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**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Application of San Diego Gas & Electric Company  
(U 902-M), Southern California Edison Company  
(U 338-E), Southern California Gas Company (U 904-G)  
and Pacific Gas and Electric Company (U 39-M) for  
Authority to Establish a Wildfire Expense Balancing  
Account to Record for Future Recovery Wildfire-Related  
Costs

A.09-08-020  
(Filed August 31, 2009)

**OPENING BRIEF OF AT&T AND CCTA**

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February 17, 2012

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Application of San Diego Gas & Electric Company (U 902-M), Southern California Edison Company (U 338-E), Southern California Gas Company (U 904-G) and Pacific Gas and Electric Company (U 39-M) for Authority to Establish a Wildfire Expense Balancing Account to Record for Future Recovery Wildfire-Related Costs

A.09-08-020  
(Filed August 31, 2009)

**JOINT OPENING BRIEF OF AT&T AND CCTA**

Pacific Bell Telephone Company d/b/a AT&T California (U-1001-C); AT&T Communications of California, Inc. (U-5002-C); TCG San Francisco (U-5454-C); TCG Los Angeles, Inc. (U-5462-C); TCG San Diego (U-5389-C); and AT&T Mobility LLC<sup>1</sup> (hereinafter, collectively, “AT&T”); and the California Cable and Telecommunications Association (“CCTA”), pursuant to Rule 13.11 of the California Public Utilities Commission’s (“Commission”) Rules of Practice and Procedure and the Assigned Commissioner’s Amended Scoping Memo and Ruling dated September 29, 2011, hereby submit this joint opening brief in the above-captioned proceeding wherein applicants San Diego Gas & Electric and the Southern California Gas Company (“SDG&E/SoCalGas” or “Applicants”) seek authority to establish a Wildfire Expense Balancing Account (“WEBA”).

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<sup>1</sup> New Cingular Wireless PCS, LLC (U-3060-C); Cagal Cellular Communications Corporation (U-3021-C); Santa Barbara Cellular Systems, Ltd. (U-3015-C); and Visalia Cellular Telephone Company (U-3014-C), d/b/a AT&T Mobility LLC.

The application includes a plan for “Third Party Recoveries” and would establish a mechanism that allows for the recovery from ratepayers of uninsured claims and defense costs without a reasonableness review. AT&T and CCTA oppose the third party recovery portion of the WEBA plan because 1) SDG&E/SoCalGas have failed to show why the existing mechanism for pursuing third party recoveries is insufficient; and 2) the plan would encourage and reward unreasonable and unmeritorious legal action against third parties. Those third parties include communication companies such as AT&T and CCTA member companies, other utilities, local governments, and individuals. We urge the Commission to disallow this “Third Party Recovery” proposal of the Amended Application on the basis that it is unnecessary, unfair, and an unwise public policy.

#### **Overview of the Amended Application’s Third Party Recovery Proposal**

The Amended Application proposes to single out for special regulatory cost recovery treatment expenses incurred pursuing lawsuits against third parties. Specifically, SDG&E/SoCalGas request that certain Wildfire Expenses, including legal expenses, not be subject to a Commission reasonableness review before recovery is permitted. In other words, SDG&E/SoCalGas would seek recovery of such expenses by merely submitting their invoices regarding lawyer bills and other related legal expenses, and would not be required to demonstrate that the expenses were reasonably incurred.<sup>2</sup>

Next, the proposal would establish financial incentives for SDG&E/SoCalGas to pursue tort claims (or other) litigation against outside third parties. Under the amended proposal, “Third Party Recoveries, net of legal expenses, would be shared 90% to the Utility and 10% to ratepayers until the Utility has been fully reimbursed for Wildfire Costs it has absorbed for that

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<sup>2</sup> Tr. at 319-20 (SDG&E/SoCalGas; Schavrein).

wildfire. Thereafter, 90% of Third Party Recoveries would be credited to Utility ratepayers and 10% to the Utility.”<sup>3</sup>

Instead of a straightforward recovery model based on the reasonableness of the expenditure, the Applicants offer a complex matrix for the assignment of cost recovery responsibilities that only disallows booking Wildfire Costs resulting from “intentional or reckless conduct by Utility management.”<sup>4</sup> Intentional or reckless conduct by employees would be recoverable under the proposal, as long as the program is not reckless as a whole.<sup>5</sup>

