SMUD®

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GM19-083

Commission on Catastrophic Wildfire Cost and Recovery
Governor's Office of Planning and Research
1400 10th St
Sacramento, California 95814
wildfirecommission@opr.ca.gov

Commissioner Carla Peterman, Chair
Commissioner Michael Kahn
Commissioner Michael Wara
Commissioner Dave Jones
Commissioner Pedro Nava

SUBJECT: SMUD Response to Commission's Request for Comment

Dear Commissioners:

The Commission on Catastrophic Wildfire Cost and Recovery ("Commission") has been tasked with assessing issues surrounding catastrophic wildfire costs and damages and recommending "changes to law that would ensure equitable distribution of costs among affected parties." SMUD appreciates the complexity of the critical task before the Commission and is pleased to offer the following in response to your Request for Comment. SMUD was also pleased to participate on panels at your March 13, 2019, meeting in Redding, California, and to provide input at your April 3, 2019, meeting in Santa Rosa, California. Written statements of the oral comments provided at those meetings are attached to these comments.

SMUD is the local, publicly owned, electric service provider to the greater Sacramento area. We serve over 600,000 customers in our 900 square mile service territory. We also operate a federally licensed hydroelectric system in El Dorado County and maintain resources in Placer and Solano counties. Safety and reliability are SMUD's priority as delineated in our strategic directions adopted by our elected Board of Directors.

SMUD has a long history of proactively implementing measures to prevent and mitigate the risk of potential fire ignition and spread. SMUD has already adopted a robust set of measures that address these risks. However, SMUD recognizes that climate change and other developments affecting the environment within which we operate has increased the potential frequency, size and length of wildfire risk in California. Addressing this new "normal" will require a multi-prong attack; utility responsibility, sustainable funding, and liability reform must all be part of any solution.

Wildfire Liability Reform

SMUD supports a fault-based liability system for wildfire risks. The current application of inverse condemnation and strict liability is unsustainable, especially in instances in which the electric utility has met required standards for the construction, operation and maintenance of its electric transmission and distribution system. SMUD and other utilities should remain liable for wildfire costs when we're at fault; that's only fair. However, utilities should not be held strictly liable for wildfire damages when the utility acted responsibly and reasonably and met all standards. Strict liability accruing from inverse condemnation must be changed; it should be replaced by a risk-based, fault-based system.

While we must not lose sight of the personal devastation inflicted on each and every member of a community impacted by wildfire, we must also be mindful of the inequities that result from shifting these costs to utilities regardless of fault. Publicly owned utilities like SMUD, which don't have shareholders to bear the costs of the damages inflicted by a catastrophic fire, have only one recourse to fund any wildfire liability - to collect from our customers. These inevitable rate impacts cannot avoid having a disproportionate impact on our most vulnerable populations that are least likely to afford it, including low-income customers, the elderly, and renters. A major wildfire, like recent fires elsewhere in California, could cause SMUD's electric rates to jump by upwards of 25 percent.

Bond ratings are a significant driver for utility capital costs and are vital to maintaining access to credit markets. Ratings reflect financial risk for the utility to meet financial obligations considering all potential risks. Lower ratings result in higher borrowing costs, which in turn leads to higher customer rates and/or lower levels of investments. Recently ratings agencies have started reassessing POU's financial risk to wildfire catastrophes and responsibility for claims given the strict liability standard in California. Like other utilities, SMUD ratings have been recently placed on "outlook negative" by Moody's, a status that is a precursor for downgrading ratings absent any structural risk changes. The Moody's report cites:

> "Our rating action reflects Moody's view that the utility operating environment in California has become more challenging as legislators and other policy makers look for viable alternatives involving the application of inverse condemnation while simultaneously balancing the potential impact on municipal utilities and ratepayers."

