Decision **PROPOSED DECISION OF ALJ BUSHEY** (Mailed 10/15/2012)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U902M), Southern California Edison Company (U338E), Southern California Gas Company (U904G) and Pacific Gas and Electric Company (U39M) for Authority to Establish a Wildfire Expense Balancing Account to Record for Future Recovery Wildfire-Related Costs.	Application 09-08-020 (Filed August 31, 2009)

DECISION DENYING APPLICATION

1. Summary

This decision denies the request of San Diego Gas & Electric Company and Southern California Gas Company for a Wildfire Expense Balancing Account, and dissolves the Wildfire Expense Memorandum Accounts authorized in Resolution E-4311. This proceeding is closed.

2. Background

On August 31, 2009, San Diego Gas & Electric Company (SDG&E), Pacific Gas and Electric Company (PG&E), Southern California Edison Company (Edison), and Southern California Gas Company (SoCal Gas), filed their initial application requesting Commission authorization to establish a balancing account to allow each utility to recover from ratepayers "all amounts paid by the utility arising from wildfires." Protests were filed by the Consumer Protection and Safety Division (CPSD), Disability Rights Advocates (DisAB),[1] the Division of Ratepayer Advocates (DRA), Protestor Ruth Henricks, Mussey Grade Road Alliance (Alliance), and The Utility Reform Network (TURN).

On December 21, 2009, the assigned Commissioner and assigned Administrative Law Judge issued a ruling finding that the application required amendment before hearings could be scheduled and directing the parties to meet and confer. The ruling specifically listed the major issues that required amendment:

1. The limitless potential for ratepayers to fund third-party claims, including fire suppression and environmental damage, all but invite governmental entities and everyone else to submit claims to utilities;
2. Utilities have no incentive to defend against third-party claims, and ratepayers are without a practical means to protect their interests; and
3. The presumption of recovery of third-party claims undermines financial incentives for prudent risk management and safety regulation compliance.

On August 10, 2010, the applicants filed their amended application. Protests were again filed by CPSD, DisAB, the DRA, Protestor Ruth Henricks, the Alliance, and TURN.

On September 14, 2010, a prehearing conference was convened at which the scope of this proceeding was contested as well as the need for a Phase II. A tentative schedule was set with the plan that the scoping memo would reflect the final schedule.

[1] Effective September 2, 2011, the Center for Accessible Technology assumed DisAB's role in this proceeding.

The assigned Commissioner and Administrative Law Judge (ALJ) then issued a ruling directing applicants to show cause why the amended application should not be dismissed, which was subsequently suspended by the assigned Commissioner to allow the parties to continue settlement discussions.

On September 29, 2011, the assigned Commissioner issued his scoping memo determining that the scope of this proceeding included all factual and legal issues necessary to determine whether the applicants have met their burden of justifying the proposed ratemaking mechanism as required by Public Utilities Code § 454, and that the proposed rates will be just and reasonable as required by § 451. The scoping memo also determined that evidentiary hearings were necessary and appointed the assigned Administrative Law Judge as the presiding officer.

On November 9, 2011, PG&E and Edison moved to withdraw as applicants, but to continue their Wildfire Expense Memorandum Accounts related to this proceeding. PG&E and Edison explained that after filing this application they also sought Commission authorization to establish a Wildfire Expense Memorandum Account via an advice letter, which was granted in Resolution E-4311, and in which the Commission authorized the applicants to begin recording certain categories of wildfire costs in their respective memorandum accounts, effective date of July 29, 2010. The Commission, however, conditioned any recovery of amounts properly recorded in the memorandum accounts on its determination on the merits of this application. While seeking to withdraw from the application, PG&E and Edison requested that any ruling granting their motion to withdraw provide for the continuation of their memorandum accounts.

On November 14, the assigned Administrative Law Judge set a schedule for considering PG&E's and Edison's request, which required PG&E and Edison to supplement their motion on December 2, 2011 with more detail regarding the proposed continuation of the memorandum account, including when and subject to what criteria they would request amortization of any amounts recorded in the account. Parties were then authorized to file and serve responses to the supplemented motion no later than December 16, 2011.

