

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



**FILED**

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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 NOTICE OF EX PARTE COMMUNICATION OF AT&T AND CCTA**

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November 7, 2011

**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

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**JOINT NOTICE OF EX PARTE COMMUNICATION 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 of Practice and Procedure 8.3, hereby submit notice of the following ex parte communication in the above referenced proceeding. On Wednesday, November 2, 2011 at 10:00 AM, David Miller, a General Attorney for AT&T; Fassil Fenikile, Director AT&T Regulatory; and attorneys Peter Casciato and Jerome Candelaria for CCTA, met with Steven St. Marie, Advisor to Commissioner Sandoval, at the San Francisco offices of the California Public

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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.



# ATTACHMENT

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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)

**TESTIMONY OF  
RICHARD N. CLARKE ON BEHALF OF  
PACIFIC BELL TELEPHONE COMPANY  
D/B/A AT&T CALIFORNIA (U-1001-C)**

September 12, 2011

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**I. INTRODUCTION**

**Q1. Please state your name, business address, job title and responsibilities.**

A1. My name is Richard N. Clarke. My business address is 1120 20th St NW, Washington D.C. 20036. I am Assistant Vice President-Economic and Regulatory Policy for AT&T, Inc., and am responsible for AT&T's public policies related to telecommunications economics and regulatory practice.

**Q2. What is your educational background and work history?**

A2. I have a Bachelor's degree in mathematics and economics from the University of Michigan, and Master's and Ph.D. degrees in economics from Harvard University. I worked as Assistant Professor of Economics at the University of Wisconsin-Madison and as an Economist in the Antitrust Division of the U.S. Department of Justice prior to joining American Telephone and Telegraph Company with Bell Laboratories in 1986. Since that time, I served as Director of Economic Analysis with AT&T Corp., assuming my current position when AT&T Corp. was acquired by SBC in 2005.

**Q3. Have you ever testified before?**

A3. Yes. I have provided testimony before numerous regulatory commissions, including the Federal Communications Commission and the state commissions in Texas, Michigan, and Wisconsin, among others. I have also previously testified before the Public Utilities Commission of California (Commission). My prior testimony generally has dealt with economic, costing and pricing issues related to local exchange competition and access services.

**Q4. What is the purpose of your testimony?**

A4. The purpose of my testimony is to explain why certain aspects of the Joint Amended Application (JAA) of San Diego Gas & Electric Company (SDG&E), Southern California Edison Company (SCE), Southern California Gas Company (SoCalGas), and Pacific Gas and Electric Company (PG&E) (collectively, the Utilities) to establish Wildfire Expense Balancing Accounts (WEBA) and recover WEBA balances from both tort litigation receipts and retail service rates are inadvisable.

**Q5. Please summarize your testimony.**

A5. The applicant Utilities, like all regulated or unregulated business firms including AT&T California, face a multitude of different costs in operating their businesses. The Utilities' JAA would single out a specific category of these costs, Wildfire Expense, including expenses incurred pursuing lawsuits against third parties, for special regulatory cost recovery treatment. In particular, The JAA proposes that certain of these Wildfire Expenses (including the Utilities' litigation expenses) be subject to no Commission review of their reasonableness and that the Utilities should receive financial encouragement for pursuing tort claims litigation beyond the economic costs of their losses. This would be faulty regulatory policy as it would encourage the Utilities to expand this segment of their "business" beyond what is economically efficient for the provision of gas or electric service, and it would expose ratepayers to excessive costs as they would now be the party insuring the Utilities against financial jeopardy for unwise litigation.

## **II. DISCUSSION**

### **Q6. What are the Utilities proposing?**

A6. The Utilities are proposing to establish WEBAs, to book their expenses associated with Wildfires into these WEBAs and to recover WEBA balances through a combination of receipts from tort litigation claims against third parties and from general service revenues obtained from their gas and electric customers.

### **Q7. Do you find these proposals to be stated clearly?**

A7. No. I do not believe the JAA states clearly the obligations of ratepayers to reimburse different types and levels of wildfire liability claims and defense costs or to explain clearly how receipts from successful litigation would be booked into WEBAs to offset what would otherwise be the cost-recovery obligations of ratepayers – as well as the potential benefits to ratepayers from especially successful litigation results.

### **Q8. What do you understand to be the proposed assignment of cost responsibilities under the JAA?**

A8. My understanding of which parties would be responsible for what portions of cost recovery is displayed in the following matrix.

***Responsibility for Cost Recovery***

		Reason for Loss		
		Ordinary risks (including ordinary negligence) from conducting business	Inverse condemnation or application of strict liability	Intentional and reckless actions by Utility management
Amount of Loss	\$0 to \$5M/\$10M*	100% Utility	100% Ratepayers	100% Utility
	\$5M/\$10M to \$1.2B	100% Ratepayers	100% Ratepayers	100% Utility
	\$1.2B to cap**	95% Ratepayers 5% Utility	100% Ratepayers	100% Utility
	Over cap**	100% Ratepayers	100% Ratepayers	100% Utility
	Cost of purchased insurance	100% Ratepayers	100% Ratepayers	100% Ratepayers
	Cost of self-insurance	100% Ratepayers	100% Ratepayers	100% Ratepayers

\* \$5M is threshold per incident, \$10M is threshold for total loss over a year.  
 \*\* Cap would be \$2.0B for SCE and PG&E, and \$1.6B for SDG&E and SoCalGas.