A downgrade for SMUD by just one ratings level, would translate into higher borrowing costs and higher rates for our customers. With a $2+ billion existing Capital Improvement Plan and aggressive $6+ billion spending goals recently approved in our long-term Integrated Resource Plan to meet our decarbonization targets, a downgrade will result in material rate impacts to SMUD customers. For every $1 billion of borrowing there would be more than $3 million of additional interest cost annually or $100 million over the life of the bonds. A downgrade will require SMUD to carry additional liquidity to meet more frequent and higher collateral requirements through its

power procurement function, stranding financial resources that could be used for other mitigation efforts and may result in SMUD having fewer counterparties willing to provide commodity sales if ratings continue to deteriorate.

Our environment will also suffer if the costs of wildfire damages are not aligned with negligence, and utilities continue to be held strictly liable. Higher insurance costs and paying claims when not at fault will divert utility investment away from meeting our aggressive renewable energy and GHG reduction goals. Now, more than ever, as wildfires wreak havoc on our environment, we must depend on a reliable electric system to meet our clean air goals.

The state must act swiftly and thoughtfully to address this urgent matter. We must hold negligent parties responsible for damages and encourage increased wildfire prevention planning activities, but we must also reform strict liability standards for utilities that act reasonably and responsibly to protect our customers, communities, and our environment.

SMUD supports the recommended changes to reform the strict liability standard set forth under "1. Wildfire Liability Regime" in the Comments of the California Municipal Utilities Association (CMUA), the Southern California Public Power Authority (SCPPA), the Northern California Power Agency (NCPA), and Golden State Power Cooperative on behalf of Publicly Owned Electric Utilities and Electrical Cooperatives. SMUD strongly believes that the existing Constitutional provisions can and should be applied in a manner that is consistent with California's environmental and economic leadership.

Insurance Market Impacts

With our hydroelectric project assets in the High Fire Threat District and the persistent specter of strict liability damages, SMUD carries specific policies for wildfire risk. Last year we were able to roughly double our wildfire insurance, while incurring a four-fold increase in premium costs. Renewal conversations have started and while we don't expect the market to move away from us, we do anticipate even higher costs. There are fewer insurers willing to insure the California wildfire market, and fewer participants in a market typically leads to higher costs; other cost drivers will certainly be the recent wildfire events and related rating agency statements. Higher insurance costs will inevitably place further burden on our customers.

Many utilities have had issues obtaining and maintaining coverage at reasonable price levels. The first and foremost question that utility wildfire insurers around the world ask is whether the utility has assets located in California (i.e., is the utility subject to inverse condemnation and strict liability laws). Several insurers have chosen to discontinue writing insurance for utilities located in California, others are reducing the amount of coverage they will sell, still others decline to write coverage for prospective new

California utility clients. Where the coverage is available, the cost of insurance that is sold is increasing significantly. Reform of strict liability standards for utility related wildfires would be the most effective approach to making wildfire liability insurance affordable and reasonably available to utilities that operate in California.

Insurance coverage should be based on wildfire risk present at the home and/or business, rather than depending solely on the utility ratepayers to be the reinsurer or insurer of last resort.

Wildfire Fund Considerations

SMUD already incurs wildfire mitigation spending and those efforts have increased rates almost 1.5% to 2%. If a fund requires an upfront capitalization contribution and to continue to provide ongoing contributions, our rates will increase further. For, example, a $200 million upfront contribution will increase our rates by almost 2% more. A wildfire fund with these higher ratepayer costs should result in real financial benefits and increased risk coverage for publicly owned utilities and their customers. A pooled fund should be structured with these considerations in mind:

- The most equitable wildfire fund solution would require all California utilities to participate, so that all Californian's share in the costs. We would not support mandating only the two largest POUs along with the IOUs to share in these costs. All Californians enjoy the benefits of the California grid and should share the cost.
- Up front and continual contributions should account for a utility's relative wildfire risk profile and factor in size by number of customers in high risk areas. The Fund should not unfairly shift cost burdens from IOUs to publicly owned utilities.
- Charges to all ratepayers should be securitized through a non-bypassable on-bill charge recovered as part of its rate.
- A fund should be held in trust, such that the funds could not be repurposed for other uses in the future, a true lockbox fund with clearly defined funding, withdrawal, replenishment and fund segregation guidelines.
- There should be a negligence standard whereby funds would only be accessible for a utility that is compliant with their approved wildfire mitigation plans.
- The fund should offer tax-exempt status protection with the ability to access tax-exempt financing that has much lower costs and private use restrictions from commingled funds should be regarded in structuring a solution so that POUs can maintain their tax-exempt status if accessing funding becomes necessary.
- State backing will provide investor and insurer market confidence since this fund will be viewed as a funding resource of last resort for catastrophic fires that deplete existing utility insurance and self-funding.