On December 2, 2011, PG&E and Edison supplemented the motion to withdraw and contended that it was premature to determine where and when costs recorded in the memorandum account will be reviewed. PG&E and Edison stated that they could potentially seek recovery of the costs in an annual Energy Resource Recovery Account proceeding, or other reasonableness review process. As for the criteria to be used in evaluating recovery of such recorded costs, PG&E and Edison argued that the framework and standards for recovery of uninsured third-party claims arising from a wildfire are controversial issues that the Commission need not and should not decide in authorizing the memorandum accounts.

In response, DRA, jointly with CPSD, did not oppose the motions to withdraw but recommended that the memorandum accounts include notification to the Commission when the utility begins recording amounts, and also that the term "wildfire event" be defined.

The Alliance supported granting PG&E and Edison's motion to withdraw from Application 09-08-020, and denying their request to continue recording costs in a memorandum account. The Alliance contended that the utilities throughout the two-year term of this proceeding had not yet demonstrated or proven that a memorandum account was necessary to recover fire-related costs, or why such an account is necessary to allow for cost recovery at a later date. Moreover, the Alliance concluded, the utilities have not demonstrated that a pre-defined process, either a balancing or memorandum account would be beneficial to ratepayers, would improve electrical utility safety with regard to catastrophic wildfires ignited by electrical utility equipment or that any of the utilities would face an imminent financial crisis due to uninsured wildfire costs that could not be addressed by the Commission on a case-by-case basis.

On January 3, 2012, the assigned Commissioner granted the unopposed motion of PG&E and Edison to withdraw from this application, but denied approval of the memorandum account request. The assigned Commissioner found that the draft memorandum account tariffs submitted by PG&E and Edison suggested cost recovery from ratepayers is anticipated, as well as overly broad definitions of costs that may be properly recorded in the account.

Evidentiary hearings for the remaining applicants, SDG&E and SoCalGas were held on January 11, 12, and 13, 2012 before the assigned Administrative Law Judge. Parties filed and served opening and reply briefs. Opening briefs were filed and served on February 17, 2012, and reply briefs on March 9, 2012.

On April 5, 2012, the assigned Commissioner and assigned Administrative Law Judge convened a Public Participation Hearing in San Diego. When scheduling the Hearing, the assigned Commissioner explained that in Resolution E-4311 the Commission authorized Wildfire Expense Memorandum Accounts with an effective date of July 29, 2010, and that since then SDG&E had been recording uninsured costs arising from the 2007 San Diego County wildfires in this memorandum account. The assigned Commissioner scheduled the Hearing to allow the public to comment on whether the uninsured 2007 fire costs should be included in the Wildfire Expense Balancing Account mechanism.

Approximately 800 persons attended the hearings and over 100 presented comment for the record. Some commenters offered general praise for SDG&E as a corporate citizen, but a majority of the commenters opposed the Commission including the 2007 costs in the Wildfire Expense Balancing Account as well as the general concept of a wildfire expense balancing account. The record was submitted for Commission consideration on April 5, 2012, at the conclusion of the Public Participation Hearing.

3. Positions of the Parties

3.1. SDG&E and SoCalGas

The remaining applicants request that the Commission make permanent the currently-authorized Wildfire Expense Memorandum Account into which they will record uninsured wildfire costs in excess of $10 million. They also seek approval of a Wildfire Expense Balancing Accounts into which balances in excess of $10 million in the memorandum account will be transferred. After such a transfer, the utility could then seek recovery of the amount by filing a request with the Commission showing that the amounts so recorded did not result from "acts or omissions intentionally engaged in or directed by an officer with the intent to cause harm" or who "willfully and deliberately" disregarded probable dangerous consequences of intentional acts or omissions.[2] So long as the wildfire

[2] *Id*. at 11 – 12. The applicants offer a construct of Category A, B, and C to describe the limited range of costs that would be excluded from ratepayer recovery pursuant to the proposed balancing account. This construct creates unnecessary complexity and obscures the narrow and extreme fact patterns under which wildfire cost recovery would be precluded under the applicants' proposal. We, therefore, simply describe the excluded costs as being caused by deliberate actions of a corporate officer.

costs were not incurred by deliberate officer action, the costs would be recovered from ratepayers via the proposed Wildfire Expense Balancing Account.

