

Ratepayer Impacts of Strict Liability and Inverse Condemnation

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SUMMARY: Now is the time to reassess the way in which we address wildfire liability in the State of California. Inverse condemnation with strict liability has significant implications for California ratepayers. While it provides a mechanism for property owners to hold utilities accountable for wildfire damages, it also places a financial burden on the ratepayers. Given that investor-owned utilities (IOUs) are responsible for most of the state's electricity transmission and distribution, we need to ensure that these utilities operate responsibly and can continue to provide reliable service to ratepayers, while still being held accountable for wildfire damages where they act negligently or imprudently.

Additionally, inverse condemnation with strict liability is not sustainable. We need to develop approaches to address wildfire damages that are broad-based, equitable, and consider fault when assessing liability. More research needs to be done to ensure that resolving wildfire damages do not undermine the reliability of service or long-term affordability and equity for ratepayers. We must be especially sensitive to the cost impacts for low-income customers, medically-vulnerable customers, and residents of areas that have low risk of wildfires.

Below are key recommendations to consider as we begin exploring changes to inverse condemnation and strict liability that protects utility customers.

RECOMMENDATIONS

The Public Advocates Office proposes the following recommendations to begin the discussion to addressing wildfire liability and inverse condemnation with strict liability:

Reform the liability provisions for utilities operating under inverse condemnation. Currently under inverse condemnation with strict liability, ratepayers can be liable for damages even where the utility's actions did not cause the wildfire. We recommend moving to a liability regime based on prudent and responsible conduct.

In addition to cost savings from the reduction in ratepayer-funded damages, we would expect to see other cost savings. Utilities' capital costs should decline due to decreased financial risk (which would lower the return on equity portion of utility rates). It is also possible the overall cost of service would be reduced through debt service declines and more cost-effective wildfire mitigation investments; however, more research is needed.

State agencies investigating wildfires should issue clear findings on whether utilities acted prudently. With any change in the liability standard, the state would also need to adopt requirements that agencies investigating wildfires – Cal FIRE, local fire agencies, and the California Public Utilities Commission (CPUC) – issue clear findings of whether or not the utility acted prudently and whether or not it violated statutes, industry standards, utility practices, and regulatory directives.

Analyze the long-term feasibility of the Wildfire Fund and identify alternative funding mechanisms. While the creation of the Wildfire Fund under AB 1054 was a needed path forward, it presents its own set of challenges regarding future liability costs and affordability. While the

Commission on Catastrophic Wildfire advocated for a such a fund, it also called the fund the “least-worst option for utility customers” in that it would “render a future of escalating and unpredictable electricity bills somewhat less costly and much more predictable.”¹ It stands to reason that the “least-worst option” is not the appropriate standard for ratepayers, and more work needs to be done to examine the equity implications and long-term sustainability of the fund. This should include considering a more sustainable funding mechanism in which funds come from taxpayers and other stakeholders and not solely from the IOUs and IOU ratepayers.

CONTEXT: INVERSE CONDEMNATION AND STRICT LIABILITY IN CALIFORNIA

In California, the frequency and severity of wildfires across the state has worsened over the years, with 7 out of 10 of the largest wildfires in California’s history occurring over the last ten years.² The total estimated damages from California wildfires in 2018 alone was as high as \$400 billion, which includes property damage, taxes, lost wages, and fire suppression efforts.³ There is no question that California electric utilities have inadequately maintained equipment and transmission lines across the state, as was the case with the 2018 Camp Fire in which a faulty piece of equipment was responsible for a fire that killed at least 85 people. Where utilities have not acted reasonably, it is imperative that they be held accountable for wildfire damages and subsequent losses. In California, property owners who suffer wildfire damages caused by utility equipment can file claims against utility companies, under the “inverse condemnation” legal doctrine.⁴

Under inverse condemnation, all publicly-owned utilities (POUs) and investor-owned utilities (IOUs) – can be treated as “public entities.”⁵ In California, inverse condemnation invokes strict liability, which means that the utility is liable whether or not its conduct was prudent. In the case of wildfires, electric utilities can be held liable for damages caused by their equipment, including power lines and transformers, regardless of whether they acted in accordance with safety standards and regulations.⁶ If a wildfire is caused by a utility’s equipment, property owners can seek compensation for their losses, including the value of their property, any physical damage to their property, and economic losses such as lost rent or business income.

While treating IOUs like a public entity is common, as with eminent domain, it is worth noting that California’s unique attachment of strict liability to inverse condemnation is not seen in other states that experience frequent wildfires. California courts have reasoned that utilities can be held strictly liable because they are state-protected monopolies. Plainly, this means the utility is required to pay damages whether or not the utility met all safety requirements and properly maintained equipment

¹ Johnson, E., Peterman, C., Jones, D., Kahn, M., Nava, P., & Wara, M. (2019). *Final Report of the Commission on Catastrophic Wildfire Cost and Recovery*. Commission on Catastrophic Wildfire Cost and Recovery, Governor’s Office of Planning and Research. Retrieved March 7, 2023, from https://opr.ca.gov/docs/20190618-Commission_on_Catastrophic_Wildfire_Report_FINAL_for_transmittal.pdf

² California Department of Forestry and Fire Protection. (2022). Top 20 largest California wildfires ranked by acres. Retrieved from https://34c031f8-c9fd-4018-8c5a-4159cdf6b0d-cdn-endpoint.azureedge.net/-/media/calfire-website/our-impact/fire-statistics/featured-items/top20_acres.pdf?rev=be2a6ff85932475e99d70fa9458dca79&hash=A355A978818640DFACE7993C432ABF81

