

Date of Hearing: June 20, 2018

ASSEMBLY COMMITTEE ON UTILITIES AND ENERGY

Chris Holden, Chair

SB 819 (Hill) – As Amended June 13, 2018

SENATE VOTE: 39-0

SUBJECT: Electrical and gas corporations: rates

SUMMARY: Prohibits an electrical or gas corporation (IOU) from recovering fines, penalties and specified liability expenses through rates. Specifically, **this bill:**

- 1) Prohibits an IOU from obtaining rate recovery for a fine or penalty.
- 2) Prohibits an IOU from obtaining rate recovery for uninsured expenses that are incurred as a result of the IOU's failure to reasonably construct, maintain, manage, control, or operate an IOU electric or gas plant, and, the unreasonable act or omission by the IOU increased the risk of the plant causing those damages.
- 3) Restricts a CPUC determination of whether an IOU incurred damages because of its failure to act reasonably from admissibility in a court action for damages brought against the IOU.
- 4) Permits an IOU to receive rate recovery for all, or a portion of, costs or expenses deemed just and reasonable.
- 5) Expresses the intent of the Legislature that:
 - a. The bill not limit or alter the CPUC's authority or obligations under current law including the authority to require that all charges be just and reasonable and that each IOU demonstrate to the CPUC that all costs that the IOU seeks to recover have been reasonably and prudently incurred; and
 - b. When the bill takes effect, the CPUC was already authorized to calculate liability and to allocate costs or expenses in full or in part, if the full or partial approval of the costs or expenses was just and reasonable, when the CPUC ruled on an application by an IOU seeking to recover costs or expenses.

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) Provides the CPUC with general, broad authority to regulate every public utility in the state. (Public Utilities Code § 701)

- 3) Requires the CPUC if, after a hearing, it finds that the rates charged or collected by any public utility are insufficient, unlawful, unjust, unreasonable, discriminatory, or preferential, to determine and fix, by order, the just, reasonable, or sufficient rates, classifications, rules, practices, or contracts to be thereafter observed and in force. (Public Utilities Code § 728)
- 4) Provides for the imposition of fines and penalties on public utilities for various violations of the Public Utilities Code. (Public Utilities Code § 2100 et seq.)
- 5) Prohibits a gas corporation from recovering any fine or penalty in any rate approved by the CPUC. Each gas corporation is required to demonstrate to the satisfaction of the CPUC, in its general rate case proceeding, that the requested revenue requirements will be sufficient to enable the gas corporation to fund those projects and activities necessary to maintain safe and reliable service and to meet federal and state safety requirements applicable to its gas plant, in a cost-effective manner. (Public Utilities Code § 959)
- 6) Restricts an order or recommendation arising from a CPUC investigation of an accident, or the accident report filed by an IOU with the CPUC, from being admitted as evidence in any action for damages based on or arising out of loss of life, or injury to person or property. (Public Utilities Code § 315)
- 7) Defines a gas plant as including all real estate, fixtures, and personal property, owned, controlled, operated, or managed in connection with or to facilitate the production, generation, transmission, delivery, underground storage, or furnishing of gas, natural or manufactured, except propane, for light, heat, or power. (Public Utilities Code § 217)
- 8) Defines an electric plant as including all real estate, fixtures and personal property owned, controlled, operated, or managed in connection with or to facilitate the production, generation, transmission, delivery, or furnishing of electricity for light, heat, or power, and all conduits, ducts, or other devices, materials, apparatus, or property for containing, holding, or carrying conductors used or to be used for the transmission of electricity for light, heat, or power. (Public Utilities Code § 217)

FISCAL EFFECT: According to the Senate Appropriations Committee, under Senate Rule 28.8 the bill was found to cause no significant reduction in revenues or additional state costs are not significant and do not require the appropriation of additional state funds.

BACKGROUND:

Impacts of Inverse Condemnation – The California Constitution provides the basis for recovery against government entities and public utilities via the theory of inverse condemnation. That section requires that just compensation be paid when private property is taken or damaged for public use. The policy underlying the concept of inverse condemnation is that the costs of a public improvement benefiting the community should be spread among those receiving the benefit, as opposed to being allocated to a single person within a community.