### **Ratepayers Cover Bulk of Litigation Costs Regardless of Claim’s Merit**

One feature of the WEBA Third Party Recovery plan is clear. Ratepayers, not SDG&E/SoCalGas, will be at risk for the brunt of attorneys’ fees incurred in pursuing claims – regardless of whether the claims are successful, or even meritorious, because the proposal generally provides that Applicants’ litigation costs to pursue claims against third parties are accorded 100% ratepayer reimbursement, regardless of the reasonableness of those costs.<sup>6</sup> For example, under Category A, the category that relates to inverse condemnation or strict liability claims where Applicants are not at fault,<sup>7</sup> if SDG&E were to spend a million dollars on attorneys’ fees pursuing a third party, but obtain no recovery on that claim, the \$1 million cost would be recovered 100% from ratepayers.<sup>8</sup> Under Category B, the category that captures ordinary negligence costs, the formula is considerably more complex. Still, however, before

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<sup>3</sup> See Ex 1 Amended and Restated Testimony in Support of Joint Amended Application for Authority to Establish a Wildfire Expense Balancing Account to Record for Future Recovery Wildfire-Related Costs (“SDG&E/SoCalGas Amended Direct Testimony”) at 28.

<sup>4</sup> See Ex 1 SDG&E/SoCalGas Amended Direct Testimony at 29.

<sup>5</sup> Tr. At 330-31 (SDG&E/SoCalGas; Schavrein).

<sup>6</sup> See Ex 6 (Testimony of Richard N. Clarke On Behalf of Pacific Bell Telephone Company D/B/A AT&T California (U-1001-C)) at 7.

<sup>7</sup> See Ex 1 SDG&E/SoCalGas Amended Direct Testimony at 10.

<sup>8</sup> Tr. At 319 (SDG&E/SoCalGas; Schavrein).

there is any allocation, shareholder's legal expense is netted out.<sup>9</sup> For example, if hypothetically, SDG&E spent \$1 million on legal expenses and recovered \$200,000, the entire \$200,000 would go to the shareholder portion of the legal expense and none to the ratepayer.<sup>10</sup> Ratepayers would not become the primary beneficiary of a third party recovery unless a sizable recovery (*i.e.*, one above the \$30 million annual wildfire risk taken on by the Applicants) was received.<sup>11</sup>

Otherwise, ratepayers must get in line behind shareholders for reimbursement.

### **Applicants Fail To Demonstrate Why Their Third Party Recovery Plan is Warranted**

Applicants bear the burden of proof to show that the regulatory relief requested is just and reasonable.<sup>12</sup> In this case, SDG&E/SoCalGas fail to show why the proposed Third Party Recovery mechanism is needed. Instead, they generally assert that it is necessary to establish separate WEBAs for Wildfire Costs because property and liability insurance have become expensive to acquire, and because insurers have recently reduced the maximum limits to which they are willing to provide wildfire coverage. As for the Third Party Recovery Plan, the Applicants contend it “will provide the Utilities with an added incentive to reduce their liability, which in turn will inure to their customers’ benefit.”<sup>13</sup> SDG&E/SoCalGas also claim that the third party recovery provision “simply provides the Utilities with a strong incentive to pursue wildfire-related claims against third parties.”<sup>14</sup> What SDG&E/SoCalGas do not provide is any example of where an additional incentive would have been necessary for the utilities to pursue a wildfire-related claim against third parties. To the contrary, they assert that “large wildfires do

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<sup>9</sup> Tr. At 317 (SDG&E/SoCalGas; Schavrein).

<sup>10</sup> *Id.*

<sup>11</sup> See Ex 2 SDG&E and SoCalGas Rebuttal Testimony at 7. December 15, 2011

<sup>12</sup> See, for example, In Re Application of the Golden State Water Company Cal PUC 2011 December 15, 2011

<sup>13</sup> See Ex 1 (Updated SDG&E/SoCalGas Amended Direct Testimony) at 10.