SDG&E and SoCalGas ask the Commission to allow them to recover wildfire costs in rates on the grounds that wildfire risk come with their obligation to serve, recovery of such costs is consistent with Commission treatment of the costs created by natural disasters, and the doctrine of inverse condemnation presupposes that costs allocated to the public entity will be shared by all users served by that entity. The applicants also argue that certainty of rate recovery for wildfire costs is necessary for utilities to maintain their financial strength.

SDG&E and SoCalGas dismiss intervenors' claims that the proposed memorandum account and balancing account mechanism for recovering uninsured wildfire costs from customers should include a reasonableness review and argue that wildfires are not the subject of deliberate action by the utility and thus a post-event evaluation of the decision-making process, such as that contemplated by a reasonableness review, is not compatible with fact pattern of wildfires.

The applicants similarly discount the effect on safe utility operations by certain recovery of wildfire costs. The applicants contend that they take their obligation to provide safe and reliable service "very seriously" and the proposed wildfire cost recovery mechanism will not change this commitment.[3]

SDG&E and SoCalGas also dispute the intervenors' arguments that assigning all litigation costs to ratepayers will create an incentive for the utilities

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[3] SDG&E and SoCalGas Opening Brief at 47.

to litigate third party claims regardless of merit. The utilities argued that ratepayer funding for litigation would not cause them to pursue frivolous claims, and that their proposed program is similar to that approved by the Commission for insurance recovery in hazardous waste clean-up cases.

3.2. Consumer Advocates

Four consumer advocate entities – the Center for Accessible Technology, DRA, CPSD, and TURN – filed a joint brief in opposition to the proposed wildfire cost recovery mechanism. The consumer advocates argued that despite numerous procedural opportunities, the utilities have not provided a clear rationale for the extraordinary ratemaking relief contemplated by the proposed mechanism, nor have the utilities demonstrated that existing ratemaking mechanisms are inadequate to address uninsured wildfire costs.

Specifically, the consumer advocates argued that that the applicants have requested a balancing account mechanism through which virtually all wildfire costs would be allocated directly to ratepayers via a formula that provides little, if any, meaningful opportunity for ratepayers or the Commission to review the reasonableness of the costs. The consumer advocates explained that the applicants have failed to justify the reasonableness of their proposal to shift liability for wildfire costs caused by utility negligence or recklessness from shareholders to ratepayers, with predictable deleterious impacts on utility operations and safety protocol.

The consumer advocates next demonstrated that the remaining applicants have not shown that existing ratemaking mechanisms are insufficient to address potential wildfire liability exceeding insurance limits. The advocates point to applicants' testimony that a special memorandum account could be requested to address a specific wildfire, and that the existing Z-factor mechanism offers a similar means to recover excess wildfire costs. The consumer advocates cited to applicants' testimony admitting that the exact costs they have recorded in the memorandum account related to this proceeding are also being simultaneously recorded in the Z-factor memorandum account. The consumer advocates concluded that the applicants' admissions of existing alternatives to the proposed Wildfire Expense Balancing Account showed that the new balancing account is not needed.

The consumer advocates went on to show that the proposed ratemaking mechanism would constitute bad public policy because it would unreasonably limit the Commission's authority to review wildfire costs and the utility's standards for system safety, as well shifting excessive risk to the ratepayers. The consumer advocates stated that the proposed balancing account would have the effect of indemnifying utility shareholders from their own failures to comply with safety regulations and to take all aggressive actions to prevent wildfires.

TURN also filed a separate brief supporting a balancing account that allowed utilities to recover up to 95% of any increase in insurance costs.

3.3. Mussey Grade Road Alliance

The Alliance is a community-based organization started in 1999 and dedicated to the preservation and protection of historic Mussey Grade Road and environs in Ramona, California.[4] The Alliance stated that power line fire safety is its primary focus at the Commission due to the experience of the Mussey Grade Road community in the wildland fire catastrophe in San Diego County during 2003. The Alliance stated that the Mussey Grade Road area was devastated in

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[4] For more information see http://www.musseygraderoad.org.

the 2003 Cedar Fire during which two-thirds of existing homes were destroyed in the southern portion of the five-mile road south of Dos Picos Park Road and long-term damage inflicted on historic oaks lining the road, and that the Mussey Grade Road area was again threatened by the Witch Fire, a catastrophic wildland fire in 2007.