Unlike negligence, inverse condemnation does not require a showing of fault, the breach of a standard of care or foreseeability of harm. Instead, any actual physical injury to real property proximately caused by a public improvement as deliberately designed and constructed is compensable under the California Constitution, whether or not the injury was foreseeable. Thus, a governmental agency is strictly liable, irrespective of fault, where a public improvement constitutes a substantial cause of plaintiff's damages. The courts have expanded inverse condemnation liability to include privately owned public utility companies transmitting power.

Because an IOU will ultimately be held responsible for all damages caused by its distribution or transmission lines (gas or electric), the trial courts do not generally consider whether the IOU acted reasonably (was negligent). Instead, the IOU is held strictly liable for all property damages and attorney's fees.

The San Diego Fires – The issue of inverse condemnation has been applied to utilities for decades but the issue was elevated this year due to the tragic coincidence of the 2017 wildfires and a 2017 CPUC decision on fire liability stemming from 2007 fires in San Diego.

Last fall the CPUC issued a final decision resulting from an application filed by San Diego Gas & Electric (SDG&E) seeking to recover \$387 million from ratepayers. This represented a portion of a total \$2.4 billion in costs and legal fees incurred by SDG&E to resolve third-party damage claims arising from the Witch, Guejito and Rice wildfires in San Diego in 2007. When translated into typical residential rates, the costs would have resulted in an increase of \$1.67 per month, per customer when amortized over six years. Inverse condemnation was applied to the cases. The courts did not consider whether SDG&E acted reasonably.

Review of IOU expenses is routine by the CPUC which uses the long-standing statutory review of whether the expense was “just and reasonable” to gauge whether the expense should be recoverable in rates. For recovery of expenses incurred as a result of third-party litigation, the CPUC also determines whether building that outside cost recovery is just and reasonable. CPUC practice (via historical decisions) has further clarified this reasonableness review to hinge on two points: 1) the burden of proof is on the IOUs; and, 2) the IOUs must show that they were “exercising best practices of the era, and using well-trained, well-informed and conscientious employees who are performing their jobs properly.” “Best practices” is often an elusive term, which the IOUs claim is a perfection standard, but is based upon cost effectiveness, safety, and expedition. The CPUC, in their role as judges, exercises the authority and considers “best practices” on a case-by-case basis.

Utilizing this “best practices” standard which has also been referred to as “prudent manager” the CPUC in the fall of 2017 rejected cost recovery for SDG&E of \$387 million from the 2007 fires. The scoping ruling specifically referenced a prior decision¹ in which the CPUC held that for costs to be found reasonable, the IOU must prove that they were:

...prudently incurred by competent management exercising the best practices of the era, and using well-trained, well-informed and conscientious employees who are performing

¹ See D.14-06-007.

their jobs properly...[T]he Commission can and must disallow those costs: that is unjust and unreasonable costs must not be recovered in rates from ratepayers.

The scoping ruling further stated that this standard is consistent with the CPUC's obligation under current law to ensure that resulting rates will be just and reasonable and that service is provided in a safe manner.

COMMENTS:

- 1) Author's Statement. SB 819 ensures California's electric corporations cannot pass costs borne by utility negligence to ratepayers. Fines and penalties are already not recoverable in rates for gas corporations; this bill extends these protections to electric ratepayers. This bill goes further by affirming the CPUC's authority to apply a reasonableness review to utility requests for cost recovery. The reasonableness review is a historical practice at the CPUC, and protects ratepayers from utility negligence while incentivizing utilities to invest in safe equipment and operations.
- 2) Liability Exposure. The issue of utility liability and inverse condemnation has been elevated due to the tragic coincidence of the fall decision which reviewed SDG&E cost recovery and the many wildfires in 2017. The IOUs are likely to have extensive financial liability due to the application of inverse condemnation in the event that the fires were caused by utility distribution or transmission lines, regardless of negligence. Review of IOU expenses is routine by the CPUC which uses the long-standing review of whether the expense was "just and reasonable" to gauge whether the expense should be recoverable in rates.

The CPUC discussed inverse condemnation in its decision on the SDG&E proceeding. Two commissioners filed a concurrence in that decision with the following comment:

We respectfully urge the California Legislature to affirmatively address the issues of liability calculation and cost allocation in instances when utility infrastructure is implicated in private property loss. We also respectfully urge the California Courts of Appeal to carefully consider the rationale for applying inverse condemnation in these types of cases.

