Date of Hearing: April 20, 2022

ASSEMBLY COMMITTEE ON UTILITIES AND ENERGY
Eduardo Garcia, Chair
AB 2937 (Calderon) – As Amended April 7, 2022

SUBJECT: Electrical corporations: financing orders: wildfire mitigation and climate adaptation costs and expenses

SUMMARY: Authorizes broad categories of costs and expenses arising from electrical investor-owned utility (IOU) work to be eligible for recovery through bonds that are secured by a fixed customer charge (securitization) if the California Public Utilities Commission (CPUC) determines the costs and expenses are just and reasonable. Additionally changes the conditions that must be satisfied for bonds to be eligible for securitization. Specifically, **this bill**:

1) Allows costs and expenses related to the IOU's wildfire mitigation plan, climate adaptation (as defined), or incurred as a result of 2018 catastrophic wildfires to be eligible for recovery through securitization, if the CPUC determines the costs and expenses are just and reasonable. Specifies operational and maintenance expenses associated with these costs and expenses are likewise eligible.

2) Defines "climate adaptation costs and expenses" as those incurred by an IOU to adapt to climate change and to mitigate the impacts of future climate change, including but not limited to, costs and expenses that benefit greenhouse gas emission reduction efforts, utility system preparedness and adaptation efforts, and climate resiliency efforts.

3) Mandates the CPUC presume a financing order provides short-term rate stability in the public interest if the CPUC has authorized an amortization period in excess of 12 months for the just and reasonable costs.

4) Modifies the conditions the securitized bond must satisfy in order to receive authorization from the CPUC. The new conditions may be satisfied if the bond provides short-term rate stability, as defined, or reduce, to the maximum extent possible, the rates that IOU customers would pay as compared to a traditional IOU financing mechanism. Previously, the securitized bond must have reduced the rates the IOU customers would pay as compared to a traditional IOU financing mechanism.

EXISTING LAW:

1) Requires that all charges demanded or received by any public utility for any product, commodity or service be just and reasonable, and that every unjust or unreasonable charge is unlawful. (Public Utilities Code § 451)

2) Prohibits a public utility from issuing bonds, or any form of indebtedness at periods of more than 12 months, unless first authorized by the CPUC. (Public Utilities Code § 818)

3) Permits the CPUC to allow for the recovery of costs and expenses arising from a covered wildfire occurring after January 1, 2019, if the CPUC finds the costs and expenses just and reasonable. Establishes a standard of reasonable conduct of an IOU, for purposes of cost recovery, based on whether a reasonable utility would have undertaken the action in good faith under similar circumstances. Specifies the IOU bears the burden to demonstrate that its conduct was reasonable, unless it has a valid safety certificate; at which point, the IOU's conduct is deemed reasonable unless a third party creates serious doubt as to the reasonableness of the IOU's conduct. (Public Utilities Code § 451.1)

4) Authorizes an IOU to request the CPUC issue a financing order to authorize the recovery, through securitization, of costs and expenses related to a catastrophic wildfire (with an ignition date in 2017 or after January 1, 2019) or undercollection amounts accrued in 2020. (Public Utilities Code § 850)

5) Specifies the conditions that must be satisfied, as determined by the CPUC, for recovery bonds eligible for securitization. These conditions include that the costs to be recovered in bonds are just and reasonable, the bonds are consistent with the public interest, and the bonds reduce (to the maximum extent possible) the rates consumers would pay compared to traditional financing mechanisms. (Public Utilities Code § 850.1)

6) Authorizes an IOU to request securitization of costs and expenses from 2017 wildfires that were either determined by the CPUC as recoverable from ratepayers or disallowed by the CPUC for rate recovery but in excess of a CPUC determination of the maximum amount the IOU can pay without harming ratepayers or materially impacting its ability to provide service. This CPUC determination was known as the "stress test" or "customer harm threshold." (Public Utilities Code § 451.2)

7) Authorizes an IOU to request securitization to finance its share of the first $5 billion of approved wildfire mitigation capital expenditures and the debt financing costs of those expenditures. Prohibits the CPUC from allowing the large IOUs to earn a return on equity on the mandated fire risk mitigation capital expenditures. (Public Utilities Code § 8386.3)

8) Authorizes the CPUC to issue a financing order for securitized bonds to finance the unamortized balance of the regulatory asset awarded to Pacific Gas and Electric Company (PG&E) following the energy crisis. (Public Utilities Code § 840)

FISCAL EFFECT: Unknown. This bill is keyed fiscal and will be referred to the Committee on Appropriations for its review.