³ Joel. N. Myers, *Accuweather Predicts 2018 Wildfires Will Cost California Total Economic Losses Of \$400 Billion*, ACCUWEATHER, <https://www.accuweather.com/en/weather-news/accuweather-predicts-2018-wildfires-will-cost-california-total-economic-losses-of-400-billion-2/432732>. (last updated July 8, 2019, 7:22 PM)

⁴ Nordman, A., & Hall, I. E. (2020). Up in Flames: Containing Wildfire Liability for Utilities in the West. *Tulane Environmental Law Journal*, 33. <https://journals.tulane.edu/elj/article/download/2943/2763>

⁵ *Barham v. S. Cal. Edison Co.*, 88 Cal. Rptr. 2d 424 (Cal. Ct. App. 1999)

⁶ Gradwohl, J. M. (2020). Electric Utility-Caused Wildfire Damages: Strict Liability Under Article I, Section 19 of the California Constitution. *Temple Law Review*. Retrieved from <https://www.templelawreview.org/comment/electric-utility-caused-wildfire-damages-strict-liability-under-article-i-section-19-of-the-california-constitution/>

and rights of way (“acted prudently”). For example, if a broken palm frond, located hundreds of feet from a power line, breaks and blows into the line, starting a fire, the utility may be liable for damages.⁷

The three major IOUs in California – Pacific Gas and Electric (PG&E), San Diego Gas & Electric (SDG&E), and Southern California Edison (SCE) – make up about seventy-five percent of electricity transmission in the state, with earnings and operations regulated by the CPUC.⁸ Under state and federal Constitutional law, a utility that acted prudently, may recover from its ratepayers the wildfire liabilities that resulted from its equipment. If the utility’s actions were deemed negligent – as with the Camp Fire – losses can be solely borne by the shareholders. Where utilities did act prudently, however, the ratepayers are at risk to pay any damages.

Strict liability with regard to utility-related wildfires means that ratepayers have largely become a de facto wildfire insurance fund. Funding this sort of societal insurance through utility rates functions as a regressive tax and is inequitable.

CONTACT

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⁷ A single palm frond can sail up to three city blocks. <https://energized.edison.com/stories/keeping-mother-nature-from-branching-into-power-lines>

⁸ Jacoby, A. (2022). Burning Down the House: Analyzing California’s Inverse Condemnation Strict Liability Rule for Utility-Caused Wildfires. *Southern California Interdisciplinary Law Journal*, 31, 107–162. <https://gould.usc.edu/why/students/orgs/ilj/assets/docs/31-1-Jacoby.pdf>

SUPPLEMENTAL CONTEXT: STATE EFFORTS TO ADDRESS UTILITY BANKRUPTCY, STRICT LIABILITY, AND COMPENSATION FOR WILDFIRE VICTIMS

In the wake of the Camp Fire and PG&E's bankruptcy, the California legislature passed Senate Bill (SB) 901, which granted the CPUC the authority to decide if IOUs can pass on damages from catastrophic wildfires to ratepayers "if the utility could prove their mitigation efforts and actions at the outset of the fire were reasonable and that the utility acted non-negligently."^{9,10} While this helped to ease the possibility of utility bankruptcies, it formalized the principle that costs can be passed to ratepayers if the utility is deemed not negligent by the CPUC. SB 901 also amended the utility code such that utilities in California could draw from a ratepayer and utility financed insurance fund, without reimbursing the fund, if they can demonstrate that they acted prudently in maintaining their equipment and facilities.¹¹ Specifically, SB 901 mandated ratepayer liability for wildfire claims brought under inverse condemnation through ratepayer funding of the wildfire liability fund. However, if the claims on the fund exceed the total fund, ratepayers could be liable for the entire amount if the utilities were deemed to have acted prudently.

In 2019, the Commission on Catastrophic Wildfire Cost and Recovery found that "the increasing costs of capital and the risks of bankruptcy associated with strict liability interpretation of inverse condemnation for POUs and IOUs is harmful to wildfire victims, ratepayers, and the utilities themselves."¹² The report from the Commission also recommended the creation of a wildfire fund. However, under this fund, which was implemented through the passage of AB 1054, the costs are borne by both utility companies and ratepayers, with an annual cap of \$10.5 billion.¹³ AB 1054 also created the Office of Energy Infrastructure Safety to oversee and enforce wildfire safety regulations for utility companies, which ensures that a regulatory agency has the power to hold utilities accountable and investigate utilities for noncompliance.¹⁴ AB 1054 attempted to remedy some of the cost burdens placed on utilities, but unfortunately it placed more of the risk on ratepayers.

SB 901 and AB 1054 were meant to work together to address the issue of wildfire liability and prevention in California. SB 901 provides utilities with greater protection from inverse condemnation, while AB 1054 establishes a funding mechanism to help cover the costs of wildfire damages. Both statutes attempt to increase utilities' focus on mitigating wildfire risk and to increase regulatory oversight. Together, these laws attempt to strike a balance between protecting utilities from excessive financial risk and trying to ensure ratepayers are not unduly burdened with the costs of wildfire damages. While SB 901 and AB 1054 have reduced the burden on ratepayers under the current strict liability regime, there is still much to consider regarding strict liability as it applies to wildfires and its implications for affordable electricity.¹⁵

⁹ Nordman, et al., 2020.

¹⁰ California Senate Bill 901, 2018 Leg., Reg. Sess. (Cal. 2018).

¹¹ SB 901 added Section 8388 to the California Public Utilities Code.

¹² Johnson et al., 2019.

¹³ California State Legislature. (2019). Assembly Bill No. 1054: Wildfire liability and utility infrastructure. https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB1054

¹⁴ AB 1054, 2019.

¹⁵ The reduced burden on ratepayers was done through some shareholder funding if a catastrophic wildfire occurs regardless of liability.