

In recent years, California has experienced its largest and deadliest wildfires in history, resulting in hundreds of fatalities and more than \$50 billion in damage. The confluence of rising temperatures, less rainfall, and strong winds signal that the annual “wildfire season” is here to stay, and will continue to proliferate. Every year, thousands of Californians are evacuated from their homes, and some return to find their communities burnt to ashes. Amid the tragic loss of life and livelihood has emerged another crisis caused by wildfires: the risk of collapse of the state’s electricity sector.

Per the doctrine of Inverse Condemnation, electric utilities in California—including investor-owned utilities—are strictly liable for any damages caused by their activity or equipment, regardless of fault or foreseeability. Although utilities have always faced strict liability in California, the burden of unlimited and unpredictable costs has become crippling amid the historic rise in wildfires.

Electric utilities cannot independently adjust their rates to recoup losses. Utilities are subject to heavy regulation due to their monopolistic attributes (the high cost of infrastructure has contributed to regional utilities with control over electricity provision in their service areas). While some utilities are government-run, these principles apply equally to investor-owned utilities (IOUs). In order to prevent private utilities from abusing their monopoly status by charging predatory rates, the Public Utilities Commission (PUC) regulates their rates, profits, and practices.

California’s investor-owned utilities, especially Northern California’s Pacific Gas & Electric (PG&E), have been hit hard by liability claims relating to recent fire seasons. For example, PG&E’s equipment was found responsible for the ignition of the [Camp Fire](#) in 2018, which killed 86 people and destroyed 13,600 homes, with estimated liability exceeding \$12 billion. In August of 2018, the California legislature enacted [SB 901](#), allowing utilities to sell bonds and increase rates to cover wildfire damages, so long as the damages were not incurred by the utility’s own negligence, and subject to PUC approval.

After a year and a half of bankruptcy proceedings, PG&E agreed to pay \$24.5 billion in settlements for catastrophic fires in 2017 and 2018. Although the utility may recoup a portion of its losses through rates, the question remains how long the utility and ratepayers can foot the bill for increasingly frequent and severe fires—and how those costs will be allocated among ratepayers, utility corporate shareholders, and other parties.

As an IOU, PG&E must submit a Rate Case to the PUC to initiate the process of increasing rates to recoup liability costs. At Rate Case hearings, which generally take place every three years, administrative law judges (ALJs) consider testimony from the utility, consumer

advocacy groups, and other parties to the proceeding. After considering all proposals and evidence, the ALJ issues a decision to adopt, modify, or deny the proposal. A PUC Commissioner may also sponsor an alternative decision, to be deliberated and voted on at a PUC Voting Meeting. This lengthy process protects the interests of ratepayers and others, but also hinders the agility with which IOUs can recoup the cost of liability and obtain capital for infrastructure improvements.

Transmission infrastructure isn't cheap to maintain or replace, but investing in wildfire resilience is critical to mitigating liability. After facing \$4 billion in liability for the Woolsey fire, Southern California Edison (SCE), another IOU, preemptively replaced more than 500 miles of power lines with covered conductor technology to prevent ignitions. The utility also installed fast-acting fuses at more than 10,000 locations to reduce electrical current when a wire is down and plans to have covered conductor technology on 4,500 miles of lines by the end of 2022.

Despite its attempts to minimize risk, however, SCE's [credit ratings](#) have been downgraded as a result of the uncertainty surrounding wildfire liability. Thus, capital has become more expensive for the utility to obtain, creating a hindrance to investing in infrastructure improvements. Last year, SCE requested to adjust its cost of capital and increase rates. The reasons for SCE's [request](#) were: (1) to reduce the risk from wildfires; (2) to reinforce grid reliability and resiliency in case of emergency; and (3) to integrate distributed energy resources. If approved by the PUC, the average residential monthly bill is projected to increase by \$14 in 2021, \$4 in 2022, and \$6 in 2023. Unfortunately, these rate increases coincide with an unprecedented blow to Californians' livelihoods due to the pandemic.

Some look to the municipally-owned utility (Muni) model as a preferred avenue to recoup losses and secure capital. As a Muni, the Los Angeles Department of Water and Power (LADWP) does not apply to the PUC to adjust rates, and instead presents its case to the Los Angeles City Council. Unlike the PUC, the city may use its taxing authority to spread costs and protect itself from the uncertainty facing IOUs. As such, LADWP's [credit ratings](#) have not been affected by wildfire liability, and capital is much more accessible.

California's legislature has considered the possibility of transforming PG&E into a public entity, and using eminent domain to take over its operations and infrastructure. Effective January 1, 2021, [SB 350](#) authorizes the creation of a new nonprofit public benefit corporation, Golden State Energy, to acquire PG&E if the PUC finds that PG&E's license to operate as an electrical utility should be revoked, for reasons including management of wildfire liability. However, it remains unclear how or whether the public/nonprofit model would actually manage liability more effectively than heavily regulated IOUs. As a nonprofit

corporation, the entity would not enjoy the taxing authority that protects LADWP's credit, and would remain governed by the PUC. The entity would, however, have permission to recover fines and penalties through rates approved by the commission, which other utilities are prohibited from doing. This access to recovery may help protect the entity's credit, but it is still the ratepayers who will ultimately incur the cost of liability.