BACKGROUND:

What is Securitization – To securitize a utility bond means to tie a rate collection mechanism—usually a fixed charge on utility customer bills —to the issued bond. (i.e. an asset-backed security). Because securitized bonds are backed by dedicated ratepayer charges, borrowing costs for the long-term debt is usually more favorable. These bonds—like any bond—are used to spread out the recovery of large electric IOU costs over many years in order to reduce the immediate impact on ratepayers.

The Legislature has provided the CPUC with statutory authority to issue "financing orders" that commit electric ratepayers to paying fixed charges on their bills to support an electric IOU bond issuance.[1] Once a financing order is issued, electric IOU ratepayers must pay principal, interest, and other costs of the bonds until those bonds are fully paid off (amortized). These fixed charges are assessed on all bundled and unbundled ratepayer bills. Since a financing order is an unavoidable commitment to charge ratepayers for bond costs until the bonds are fully paid off, these bonds generally yield low interest rates in comparison to unsecured bonds.

Securitization in Action – SB 901 (Dodd, Chapter 626, Statutes of 2018) and AB 1054 (Holden, Chapter 79, Statutes of 2019), allowed financing and securitization of costs and expenses that are approved by the CPUC as just and reasonable and related to catastrophic wildfires occurring in either 2017 or in or after 2019. The securitization authority specifically includes, but is not limited to, $5 billion of "fire risk mitigation capital expenditures" the large electric IOUs are required to spend. Additionally, AB 913 (Calderon, Chapter 253, Statutes of 2020) allowed securitization of COVID-19 undercollections.

In 2021, the CPUC issued several financing orders authorizing the issuance of recovery bonds for the electric IOUs:

- In May 2021, the CPUC issued a financing order authorizing PG&E to issue recovery bonds for $7.5 billion to fund costs related to the 2017 North Bay Wildfires. [2]
- In June 2021, the CPUC issued another financing order[3] for PG&E to issue $1.2 billion in Wildfire Hardening Recovery Bonds to finance fire risk mitigation plan capital expenditures authorized by Public Utilities Code § 8386.3(e).
- In October 2021, the CPUC issued a financing order[4] for Southern California Edison (SCE) to issue bonds to recover approximately $526 million in wildfire-related capital expenditures. The CPUC denied SCE's request for operations and maintenance (O&M) expenses to be recovered through this financing order.

O&M Costs versus Capital Expenditures –O&M expenses are generally pass-through costs and collected in rates over the course of a year, as forecasted during electric IOU general rate cases. These expenses include all labor and non-labor expenses for the operation and maintenance of utility infrastructure, as well as general administrative expenses. They also do <u>not</u> have a profit mark up to shareholders. O&M expenses are meant to provide short-term benefits; such as maintenance to a powerplant which provides benefits within the year of that maintenance

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[1] See Public Utilities Code §§ 850, 451.2, and 8386.3
[2] D. 21-05-015
[3] D. 21-06-030
[4] D. 21-10-025

(O&M).[5] The O&M expenses are matched to the ratepayers that are paying for them, avoiding intergenerational equity issues (i.e., seeking to avoid a ratepayer 20 years from now paying for work that only benefitted a ratepayer today). There is also no need to incur financing costs (from bonds) since they are short expenses recovered in rates annually. One downside of traditional O&M cost recovery is that if a large O&M expenditure arises, ratepayers must absorb the entire costs in their rates in a single year. This could lead to rate shock and other bill volatility issues, such as large increases one year and potential decreases the next.

In contrast to O&M expenses, capital expenditures for long-lived assets are financed over a period greater than one year. Capital expenditures are typically included in an electric IOUs' calculation for determining their profit, and are financed over the useful life of the assets. Bonds—either traditional or securitized—are typically taken out to fund capital projects. The upside to this method is it matches the benefits received from the capital expenditures with the same time-period of the financing from the ratepayers receiving the benefits (i.e. an asset with a 30 year lifetime could be financed on a 30 year loan). This also allows very large capital expenditures, which can be expensive to finance, to be spread out over time. However, the total costs associated with recovery from bonds will be larger than the annual pass-through recovery of typical O&M expenses. This is due to bond issuance having not only the principal but interest, utility profit, and taxes accruing as part of the bond financing.

COMMENTS:

1) *Author's Statement.* According to the author, "In an effort to achieve greater rate stabilization for electric utility ratepayers, AB 2937 will allow an electric utility to request authorization from the California Public Utilities Commission for the securitization of their operation and maintenance of climate adaptation and wildfire mitigation efforts. With an increase in more prolonged destructive wildfires, mega-droughts, and other serious effects of climate change, it is imperative that all financing mechanisms be made available so that electric utilities can continue investing in important climate adaptation efforts, and not subject California families to significant electric bill spikes."