- 3) Words Matter. The author states his intent is to codify the CPUC's existing practice of review of just and reasonable when evaluating whether it should allow liability costs, generally stemming from the application of inverse condemnation, to ratepayers. Current practice by the CPUC uses what they frame as a "prudent manager standard" to consider...It provides that:

The IOU must prove that the costs were prudently incurred by competent management exercising the best practices of the era, and using well-trained, well-informed and conscientious employees who are performing their jobs properly...[T]he Commission can and must disallow those costs: that is unjust and unreasonable costs must not be recovered in rates from ratepayers.

The author represents that this bill codifies the standard used but the standard in the bill looks nothing like the prudence standard used by the CPUC. Although it also expresses legislative intent that this bill is not intended to change the CPUC's standard, a plain reading of bill leaves a different impression.

The CPUC has yet to comment on this bill. If the bill is approved by this committee, it will be referred to the Assembly Judiciary Committee for its consideration. Going forward, the author should work with learned counsel and the CPUC to determine whether he has accurately captured his intent which we understand to be to codify the CPUC's current standards of review when considering the impact on ratepayers stemming from civil litigation.

- 4) Binary Choice. But at least two commissioners opine that the CPUC's current standard of review leaves them with an up or down vote on approving all costs or none, stating that they find this "to be a binary choice of determining prudence in the aggregate, [which] could be improved upon to explicitly allow a more nuanced assessment of fault."

The complexity of that decision reflected in the record in this case demonstrates the challenge of applying a prudence standard, which requires us to consider in the aggregate whether SDG&E acted reasonably and make what we consider to be a binary choice whether SDG&E should be able to recover all or none of the costs. The ability to do a more nuanced assessment of fault could be a helpful regulatory tool and we respectfully ask the legislature to consider this issue.

The author's stated intent in this bill is to codify the standard used but allow the CPUC to allow partial recovery of liability costs. The result is that ratepayer exposure to absorbing the costs of liability would be increased under the principle of inverse condemnation and where the CPUC finds that the utility acted prudently.

- 5) Which Dollars? The bill uses several terms to refer to the financial impacts of liability which generally carry different meaning. Damages are generally construed as arising from liability and limited to those costs incurred by third parties. Costs could be damages but could also be the litigation expenses incurred by the IOU, for example attorney fees. The bill uses damages, costs, expenses, and charges. Going forward, the author should clarify his intent.
- 6) There's a Connection. Senate Bill 1088 (Dodd) also before the committee today, consolidates existing maintenance and safety programs into one application filed by IOUs. Once approved by the CPUC, if an IOU is deemed to be in:

...substantial compliance with its approved plan, the commission, to the extent the commission finds it is consistent with the ratepayer protection duties established ...shall find that the utility's performance, operations, management, and investments addressed in the plan are reasonable and prudent for purposes of any subsequent commission proceeding.

It appears that when that action of the CPUC is coupled with the “partial” recovery provisions of this bill, it would be easier for an IOU to pass the costs liability under inverse condemnation onto ratepayers.

- 7) Not Cooked Yet. Like SB 1088, the regulating agency has yet to formalize comments or a position on how these bills would affect programs.
- 8) Related Legislation.

SB 901 (Dodd) Requires a wildfire mitigation plan prepared by an electrical corporation, and wildfire mitigation measures prepared by a local publicly owned electric utility or electrical cooperative, to include: (1) a description of the factors the entity uses to determine when it may be necessary to deenergize its electrical lines and deactivate its reclosers, and (2) procedures for notifying customers, including, critical first responders, who may be impacted by the deenergizing of electrical lines. Status: Set in Assembly Utilities & Energy Committee June 27th

SB 1088, Dodd, 2018 (referred to Com. on Utilities and Energy) Among its other provisions, mandates that once the CPUC determines “substantial compliance” with an approved utility plan the utility’s “performance, operations, management, and investments addressed in the plan are reasonable and prudent for purposes of any subsequent commission proceeding. Status: Set in Assembly Utilities & Energy Committee June 20th

- 9) Prior Legislation.

AB 56, Hill, Chapter 519, Statutes of 2011—among its other provisions, ensured fines or penalties levied on gas corporations could not be recovered in rates.

REGISTERED SUPPORT / OPPOSITION:

Support

California State Association of Counties
Consumer Attorneys of California
The Utility Reform Network

Opposition

None on file.

Letter of Concern

Southern California Edison
Pacific Gas and Electric

Analysis Prepared by: Kellie Smith / U. & E. /