**Q9. This looks complicated, what is the typical matrix for the assignment of cost recovery responsibilities for regulated utilities?**

**A9. The following matrix would represent typical recovery responsibilities.**

***Responsibility for Cost Recovery***

		Reason for Cost	
		Reasonable expenditure	Unreasonable expenditure
Cost Level	Any amount resulting in a just and reasonable rate	100% Ratepayer	100% Utility
	Any amount resulting in an unjust or unreasonable rate	100% Utility	100% Utility

**Q10. What is your understanding of the basis for the structure and complexity of liability cost recovery under the Utilities' JAA?**

A10. The Utilities claim that because property and liability insurance has become so expensive to acquire, and because insurers have recently reduced the maximum limits to which they are willing to provide wildfire coverage, it is necessary for the Utilities to establish separate WEBAs for these expenses and for the Commission to apply exceptional standards for evaluating the appropriateness of balances booked into these accounts. In particular, the Utilities propose that expenses booked into these WEBAs be subject to a reduced "reasonableness" standard that would disallow the booking only if the nominated Wildfire Costs were the result of "intentional or reckless conduct by Utility management." (JAA at 9). In return, the Utilities propose that they would be willing to bear recovery responsibilities for the first \$5M of expense associated with an individual wildfire (subject to a \$10M limit per calendar year), and be responsible for 5% of all wildfire expenses greater than \$1.2B in a given year (up to a limit of \$40M for SCE and PG&E and \$20M for SDG&E and SoCalGas). Further, the Utilities propose that to provide themselves with greater incentives to seek reimbursement from third parties for their Wildfire liability costs and reduce the burden of ratepayers, the Utilities should retain "90% of third-party recoveries (net of legal expenses relating to the recovery) until the Utility has been fully reimbursed for Wildfire Costs it has absorbed ... thereafter, 90% of third-party recoveries will be credited to utility customers, via a credit to the WEBA, and 10% will be retained by the Utility." (JAA at 8).

**Q11. Do you believe it is good regulatory practice to permit such a complex matrix of cost recovery responsibilities for the Utilities' liability costs?**

A11. No. It is not clear to me that third party liability costs, including the litigation costs of pursuing claims against third parties, differ greatly in character from the myriad of other costs faced by regulated utilities. In addition to litigation costs, these costs include labor costs, transportation costs, technology costs, tax expenses, casualty costs and potential liability costs, to name a few. None of these costs are known perfectly in advance, and there is always a significant risk that the level of their actual cost will turn out to be different from the cost level anticipated when the decision was made to incur these costs. As a result, regulated utilities, like all companies, need to manage wisely and take account of potential variability in *ex post* cost outcomes when they make their business decisions. But if 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.

**Q12. Could the exceptional set of cost recovery responsibilities proposed in the JAA invite excessively risky, financially unwise behavior by the Utilities?**

A12. Yes, in economics and insurance there is a concept known as "moral hazard." Arrow (1963). What the concept means is that if an economic actor faces reduced jeopardy for its actions, this actor is likely to act in a riskier manner than if it bore complete responsibility. For example, an automobile owner who is insured against windshield damage may be more likely to drive on gravel roads than an owner who lacks

such insurance. As noted in the matrix, the JAA provides that the Utilities' litigation costs to pursue claims against third parties are always accorded 100% ratepayer reimbursement, regardless of the reasonableness of these costs. The JAA, in proposing to remove nearly all financial jeopardy from the Utilities in their pursuit of third party reimbursements, would appear to encourage them to "over invest" in such activity. Tort litigation is generally considered both a risky and expensive activity. Winning one's case is never assured, and even if victorious, litigation expenses and attorneys' contingent fees may amount to 30% to 40% or more of awards. But if it should occur that when a Utility-initiated litigation fails to secure an award that covers fully the Utility's losses and litigation expenses, all of these uncovered expenses become the liabilities of ratepayers (as provided for by the JAA); there is little to dissuade the Utility from pursuing even cases that lack any significant merit.

### **III. CONCLUSION**

**Q13. Based on your review of the JAA and testimony filed by the Utilities, what action do you recommend the Commission take?**

A13. The Commission should not develop special reimbursement rules and accounting schemes for recovering the costs of wildfires, including the Utilities' litigation costs of pursuing claims against third parties. The risks associated with these expenses are not so different from other business risks facing regulated utilities such that exceptional treatment is warranted. Furthermore, it would be extremely unwise to adopt the particular special accounting/cost recovery method for litigation expenses proposed in the

JAA -- because these proposed rules would dampen the Utilities' incentives to operate efficiently and charge affordable customer rates.

**Q14. Does this conclude your Testimony?**

A14. Yes.

REFERENCE

Arrow, Kenneth (1963). "Uncertainty and the Welfare Economics of Medical Care," *American Economic Review* 53 (5): 941–973. Available at: <http://jstor.org/stable/1812044>.