- The Fund should work as a supplement to existing insurance and self-funding liquidity measures, including proper attachment points to incentivize a utility to provide their ratepayers with adequate and cost-
- effective insurance coverage as well as incentives to invest in prevention and mitigation.
- A fund must offer a form of increased insurance coverage for POUs they would not otherwise be able to obtain on the market and should help California return to more normal functioning insurance market by making available alternative catastrophic funding mechanisms over the longer term.
- The fund must consider how funds would be replenished once drawn and should include protections that ensure one utility with significant claims cannot "drain" the fund or make it in any other way insolvent for use by other electric utilities, stranding the costs incurred to pre-fund and subsequent funding contributed.
- A fund must be appropriately structured to be sustainable over multiple years, meaning it can withstand multiple years of high-cost catastrophic wildfires.

Support for Communities

SMUD exists to serve its communities and has long standing relationships with the first responders and local agencies serving those communities. These relationships and open lines of communication are very important. Electric Utilities cannot be solely responsible for addressing the risks posed by potential wildfires. Recognition must also be given to the role of public education for disaster prevention, and community preparation and recovery measures. This includes continued enhancements for state's emergency response systems. Mutual aid resources, telecommunications, 911 systems and community engagement, particularly in low-income and vulnerable rural and urban communities, can minimize the impact caused by wildfires.

Miscellaneous

There is no single solution; rather, a wholistic approach to addressing catastrophic wildfire costs and recovery is required. That approach must include a continued focus on forest and vegetation management, the implementation of cost-effective prevention and response programs including the development and implementation of new technologies, the prompt availability of wildfire investigation findings to inform the development of industry best-practices, support and funding for public education and emergency response, as well as an equitable apportionment of wildfire risk.

Thank you for the opportunity to provide these comments. We look forward to continuing the dialogue on these very critical issues.

Sincerely,

Arlen Orchard
Chief Executive Officer and General Manager

Enclosures

cc: The Honorable Gavin Newsom, Governor of California
The Honorable Toni Atkins, President Pro Tempore of the California State Senate
The Honorable Anthony Rendon, Speaker of the California State Assembly
The Honorable Ben Hueso, Chair of the Senate Committee on Energy, Utilities and Communications
The Honorable Chris Holden, Chair of the Assembly Committee on Utilities and Energy
Members, Senate Committee on Energy, Utilities and Communications
Members, Assembly Committee on Utilities and Energy
Commission on Catastrophic Wildfire Cost and Recovery, Executive Director, Evan Johnson

Comments of Joy Mastache presented at the March 13, 2019, meeting of the Commission on Catastrophic Wildfire Cost and Recovery, Panel on Existing wildfire liability legal regime.

Thank you for the opportunity to participate as a panelist at your April 13, 2019, meeting in Redding, California, to address utility wildfire liability. I am submitting my comments in writing below and including responses to several of the questions raised by the Commission.

SMUD is the nation's sixth-largest, community-owned, not for profit, electric service provider; the second largest in California. We serve the 1.5 million residents in Sacramento County and small adjoining portions of Placer and Yolo Counties. We also operate our Upper American River hydroelectric project, or UARP, in El Dorado County within the CPUC's High Fire Threat District.

As we come to grips with the "new normal" of our changing climate, including unprecedented wildfires, we must all do more to keep our communities safe. SMUD has and continues to implement more expansive wildfire prevention plans and to strengthen the construction, maintenance, and operation of electrical equipment throughout our service area and UARP.