The Alliance presented a well-qualified expert witness on fire history data and power line firestorms. In its testimony and briefs, the Alliance explained that power line firestorms – clusters of fires caused by extreme winds downing power lines and the most likely cause of catastrophic human and economic loss - should not be expected to occur very often, and certainly not frequently enough to merit the establishment of a special cost recovery mechanism such as the proposed balancing account. The Alliance did not dispute SDG&E's assertion that a utility has little control over how large a fire becomes once it has started, but emphasized that that the ignition of power line fires is something that is under the utility's control, and that therefore that their actions have a significant effect on the probability and frequency of fires. Moreover, while the exact source of ignition may not have an effect on the extent of a fire, the timing of the ignition does – and power line fires tend to ignite under high wind conditions that stress utility infrastructure and thus increase the expected number of fire starts in a given area. The Alliance recommended preventing these catastrophic firestorms by adopting high engineering standards for power lines.

The Alliance explained that one of the key decisions SDG&E made was the engineering standard for wind loading to apply to the design and maintenance of its lines. The minimum wind loading allowable by the Commission is specified in General Order 95, and specifies the engineering design standard for distribution infrastructure in terms of wind pressure, readily convertible to wind speed by standard calculations, but also requires adjustments for local conditions. The Alliance stated that SDG&E has decided to design to the minimum standard of a distribution system built to withstand at least 56 mph gusts throughout San Diego County. The Alliance noted that standard engineering practice in the United States, when there is the potential that an engineering failure can result in widespread public harm (certainly true in the case of wildfires), systems are required to be designed to withstand conditions expected no more often than 1700 years, with conditions that initiated the 2007 wildfires might be expected to occur every at an interval estimated to be 20 and 200 years. The Alliance concluded that SDG&E's engineering standards may not be sufficient to prevent power line firestorms from occurring every few decades.

The Alliance next pointed out that the proposed balancing account would remove the only significant financial incentive that utilities have to improve wildfire safety. The Alliance explained that the Commission's policies insulating utilities from the financial consequences of increased insurance premiums had already removed any financial incentive to reduce the risk of wildfires created by those increasing costs. The Alliance explained that where a business or person is responsible for paying insurance costs such as premiums, co-payments, and deductibles, reducing these costs is a strong incentive for behavior that reduces the risk of losses. However, the Alliance contended, the Commission's existing ratemaking mechanisms allow utilities to recover all insurance costs from ratepayers and, consequently, eliminates these incentives. The Alliance cited to a recent paper by leading academic insurance experts showing that programs that assure the coverage of losses without risk-based pricing can create moral hazard by raising the frequency of adverse events by lessening incentives for risk-reducing effort.[5] The Alliance offered a specific example of a study in Michigan and Illinois which showed that switching from a government-run assurance program to private insurance for fuel tank accidents reduced the number of fuel tank leaks by 20%, saving Michigan taxpayers $400 million. The Alliance concluded that the Commission's policy of allowing California utilities to recover all insurance costs from ratepayers has eliminated insurance cost as a factor when the utility selects and negotiates insurance contracts or when it evaluates measures to reduce risk, thus removing this important tool for reducing moral hazard and improving safety. The Alliance argued that the balancing account proposal would remove the sole remaining financial incentive imposed on a utility to reduce wildfire losses.

The Alliance analyzed executive decision-making regarding wildfire risk and found that utility executives have many responsibilities to their shareholders and customers and safety is one of these concerns, but these decision-making executives are primarily rewarded for the financial performance of their companies. When an executive must make the decision whether to allocate a given set of resources to improving the financial outlook of the company or whether to allocate the same resources to enhance safety measures, the executive does so with the knowledge of near-certain rewards for enhanced profits, and the low probability of consequences for safety problems that might or might not show up some day. The Alliance contended that the Commission must adopt policies that counter this disincentive towards the priority of safety.