2) *Impact of Wildfire Costs on Customer Rates.* As highlighted in many discussions—most recently in this Committee's informational hearing on March 30, 2022—California's electric rates are increasing and forecasted to continue to increase at an alarming pace. According to the CPUC's 2021 *Utility Costs and Affordability of the Grid of the Future*

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[5] whereas the powerplant itself provides benefits for the lifetime of its generation (capital expenses)

Report,[6] electric costs have been on the rise, with wildfire mitigation efforts expected to contribute to significant rate growth in the near term.[7]

SB 901 (Dodd, Chapter 626, Statutes of 2018) and AB 1054 (Holden, Chapter 79, Statutes of 2019) permitted the IOUs to open accounts in 2019 to track spending to implement their wildfire mitigation plans (WMPs). The IOUs are allowed to seek recovery of this spending in their general rate cases or through a separate application, after the conclusion of the period covered by the WMP. Therefore, there is lag between when spending takes place and when it is reflected in rates.

Table 1 shows spending related to the WMPs that is reflected in 2019 and 2020 rates. These values are likely minimal compared to increases expected in future years but do demonstrate the large (relative to capital expenses) O&M costs associated with wildfire work. As an example, vegetation management (tree trimming) is a type of O&M expense; whereas undergrounding of electric lines would be a capital expense.

Table 1: Wildfire Mitigation Plan Costs in Rates ($ millions)[8]

	2019		**2020**	
	O&M	Capital	O&M	Capital
PG&E	-	13.7	20.3	15.8
SCE	33.9	3.0	173.1	82.4
SDG&E	25.8	-	28.3	-

According to responses from the large IOUs, wildfire O&M has increased over the past decade. For SDG&E, this increase has been approximately 35-40% just from 2019-2021, and is forecasted to continue to rise largely due to wildfire mitigation expenses.[9]

3) *CPUC Denial of O&M in Bonds.* As mentioned previously, capital expenditures are typically financed through bonds. Once adopted by the CPUC, the fixed ratepayer charges used to pay for securitized bonds must be collected until bonds are fully paid off. As a result, bond charges take up space in customer rates for long periods of time. For example, the securitized bonds issued in 2003 to cover some of the costs from the energy

[6] Submitted pursuant to SB 695 (Kehoe, Chapter 337, Statutes of 2009); "Utility Costs and Affordability of the Grid of the Future: An Evaluation of Electric Costs, Rates, and Equity Issues Pursuant to P.U. Code Section 913.1," CPUC, February 2021.
[7] Pg. 7, *Ibid.*
[8] Pg. 33, *Ibid.*
[9] Data request from Committee to PG&E, SCE, and SDG&E, April 2022.

crisis were finally paid off in September 2020.[10] Bonds are more expensive, over the long term, but do help smooth cost spikes that could adversely impact customer bills.

The CPUC thus weighs for each IOU application whether bond financing will provide short-term and long-term economic benefits to ratepayers. In October 2021, when considering SCE's application to recover various wildfire-related capital expenditures, certain O&M expenses, and certain uncollectible COVID-19 arrears, the CPUC approved bonds for some, but not all, of the requested costs. Specifically, the CPUC denied securitized bonding for O&M expenses, noting: "*We find that the time-value-of-money benefits associated with securitizing the O&M expenses over a 25-year bond term is* ***substantially outweighed*** *by associated financing costs and higher utility rates for future customers.*"[11] The CPUC goes on to note that adjustments to conventional rate recovery approaches, such as paying off O&M over three years (versus the traditional one year term), can help ease bill shock concerns while not obligating ratepayers to a 25-year bond for costs that only benefit current ratepayers.

This bill reverses this CPUC decision by explicitly including O&M cost as eligible for securitization and by changing the factors the CPUC must weigh when deciding whether a bonds provides economic benefits to ratepayers. Specifically, this bill no longer requires that bonds must reduce rates (as compared to traditional financing). Instead, this bill requires only that the bonds provide short-term rate stability, which is presumed as being met—per the language in the bill—if the CPUC has authorized the costs to be paid off over more than a year. This is a dangerously low bar; all securitization could be considered as providing "short-term rate stability" under this definition, as all bonds are on terms longer than a year. This could have the effect of endorsing an expensive transaction solely on the grounds that it is rate smoothing in the near-term, despite higher long-term overall costs.