In an attempt to spread liability across the state, [AB 1054](#) established a wildfire fund worth \$21 billion, funded equally by utility customers and shareholders. IOUs that obtain annual safety certifications may opt in to this fund to pay for damages that exceed insurance coverage. Private utilities are required by state law to have reasonable insurance coverage, which can be recovered by rates. Wildfire insurance is extremely expensive, however, and contributes to the growing burden borne by customers. For one year of [coverage](#), SCE paid \$450 million to secure a \$1 billion policy, and PG&E had to pay \$750 million to secure a \$1.4 billion policy (only half of which is for wildfire liability). While AB 1054 helps mitigate liability, it is unlikely to prevent additional cost recovery through rates.

Some advocates argue that scrapping the doctrine of Inverse Condemnation would most effectively reduce the risk of bankruptcy and decrease the cost of capital for utilities. Former Gov. Jerry Brown attempted to change the doctrine to a fault-based standard, but failed to overcome opposition from wildfire victims, insurance companies, and lawmakers. Although a fault-based standard would reduce utilities' liability and the uncertainty that plagues their credit, it would also reduce access to recovery for wildfire victims. At the root of the issue is a question of values that must be answered: who, if anyone, should be responsible for compensating victims of catastrophes where there is no finding of fault, and any strategy for compensation will impose massive costs on some class of people or entities?

While there are arguments in favor of a fault-based system to relieve the financial pressure on utilities, the arguments against such a change are also quite strong. If utilities weren't strictly liable for these fires, then other innocent parties, or their insurers, would be. The most likely outcome of a fault-based standard would be the assumption of liability by insurers of homes and businesses, without the reimbursement that utilities collect through rates. Although the Wildfire Fund is designed for insurers to be its primary claimants, the pressure of wildfire liability on the insurance industry would cause higher insurance rates, and potentially the insolvency of insurers, with tremendous impacts on business and homeowner access to capital.

Moreover, if California were to use a fault-based standard, it would rely on tax revenue to compensate victims of fires where there is no showing of fault. The California legislature has very rarely imposed new taxes in recent years, and such proposals are subject to a 2/3

vote by both houses. Although a public-recovery model may reduce the uncertainty that downgrades utilities' credit and reduces their access to capital, it would shift the burden from utilities and ratepayers to victims and insurers (and their ratepayers), which has proven unpopular among state leaders.

If lawmakers were to replace strict liability with a negligence standard, the flood gate could open for litigation, only adding to financial crises caused by the fires. Negligence is so challenging and expensive to prove, and the stakes are so high, that every major fire would result in a lengthy legal battle, further preventing a swift recovery for victims. Moreover, the outcomes of negligence cases are so unpredictable that utilities' credit would remain at risk of being downgraded, and the fundamental issue is not likely to be resolved.

Thus, there is no clear solution to the challenge that utility liability for wildfire poses. The new state compensation fund will help: it is designed to provide similar incentives to a fault or negligence-based system, without the downsides, by making eligibility contingent on utilities engaging in best practices to mitigate wildfire risk. A recovery model that rewards risk mitigation is practical, but comes at its own costs. In 2019, PG&E was condemned for [shutting off](#) power to more than 2 million residents across 38 counties to prevent ignitions from load-bearing infrastructure during high-risk conditions. On August 13, 2020, PG&E hosted a virtual [meeting](#) to ensure regulators that the disruptive outages of 2019 would not happen again. However, many customers experienced rolling outages following that meeting, amid high-risk weather conditions that sparked a new wave of wildfires. As precautionary measures like rolling outages become part of California's "new normal," the state faces the challenge of ensuring that its most vulnerable are not displaced without critical resources, like electricity, on hot days. Other limitations on the new compensation fund include its financial capacity, which—while significant—may not be sufficient to cover all the wildfire-related costs utilities must bear.

An effective management plan for wildfire liability will be critical to California's ability to achieve its ambitious Renewable Portfolio Standard (RPS), the driver of the state's efforts to reduce greenhouse gas emissions. California's RPS program requires utilities to increase energy procurement from eligible renewable energy resources, with the goal of 60% of total procurement by 2045, and complete decarbonization by 2045. The program also requires large utilities, like LADWP, to include plans for energy storage, transportation electrification and demand response. Regardless of governance model, every utility relies on access to capital to divest from legacy hydrocarbons and invest in renewables, storage, and grid modernization.

Utilities are facing insurmountable pressure to withstand unprecedented liability, invest in

wildfire resilience, and decarbonize the electric grid. In the short term, transforming the electricity sector into a more resilient system will likely involve a hybrid of cost recovery through rates and insurance, and some level of state intervention to ensure access to capital for IOUs. In the long term, IOUs may be forced to transition toward the Muni model of governance, in order to maintain access to capital amid unpredictable liability. Distributed energy - especially residential solar and storage - will likely play a critical role in wildfire resilience, and ultimately shape the future of the state's electricity sector. California is grappling with the unprecedented, but when the dust settles, the state's grid will be more resilient, and utilities will be in a better position to protect and serve their customers.

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