<sup>14</sup> See Ex 2 SDG&E and SoCalGas Rebuttal Testimony at 7. December 15, 2011

not take place often, and there are a limited and defined number of parties responsible for any particular fire.”<sup>15</sup> While this may be true, it is no justification for the need for additional incentives.

Remarkably, SDG&E/SoCalGas do provide evidence demonstrating that the existing reasonableness review-based recovery mechanism is working and that an additional incentive is not necessary. Specifically, using the 2007 fires as an example, SDG&E witness Mr. Schaverien testified that SDG&E is pursuing major claims against three third parties related to the 2007 fires. One claim has already been settled for \$444 million, of which “[SDG&E] has received all of that.”<sup>16</sup> The other two claims against third parties range from “zero to hundreds of millions of dollars.”<sup>17</sup> The fact that SDG&E currently does pursue third party claims under the existing reasonableness review-based recovery system, and has already received a very large settlement from the 2007 fire third party lawsuits, begs the question: Isn’t “a limited and defined number of defined third parties”; a half-billion dollars already paid, and the prospect of “hundreds of millions of dollars” more, evidence enough that there exists sufficient incentive and opportunity for SDG&E to pursue these types of claims in the case of large wildfires? SDG&E/SoCalGas’s unsupported assertion that it requires a “strong incentive to pursue wildfire-related claims against third parties”<sup>18</sup> is, frankly, hollow against the historical reality of the current system’s effectiveness, and certainly does not demonstrate the need for the requested relief.

### **Imposing Utility Litigation Expenses Upon Ratepayers Without Reasonableness Review Protections Would Be Poor Public Policy**

SDG&E/SoCalGas’s plan concerning Third Party Recovery is not only unnecessary, it is unwise from a public policy perspective. AT&T economist and expert witness Richard N.

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<sup>15</sup> *Id.*

<sup>16</sup> Tr. At 322-23 (SDG&E/SoCalGas: Schavrein).

<sup>17</sup> Tr. At 323-24 (SDG&E/SoCalGas: Schavrein).

<sup>18</sup> See Ex 2 SDG&E and SoCalGas Rebuttal Testimony at 7. December 15, 2011

Clarke’s testimony highlights the reasons why. First, it is not clear that the risks associated with third party liability costs, including the litigation costs of pursuing claims against third parties, differ sufficiently from other business risks facing regulated utilities to justify the requested exceptional treatment.<sup>19</sup> Regulated utilities, like all companies, need to manage resources wisely and take account of potential variability in *ex post* cost outcomes when they make their business decisions. Dr. Clarke explains that when “certain classes of cost are permitted to have a different influence on a company’s profits from what the raw dollar value of these costs would suggest, this invites the company to manage its business in a way that maximizes its retained profits rather than in a way that is most efficient and cost minimizing for ratepayers.”<sup>20</sup>

Second, Dr. Clarke explains that creating an exceptional set of cost recovery responsibilities for costs associated with Third Party Recovery invites “excessively risky, financially unwise behavior by the Utilities.”<sup>21</sup> In economic terms, this concept is known as “moral hazard,” -- if an economic actor faces reduced jeopardy for its actions, the actor is likely to act in a riskier manner than if it bore complete responsibility.<sup>22</sup> Such is the risk presented by the SDG&E/SoCalGas proposal, where the Applicants’ litigation costs to pursue claims against third parties would be accorded 100% ratepayer reimbursement, regardless of the reasonableness of these costs. Applicants would be encouraged by the plan to “over invest” in tort litigation, according to Dr. Clarke, generally an otherwise risky and expensive activity. Winning is never assured, but if litigation initiated by Applicants failed to secure an award that covered fully the Applicants’ losses and litigation expenses, all of those uncovered expenses would become the

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<sup>19</sup> See Ex 6 (Testimony of Richard N. Clarke On Behalf of Pacific Bell Telephone Company D/B/A AT&T California (U-1001-C)) at 6-7.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

liabilities of ratepayers; and there would be little to dissuade Applicants from pursuing even cases that lack any significant merit.<sup>23</sup>

SDG&E/SoCalGas claim those concerns are unfounded<sup>24</sup> and that “[t]he Utilities will not engage in frivolous litigation against third parties because of this sharing mechanism.”<sup>25</sup>

