitude of wildfire damages increases, commercial insurance markets have not provided the capital to insure these catastrophic events. While wildfires can cause damage into the tens of billions of dollars, the commercial insurance and reinsurance markets by all accounts will only cover up to approximately \$1.5B. For damage above commercial insurance, there is a critical need for an alternative risk financing vehicle, such as a catastrophic wildfire recovery fund that would be capitalized both pre- and post-loss through utility rates charged to customers. Any fund should have procedural safeguards that require shareholder contributions to post-loss additional premiums if the utility is deemed to be imprudent, and this imprudence was a direct cause of the wildfire.

Community Needs Following Wildfire

With guidance and approval from the CPUC, SCE attentively offers a “helping hand” of special assistance to our customers who are impacted by devastating wildfires, by providing customer protections designed to help people, including critical care customers, in their time of need.

We do not bill our customers whose homes cannot receive electricity service due to wildfires. In addition, we do not disconnect service for wildfire-impacted customers who are unable to pay their SCE bills and associated fees, and therefore do not assess disconnection charges for these customers.

For affected residential customers who wish to re-establish their service, SCE waives deposits and late fees for a period of one year, and expedites move-in and move-out service requests. Additionally, for affected customers who have prior arrearages and have lost their homes, and for those who have been displaced and seek to establish service in their new residences, we offer payment plans with initial payments of no more than 20 percent of the amount due. These customers are able to make payments in installments for at least one year.

SCE also prorates the monthly access charges and minimum charges we typically assess, to ensure affected customers will not be burdened by these costs for the time period after their homes were

made unserviceable due to wildfire. We do not bill basic charges to evacuated customers, and we offer extended payment arrangements to help affected customers while they recover.

For our low-income residential customers in impacted areas, we freeze all standard and high-usage reviews typically required for California Alternate Rates for Energy (CARE) program eligibility until at least the end of the year, and potentially longer, as warranted. For our eligible, impacted Energy Assistance Fund (EAF) customers, we provide an additional, one time bill payment assistance amount of \$100 over and above the standard \$100 EAF bill credit the program offers, for a total one-time amount of \$200.

To offer support to all our affected customers, dedicated SCE representatives are reachable via a toll free number throughout the week and on weekends and are available on site at local county assistance centers.

Moving Forward Toward Meaningful Solutions

SCE appreciates the opportunity to provide additional information on the agenda items before you. We look forward to supporting your efforts and deliberations as they progress. SCE is committed to finding meaningful solutions to these urgent problems – and we are committed to ensuring that our electric system, our customers and our communities can rise to the challenge of a changing climate.

Sincerely,

A handwritten signature in blue ink, appearing to read "Caroline Choi". The signature is fluid and cursive, with a long horizontal stroke at the end.

Caroline Choi
Senior Vice President, Corporate Affairs
Edison International