SMUD and other utilities should remain liable for wildfire costs when we're at fault. That's only fair. However, utilities should not be held strictly liable for wildfire damages when the utility acted responsibly and prudently, and met all safety, inspection and maintenance standards.

The current system is unsustainable in the face of increasingly severe and frequent weather events. Concerns over the liability structure have been repeatedly voiced by credit rating agencies and others. Updating the liability standard is essential to ensure California's utilities can continue to provide affordable and reliable service, as well as make investments in programs designed to achieve the state's climate goals.

While we must not lose sight of the personal devastation inflicted on each and every member of a community impacted by wildfire, we must also be mindful of the inequities that result from shifting these costs to utilities regardless of their fault.

Unlike investor owned utilities, publicly owned utilities like SMUD don't have shareholders to bear the costs of the damages inflicted by a catastrophic fire. Our only recourse is to collect from our customers, with those costs having a disproportionate impact on customers least likely to afford it (low-income customers, the elderly, and renters).

Assuming current financing options continue to be available, a major wildfire reaching billions in damage and liability, could cause SMUD's electric rates to increase in the neighborhood of 25 percent. Small POUs could be impacted even more severely.

While SMUD retains wildfire insurance to protect against the financial impact of a catastrophic fire, strict liability for damages has caused wildfire insurance rates to skyrocket. Our wildfire insurance costs for this year were almost four times higher than the prior year, for limited amounts of additional coverage.

Higher insurance costs and paying claims when not at fault will divert utility investment away from meeting our aggressive renewable energy and GHG reduction goals. Now, more than ever, as wildfires wreak havoc on our environment, we must depend on a reliable electric system to meet our clean air goals.

California must act swiftly and thoughtfully to address this urgent matter. We must balance the public benefit of the electrical infrastructure with the harm caused to private property. We must hold negligent parties responsible for damages and encourage increased wildfire prevention planning activities, but we must also reform strict liability standards for utilities that act reasonably and responsibly to protect our customers, communities, and our environment.

As the not-for-profit, community-owned utility serving the state capital, SMUD is doing everything in its power to ensure the continued safe delivery of electricity to the 1.5 million residents who depend on it. SMUD's elected Board of Directors takes this safety and reliability very seriously. It has adopted a strategic directive that SMUD will maintain the electric system in good repair and make the necessary upgrades to maintain load serving capability and meet regulatory standards.

We participate in the development of a broad array of federal and state safety regulations and, for example, incorporate the CPUC powerline construction, inspection, and maintenance regulations into our standards and practices. This includes the recently adopted statewide fire threat map and the substantially increased vegetation management and safety hazard correction requirements.

We are on target to complete our Wildfire Mitigation Plan prior to SB 901's December 31 deadline. SMUD's fire prevention efforts include many of the same elements you have heard from the IOUs:

- Expanded vegetation management activities using advanced technologies
- Regular ground and aerial patrols
- Ignition resistant construction
- Procedures for deactivating reclosers and de-energizing our power lines to limit the impact of severe weather events

- Improving situational awareness
- Continued coordination and collaboration with local agencies and first responders

We are forecasting a sixty percent increase for 2020 and 2021 wildfire planning related costs, including insurance, enhanced vegetation management technologies, and system improvements. SMUD's Local Hazard Mitigation Plan is currently being reviewed by FEMA and we address wildfire as a part of the LHMP. Approval of the plan will provide additional access to funding for future projects.

SMUD had to triple our wildfire liability insurance limits, which has almost quadrupled our premium. At the same time more than 1/3 of the coverage risk remains with SMUD and its ratepayers. We are also expecting our premium to significantly increase when we renew the same limits this year without any increases in coverage. SMUD's expert on these issues will be presenting on the upcoming panel.

We are participating in ongoing discussions regarding potential financing and funding approaches, including AB 235; any such approach would have to ensure that if our ratepayers contribute to such fund, utility contribution levels are based on risk as well as size, and a proportionate benefit is available if needed. Another concern is that an occurrence such as we have seen over the last couple years could deplete any shared fund, particularly if there are multiple events throughout the state within a short time period.