SDG&E/SoCalGas suggest that, if additional profits through frivolous litigation were their goal (although they claim it is not), they would actually be better off pursuing such actions under the standard test-year (General Rate Case) ratemaking regime “under which [Utilities] would generally keep 100% of any forecasted third party recovery.”<sup>26</sup> Finally, SDG&E/SoCalGas contend that the proposed third party recovery sharing mechanism is “similar in nature and intent to the insurance recovery provisions found in the hazardous waste (“hazwaste”) recovery mechanism adopted by the Commission in D. 94-05-020.”<sup>27</sup>

This explanation is insufficient to justify the adoption of the proposed plan. With respect to rate-of-return regulated utilities, the Commission has recognized that a preferred regulatory scheme should provide for a rational system of incentives for management to take reasonable risks and control costs.<sup>28</sup> As the evidentiary hearings showed, SDG&E/SoCalGas could spend \$1 million seeking a \$200,000 recovery, and recover the entirety of their costs from consumers – without any reasonableness review.<sup>29</sup> If adopted, the proposed mechanism would create a very real financial incentive for Applicants to initiate litigation against third parties, even those cases that lack significant merit, since ratepayers would cover the cost of litigation without a

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<sup>23</sup> *Id.*

<sup>24</sup> See Ex 2 SDG&E and SoCalGas Rebuttal Testimony at 7. December 15, 2011

<sup>25</sup> See Ex 2 SDG&E and SoCalGas Rebuttal *Supra* at 8.

<sup>26</sup> We question whether the Commission’s reasonableness review process would leave unchallenged legal costs from seemingly meritless or weak suits against third parties, as SDG&E’s Rebuttal Testimony suggests.

<sup>27</sup> *Id.*

<sup>28</sup> See, for example, D. 99-05-030, Opinion Regarding SDG&E’s Distribution Performance-Based Ratemaking Mechanism, Finding of Fact 5 and dicta at 2.

<sup>29</sup> Tr. At 318-20 (SDG&E/SoCalGas: Schavrein).

Commission review for reasonableness. If SDG&E manages to prevail in litigation, consumers *may* stand to benefit, assuming the utility’s legal costs are covered first. However, if SDG&E does not prevail, consumers – and not SDG&E shareholders – pay the legal costs.

SDG&E/SoCalGas contend that the Commission has already approved a mechanism similar in nature and intent to that requested here, when the Commission approved the hazwaste recovery mechanism adopted by the Commission in D. 94-05-020. This is incorrect; D.94-05-020 concerns the adoption of a settlement agreement, and according to Rule 12.5 of the Commission’s Rules of Practice and Procedure, “does not constitute approval of, or precedent regarding, any principle or issue in the proceeding or in any future proceeding.” Indeed, Applicants recognize that a similar incentive [to the hazwaste recovery mechanism] “does not appear to be necessary for wildfire insurance since such coverage claims are generally pretty cut and dried....”<sup>30</sup> While SDG&E/SoCalGas acknowledge the inapplicability of the cited decision to the insurance aspect of WEBA, still they baldly suggest that the hazwaste case is relevant because “wildfire-related claims against potentially responsible third parties are generally vigorously contested...so the sharing percentages we have proposed make sense.”<sup>31</sup> Applicants somehow reason, without providing any empirical data, that third parties such as telecommunications companies and local jurisdictions are more like hazwaste insurance companies than wildfire insurance companies when it comes to utilities needing additional incentives to sue. This unsupported rationale does not back SDG&E’s claim that concerns against their Third Party Recovery plan are “unfounded.”

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<sup>30</sup> Ex 2 SDG&E and SoCalGas Rebuttal *Supra* at 8.

<sup>31</sup> *Id.*

## Conclusion

SDG&E/SoCalGas have failed to justify why their proposed third party mechanism is necessary for them to pursue claims against third parties in the event of large wildfires. They have also failed to provide a rational and reasonable explanation concerning why this incentive mechanism devoid of the Commission's reasonableness review, which if granted would greatly dampen Applicants incentives to operate efficiently and charge affordable customer rates, is in the public interest. Accordingly, the Commission must reject Applicants' third party recovery mechanism proposal.

Respectfully submitted,

/S/ David J. Miller

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