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5 See Hearing Exh. 15 at 32, and papers cited therein.

The Alliance recommended requiring the utilities to study and quantify the risk of power line fires to provide more sophisticated analysis to insurance carriers as a means to reduce costs. The Alliance stated that catastrophe modeling techniques could reduce insurance costs as well as guide utilities in selecting cost effective safety measures. The Alliance also opposed including 2007 fire costs in the proposed balancing account.

3.4. AT&T and California Cable and Telecommunications Association (CCTA)

These parties opposed the proposed inclusion of all legal and litigation costs in the balancing account for recovery from ratepayers without Commission reasonableness review. AT&T and CCTA explained that the proposed mechanism would have ratepayers at risk for nearly all attorneys' fees incurred by the utilities in pursuing claims against third parties, regardless of whether the claims were successful or even meritorious. AT&T and CCTA observed that the remaining applicants bear the burden of proving that the relief requested is just and reasonable, and that the applicants have not shown that utilities need additional incentives to pursue wildfire-related claims against third parties.

3.5. Ruth Henricks

Henricks challenged the remaining applicants' assertion of an insurance market failure, and argued that SDG&E's role in the 2007 fires caused the increase in insurance premiums. Henricks also opposed including the 2007 fire costs in the proposed balancing account.

4. Discussion

Pursuant to Public Utilities Code Section 451 each public utility in California must:

> Furnish and maintain such adequate, efficient, just and reasonable service, instrumentalities, equipment and facilities, …as are necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public.

The duty to furnish and maintain safe equipment and facilities is paramount for all California public utilities.

When initially considering this application, the assigned Commissioner and Administrative Law Judge took the unusual step of issuing a ruling finding that the application presented significant issues which were not addressed and requiring that the applicants amend the application. As set forth below, specific issues were identified as requiring additional information:

> The issues raised in the protests are substantial and require that the application be amended prior to setting the procedural schedule for this proceeding. Specifically, the limitless potential for third-party claims, including fire suppression and environmental damage, all but invite governmental entities and everyone else affected by a wildfire to submit wildfire claims to utilities. The utilities, in turn, would have no financial motivation to defend such claims, and ratepayers, who ultimately must bear the cost of claims, are without any practical means of defense in the proposed scheme. Financial incentives for prudent risk management and safety regulation compliance are substantially undermined by the presumption of recovery from ratepayers. These issues and others raised in the protests must be addressed to provide an adequate information basis on which to set further proceedings in this docket. The applicants' reply, however, is limited to vague assertions and opposition to evidentiary hearings. Accordingly, at this point, the record

> does not include sufficient information on which to set further proceedings.[6]

To further assist the applicants when amending the application, the assigned Commissioner and Administrative Law Judge, however, went on and explained their conceptual view of the essential elements of prudent wildfire risk management:

> To guide the utilities in amending the application, we offer our perspective on the essential components of a prudent wildfire risk management program. Fundamentally, the risk management program must be comprehensive; that is, all facets of risk reduction and liability funding must be considered. The current proposal appears to be solely aimed at providing a certain source of funding for any and all potential liability. Creating powerful financial and operational incentives for continuously reducing wildfire risk must be the primary focus of a wildfire risk management program. Identifying and mitigating wildfire risk requires immediate and serious utility management attention due not only to the potential financial imposition on the utility and ratepayers but also due to the human, economic, and environmental harm caused by wildfires. Utility management and employees must have demonstrable incentives to reduce the risk of wildfires.
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> Risk reduction efforts, however, often require new or redeployed resources, and can encompass multiple aspects of utility operations. Consequently, the parties should identify which issues may be best considered in a proceeding with a wide scope, such as a general rate case. Creating limitations on liability through contracts, tariffs, or other means is a well-known technique for businesses such as public utilities to limit their potential financial exposure. The full range of insurance

[6] Assigned Commissioner and Administrative Law Judge Ruling at 7, (December 21, 2009).