We believe that there is no single answer here but rather action on multiple fronts is required.

- **Continued focus on forest and vegetation management.**
  SMUD supports policies that seek to fund efforts to reduce the overall statewide wildfire threat, such as multi-prong fuel reduction activities and improving forest health. Utilities, agencies and property owners alike have roles in this important effort.
- **Implementation of cost-effective prevention and response programs.**
  Clearly, cost effective measures to help utilities maintain their systems in a manner that maximizes public safety and reliability during extreme weather events are also critical. We support approaches that allow utilities to implement feasible wildfire prevention and response measures, that retain necessary operational flexibility based on local assessments and need, and provide additional resources to implement those programs

- **Prompt availability of wildfire investigation findings to inform development of best practices.**
  We encourage CPUC and Cal Fire to promptly share wildfire investigation findings. We need to harness the value potential for lessons learned and apply best practices in our service territory where similar topography and construction standards exist. We should not wait for court proceedings when as a state we can begin modifying our approach based on findings of the investigations.
- **Support for public education and emergency response.**
  Public education for disaster prevention, preparation and recovery measures should be a strong focus as well. This includes continued enhancements for state's emergency response systems. Mutual aid resources, telecommunications, 911 systems and community engagement, particularly in low-income and vulnerable rural and urban communities, can minimize the impact caused by wildfires.
- **Equitable apportionment of wildfire risk.**
  Support equitable apportionment of wildfire risk based on causation. In addition to these other efforts, updating the strict liability standard is essential to ensure California's utilities can continue to provide affordable and reliable service.

We look forward to working with the Wildfire Commission on these issues

Greetings members of the Commission and the public, I am Russell Mills, Treasurer and Director of Risk Management for the Sacramento Municipal Utilities District, SMUD. We have a service territory in and around the State Capital. I have some comments to provide for the Commission concerning two specific subjects

1) Insurance markets and the effects of wildfire on POU credit

2) Some considerations on a wildfire fund solution.

Insurance Market Dislocation and Increasing POU Risk Profile

- Due to inverse condemnation and strict liability, CA wildfire insurance markets are not functioning. Insurers have no choice but to price risk and coverage much higher than normally required or exit the market. Utilities are having difficulties obtaining and maintaining coverage at reasonable cost.
- Bond ratings are a significant driver for utility capital costs and are vital to maintaining access to credit markets. Ratings reflect financial risk for the utility to meet financial obligations considering all potential risks. Lower ratings result in higher borrowing costs.
    - Recently ratings agencies have started reassessing POU's financial risk to wildfire catastrophes and responsibility for claims
    - Ratings have been placed on "negative watch" a precursor for downgrading ratings absent any structural risk changes, for the largest POUs in CA. LADWP last month was revised to negative outlook and then just yesterday SMUD was also revised to negative outlook.
    - They cite "rating actions reflects Moody's view that the utility operating environment in California has become more challenging as legislators and other policy makers look for viable alternatives involving the application of inverse condemnation while simultaneously balancing the potential impact on municipal utilities and ratepayers."

Wildfire Fund Considerations

A wildfire fund with utility ratepayer dollars should result in real financial benefits and increased risk coverage for POUs and their ratepayers.

- If a fund is established, POU participation in the fund could be on an opt-in basis or if mandatory would be most equitable if all California ratepayers were required to participate.
- It should be structured to work as a supplement to existing insurance and self-funding liquidity measures, including proper attachment points to incentivize a utility to provide their ratepayers with adequate and cost-effective insurance coverage.
- A catastrophic wildfire fund must be more than a pooling of shared ratepayer funds but must offer a form of increased insurance coverage for POUs they would not otherwise be able to obtain on the market and should help California return to more normal functioning insurance market by making available an alternative catastrophic funding mechanism over the longer term. Attachment points will help with pricing for underwriters.