The author has noted her intent is to clarify that O&M is eligible for securitization, given the recent and projected increases in these costs, largely from wildfire mitigation efforts. Providing the CPUC with more tools to ease the cost burden on ratepayers is aligned with broader efforts of this Committee, however, such tools must be used judiciously to minimize unintended consequences. This bill upends a CPUC ratemaking decision. When the Legislature modifies such decisions, it is like pulling a brick out of a wall. You cannot touch one aspect of the rate structure without creating a ripple effect across the entire edifice; we just don't know where or what. *As such, the Committee may wish to consider amending this bill to modify the presumption of public interest, and retain the consideration that securitized bonds must reduce rates.*

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[10] At which point the DWR bond charge expired, but an equivalent charge to support the participation of large IOUs in to the Wildfire Fund was established pursuant to AB 1054 (Holden, Chapter 79, Statutes of 2019).
[11] Pg. 27-28, D. 21-10-025.

4) *Is Everything Climate Adaptation?* This bill additionally permits costs and expenses for "climate adaptation" work—both capital and O&M—to be eligible for securitization. The bill defines "climate adaptation costs and expenses" as any that are incurred to "adapt to climate change and to mitigate the impacts of future climate change," including those which "benefit greenhouse gas emission reduction efforts, utility system preparedness and adaptation efforts, and climate resiliency." This definition is so broad as to include any and all utility work.

   The Committee has requested more clarity from the utilities on what work they seek to be recoverable under this definition. The utility responses have largely focused on future O&M costs related to wildfire. *In an effort to capture the costs and expenses that are leading to current rate pressure without permitting all utility expenses to be securitized, the Committee may wish to consider striking the inclusion of "climate adaptation" in the bill, while retaining wildfire and wildfire mitigation costs and expenses.*

5) *2018 Wildfire Securitization.* SB 901 (Dodd, Chapter 626, Statutes of 2018) permitted securitization of 2017 wildfire costs in circumstances where the CPUC either 1) determined the costs were just and reasonable, or 2) the costs were not just and reasonable but did exceed a maximum dollar amount the CPUC determined was the limit above which the IOU could not pay without harming ratepayers or materially impacting its ability to provide service. This CPUC determination was known as the "stress test" or "customer harm threshold."

   AB 1054 (Holden, Chapter 79, Statutes of 2019) permitted securitization of wildfires after January 1, 2019. For these fires, a standard for cost recovery —known as the "prudent manager standard"— was adopted. Under this standard, reasonable conduct of an IOU, for purposes of cost recovery, is based on whether under similar circumstances a reasonable utility would have undertaken the action in good faith. Traditionally, if the IOU submits an application for cost recovery, the burden of proof is on the IOU to demonstrate it has behaved reasonably. However, under the new standard, if the IOU has a valid safety certificate then the IOU's conduct is deemed reasonable unless a third party creates serious doubt as to the reasonableness of the IOU's conduct; at which point, the burden shifts back to the utility to dispel the doubt and prove its conduct was reasonable.

   This bill permits securitization of costs and expenses arising from 2018 catastrophic wildfires, a period of coverage currently not mentioned in statute. This period of time covers the Woolsey fire in Edison territory and the Camp fire in PG&E territory, among other fires. This bill does not, however, explicitly choose either the SB 901 or AB 1054 standards of review for cost recovery. Rather, eligibility depends on the CPUC finding an IOU's application of costs to be reasonable. It is unclear to the Committee how the utilities plan to use this provision or to which fires they seek to apply it. While the ultimate determination remains with the CPUC, this provision, as written, would permit the utilities to seek securitization of costs for fires – such as the Camp and Woolsey – where penalties in the millions of dollars have been levied for the utilities' actions.

6) *Prior Legislation.*

AB 913 (Calderon) authorizes the CPUC to approve the securitization by electric IOUs of undercollection of utility bill amounts for the year 2020. Additionally, the measure aligns the "eligible claims" period with a utility's insurance policy period for purposes of wildfire related claims. Status: Chapter 253, Statutes of 2020.

AB 1054 (Holden), among its many provisions, authorizes the issuance of financing orders for the recovery of costs and expenses related to catastrophic wildfires (in 2019 and after). Also permits securitization of fire risk mitigation capital expenditures associated with the IOU's proportionate share of $5 billion in safety improvements. Status: Chapter 79, Statutes of 2019.

SB 901 (Dodd) among its many provisions, authorizes the issuance of financing orders to finance costs, in excess of insurance proceeds, incurred, or that are expected to be incurred, by an electrical corporation, excluding fines and penalties, related to 2017 wildfires. Status: Chapter 626, Statutes of 2018.

REGISTERED SUPPORT / OPPOSITION:

Support

Edison International and Affiliates, Including Southern California Edison
Sempra Energy Utilities

Opposition

None on file.

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