> products must be analyzed and a package assembled that is a prudent mix of purchased liability insurance and utility continuing liability. The current application shows increasing retained liability in the form of deductibles or other retained obligations. Self-insurance is another approach that has been suggested for the utilities to consider. This approach, where a utility would set aside a sum as a protection against a potential loss, is more accurately described as risk retention because no external insurance is involved. Extensive analysis of wildfire probability and potential liability would be critical to demonstrate the soundness of this approach to risk management, and to quantify any funding amount to be included in regulated revenue requirement. Any self-insurance proposal must also properly align utility financial and operational incentives to reduce the need to call upon self-insurance or risk retention funds. Finally, although we have discussed traditional utility approaches to risk management, we do not intend to exclude innovative approaches. So long as our central goals of risk reduction and revenue requirement limitation are achieved, we are open to considering other approaches.

Thus the remaining applicants were instructed that the initial application failed to meet the Commission's requirements and that substantial revisions were necessary. The issues to be addressed included the potential for limitless costs to be assigned to ratepayers as well as proper incentives for risk management and safety regulation compliance.

The assigned Commissioner, when determining the scope of this proceeding, reiterated that the burden was on the applicants to demonstrate that they had addressed all factual and legal issues necessary to justify the proposed balancing account, and that the proposed rates would be just and reasonable.

As set forth above, the remaining applicants have made no meaningful effort to remedy the deficiencies identified in the rulings. Ratepayers remain subject to limitless potential liability for uninsured damages to third parties. No financial or operational incentives for management to reduce the risk of wildfires have been proposed.

Moreover, SDG&E's presentation included the admission that it currently has available an alternative ratemaking opportunity to seek Commission authorization to recover uninsured third-party liability for wildfire costs from ratepayers, namely, the Z-factor memorandum account and application. In fact, SDG&E has recorded its uninsured 2007 wildfire costs in both the Z-factor memorandum account <u>and</u> the memorandum account established for this proposed balancing account. This fact, on its face, demonstrates conclusively that SDG&E has available options for seeking Commission authorization to allocate uninsured wildfire costs to ratepayers. This fact substantially undermines the applicants' claim of necessity for the proposed balancing account.

Therefore, we conclude that the remaining applicants have not met their burden and that the application should be dismissed.

5. Comments on the Proposed Decision

Comments on the proposed decision and alternate proposed decision were filed on November 5, 2012, with reply comments filed on November 13, 2012. SDG&E and SoCalGas opposed the proposed decision and the alternate proposed decision, arguing that only the wildfire mechanism as set forth in the application met the requirements of due process and California statute. The Center for Accessible Technology, TURN, DRA, and CPSD supported the proposed decision. The Alliance also supported the proposed decision and requested that the Commission hold its meeting to decide this matter in San Diego.

All opening and reply comments have been fully considered and no substantive revisions have been made to the proposed decision.

6. Assignment of Proceeding

Timothy Alan Simon is the assigned Commissioner and Maribeth A. Bushey is the assigned ALJ in this proceeding.

Findings of Fact

1. The assigned Commissioner and Administrative Law Judge rulings identified serious deficiencies in the initial application.
2. In their amended application, the remaining applicants did not meaningfully address the deficiencies identified in the initial application.
3. The amended application continues to provide for unlimited potential for uninsured wildfire costs to ratepayers.
4. The amended application does not create incentives to reduce the risk of wildfires.
5. SDG&E admitted that other ratemaking mechanisms are available under which SDG&E may seek recovery of uninsured wildfire costs from ratepayers.

Conclusions of Law

1. Remaining applicants have not met their burden of demonstrating that they had addressed all factual and legal issues necessary to justify the proposed balancing account, and that the proposed rates would be just and reasonable.

2. This application should be dismissed.

O R D E R

IT IS ORDERED that.

1. The application by San Diego Gas and Electric Company and Southern California Gas Company for a Wildfire Expense Balancing Account is dismissed, and the memorandum accounts authorized by Commission Resolution E-4311 are dissolved.

2. Within 10 days of the effective date of today's decision San Diego Gas & Electric Company and Southern California Gas Company shall each file a Tier 1 Advice Letter to remove the Wildfire Expense Memorandum Account from their tariffs. These advice letters shall be effective on filing subject to Energy Division determining that they comply with this Order.

3. Application 09-08-020 is closed.

This order is effective today.

Dated ____________________________, at San Francisco, California.