- Any fund with POU participation should be held in trust, such that the funds could not be repurposed for other uses in the future, a true lockbox fund with clearly defined funding, withdrawal, replenishment and fund segregation guidelines.
    - In a single fund with unclear segregation of funds, POU/IOU cross-subsidization could result in use of public funds to pay for private uses. This could result in issues for POUs maintaining their tax-exempt status. Consulting tax counsel on this will be vital for POUs.
    - The State must consider how funds would be replenished once drawn (e.g. is there state-funded backing?) and a fund should include protections that ensure one utility with significant claims cannot "drain" the fund or make it in any other way insolvent for use by other electric utilities, stranding the costs incurred to pre-fund and subsequent funding contributed.
    - Contributions should account for participating utilities' relative wildfire risk profiles, number of customers, among other factors. A one-size-fits-all approach may not work and could unfairly shift cost burdens from IOUs to other utilities.
    - A fund must be appropriately structured to be sustainable over multiple years, meaning it can withstand multiple years of high-cost catastrophic wildfires.

In closing this is a severe issue affecting the entire state. The insurance markets are no longer functioning, credit markets are beginning to show signs of future pressures for all POUs. Viable alternatives for funding are needed but need to be structured fairly and recognize each utility has different risk profiles and funding needs.

Greetings everyone and thank you for allowing me to participate in this forum and give SMUD's perspective on insurance, availability of financing and other financial considerations.

As my colleague Joy has already explained in the prior panel SMUD is the nation's sixth-largest, publicly-owned, electric service provider; the second largest in California, serving 1.5 million residents around the State Capital region. We operate the Upper American River Project, or UARP located in very low populated area including transmission lines in the higher risk Tier 2 and 3 areas designated in the CPUC's High Fire Threat District.

With transmission assets in higher-risk areas and the existence of strict liability, SMUD carries specific policies for wildfire risk. Last year we were able to increase our policy limits to levels roughly double the amount for a maximum claim benefit after co-insurance is considered while incurring a four-fold increase in premium costs. The good news for SMUD is that there was capacity available given our well managed relationships with insurers and risk profile. Many utilities have had issues with obtaining and maintaining coverage at reasonable price levels. Renewal conversations have started and while we don't expect the market to move away from us, it is highly possible the recent events will place further burden on our ratepayers.

A factor in SMUD's and all utilities financing plans is the element of cost of funding which is driven by decisions around how long to finance and interest rate markets, but also tangentially, ratings. Ratings agencies have started to comment on the risks outside of IOUs and the PG&E bankruptcy. We have responded to many questions from the three major ratings agencies and investors about our risk profile and the many proactive steps that we have been taking including:

- Expanded technology driven vegetation management activities
- Regular ground and aerial patrols of all facilities
- Ignition resistant construction of power line facilities
- Implementing procedures for deactivating reclosers and deenergizing our distribution and transmission lines

- Installation of weather stations for better reactive and situational awareness

But as events continue to occur we are all subject to ratings migration that will increase our rates from higher costs of borrowing. Finding alternate ways for preparing financially is necessary. We have expanded our commercial paper line to add flexibility and have some capacity to find short term capital funding if needed. Those measures are a great step, but wildfire events such as those occurring in 2017 and 2018 may find SMUD and other POUs in need of supplemental funding alternatives.

As discussed by my colleague we are participating in the process for finding solutions for utilities to this issue including AB235. We feel that any proposed solution needs to balance the benefits to ratepayers with the costs prescribed. Considerations for mandatory participation might make policy sense but there can be equitable ways to structure a solution such that utilities only pay for benefits they may receive and thus give their ratepayers cost effective financial protection. Most POUs will find themselves seeking ways to finance the required contribution and SMUD has estimated that AB235 as proposed may raise our rates by as much as 2% per year to participate but leave the unknown risk of funding availability if multiple events happen over the course of years. From a risk management perspective viewing the fund as a supplement to coverage and discounting its availability may be necessary. Considerations on attachment points will become important for POUs as the make financial risk management decisions. But all utilities do need some mechanism for funding alternatives.

In closing we would further reiterate that benefits need to be matched with assumed costs and not set up a paradigm of low risk area ratepayers subsidizing those in higher risk areas into perpetuity.