

Client Alert

California Enacts Landmark Law to Fund Future Utility Wildfire Liabilities and to Boost Safety of Electricity Infrastructure

July 12, 2019

California Governor Gavin Newsom signed Assembly Bill 1054 into law today, marking a significant financial commitment by the state to shore up the financial position of California's major investor-owned utilities. The new law establishes a Wildfire Fund of up to \$21 billion to provide liquidity for utilities to cover eligible, uninsured third-party damage claims resulting from future catastrophic wildfires. The law also establishes a new framework to encourage and certify utility safety practices intended to reduce the risk of wildfires ignited by power infrastructure.

Bipartisan Support

The sweeping legislation was passed with bipartisan support quickly after intense committee hearings over the past two weeks after several months of discussion, analysis and collaboration by the Governor, legislators and their advisors, and key stakeholders. On April 12, 2019, the Strike Force assembled by the Governor released its recommendations for addressing the challenges posed by California wildfires in a report entitled "*Wildfires and Climate Change: California's Energy Future*." AB 1054, which is based on Strike Force recommendations with a few key differences, was introduced on February 21, 2019 by California State Assembly Members Chris Holden (chair of the Committee on Utilities and Energy) and Autumn Burke (a member of the Committee on Utilities and Energy and chair of the Committee on Revenue and Taxation), both Democrats, along with the Republican Minority Leader, Assembly Member Chad Mayes (vice chair of the Insurance Committee and a member of the Committee on Utilities and Energy).

After being amended by the California State Senate first on June 27, 2019 and again on July 5, 2019, AB 1054 was advanced by the Senate Energy, Utilities and Communications Committee and the Senate Appropriations Committee and, on July 8, 2019, passed the California State Senate by a vote of 31 to 7. AB 1054 was then advanced by the Assembly Committee on Utilities and Energy on July 10 by a 10 to 1 vote before being passed by the State Assembly on July 11, 2019 by a margin of 63 to 8 (with 8 Assembly members not voting). The Governor signed AB 1054 into law on July 12, 2019. Because the law passed as an "urgency bill" with more than two-thirds majority votes in each chamber, by its terms AB 1054 takes immediate effect. Related laws (AB 111, along with other measures) were also passed to implement this complex legislation, creating a new Office of Energy Infrastructure Safety and, to oversee the administrator of the Wildfire Fund, a new California Catastrophe Response Council.

New \$21 Billion Wildfire Fund

The Wildfire Fund created by AB 1054 essentially acts as a supplemental line of credit for private utilities beyond what is covered by their insurance to pay for adjudicated, covered third party-claims arising from catastrophic wildfires ignited by utility equipment. The Wildfire Fund will create a state-backed pool of capital of at least \$10.5 billion, which could be increased by contributions from participating utilities to a total of at least \$21 billion. The state's participating investor-owned utilities may seek payment from the Wildfire Fund to satisfy, settle or finally adjudicate eligible third-party wildfire claims that have been reviewed and approved by the Wildfire Fund Administrator. An affected utility may submit to the California Public Utilities Commission (CPUC) an application to recover wildfire costs and expenses from its ratepayers, subject to having acted reasonably. The utilities still must maintain insurance apart from the fund. The utilities generally will have to repay to the Wildfire Fund at least some of the amounts advanced to pay claims, depending on whether the utilities have previously contributed additional monies to increase the Wildfire

Fund, have been permitted to recover costs from ratepayers, or have failed to be certified and taken reasonable steps for fire safety.

Capitalizing the Wildfire Fund

Ratepayers (through the extension of an existing, small monthly charge on electricity bills) will ultimately fund \$10.5 billion of the Wildfire Fund, by repaying the start-up bridge funding to be provided by the state from other surplus funds on hand and future bond proceeds. For legal certainty, the state's funding obligations are supported by a continuing appropriation. Specifically, the Wildfire Fund will be capitalized initially by a loan from California's Surplus Money Investment Fund. This loan will be repaid from the proceeds of AB 1054's extension of a \$2.50/month surcharge on retail electric utility bills collected by the Department of Water Resources that was due to expire in 2020. With the initial state funding and the continuing ratepayer assessments, the Wildfire Fund will be able to cover at least \$10.5 billion in eligible liabilities from future wildfires. It will be treated as a revolving fund, to be replenished from utility reimbursements and future contributions as the fund is used.

If Southern California Edison (SCE) and San Diego Gas & Electric (SDG&E) – the state's two largest investor-owned utilities that are not currently in bankruptcy – elect to increase the Wildfire Fund, then the Wildfire Fund would be doubled by additional contributions over time from all large investor-owned utilities participating in the Wildfire Fund and *de minimis* contributions from participating regional utilities. If Pacific Gas & Electric Company (PG&E), subject to bankruptcy court approval, elects to benefit from the Wildfire Fund, then PG&E (once out of bankruptcy) would be required to make contributions to the Wildfire Fund alongside the other large utilities opting to contribute. The utilities will not be permitted to recover their contributions to the Wildfire Fund from ratepayers, in effect passing that cost indirectly on to utility shareholders in exchange for access to the additional reserves. The contributions will also be excluded from the measurement of the utilities' authorized capital structure. The investor-owned utilities are expected to opt for the larger \$21 billion Wildfire Fund, including both ratepayer and utility contributions, to satisfy rating agency concerns about utility solvency and liquidity for future wildfire liabilities.

Assuming the utilities elect to contribute to the larger fund, the initial contributions of the utilities to the Wildfire Fund will total \$7.5 billion, with aggregate annual contributions of \$300 million required thereafter. Each participating utility will be responsible for a percentage of the total initial contributions equal to \$7.5 billion multiplied by the utility's "Wildfire Fund allocation metric". Thereafter, each utility will be required to make annual contributions in an amount equal to \$300 million multiplied by its assigned percentage under the Wildfire Fund allocation metric.

The Wildfire Fund allocation metric will be determined by the California State Director of Finance no later than five days after the effective date of AB 1054 and, for each utility, will be calculated as the average of (i) the proportion of land area that sits in high fire-threat districts that is served by such utility as compared to the total land area in high fire-threat districts served by all utilities and (ii) the proportion of the line miles of transmission and distribution lines owned by such utility as compared to the total line miles owned by all utilities collectively; with such average subject to adjustment based on the utility's historic risk mitigation efforts. The law expressly contemplates that the Wildfire Fund allocation metric will be about 64.2% for PG&E, 31.5% for SCE and 4.3% for SDG&E.

Special Conditions for Insolvent Utilities

AB 1054 lays out certain conditions that must be satisfied for the utilities to be eligible to utilize the Wildfire Fund in connection with future wildfire liabilities. For a utility to be eligible to participate in the Wildfire Fund, it may not be, nor may it have been since the effective date of the legislation, the subject of an insolvency proceeding or criminal probation unless it meets the following conditions: (i) the utility insolvency proceeding has been resolved pursuant to a plan or a similar document not subject to a stay, (ii) the bankruptcy court, or other court of competent jurisdiction, has determined that the resolution of the insolvency case provides funding or establishes reserves for, provides for assumption of, or otherwise provides for the satisfaction of any prepetition wildfire claims asserted against the utility in the insolvency proceeding in full in the amounts of the allowed claims approved by the court, (iii) the CPUC has determined that the reorganization plan and other documents resolving the insolvency proceeding, including the utility's resulting governance structure, are acceptable in light of the electrical corporation's safety history, criminal probation, recent financial condition, and other factors deemed reasonable by the CPUC, (iv) the CPUC has determined that the reorganization plan and other documents resolving the insolvency proceeding are consistent with

California's climate goals and are neutral, on average, for the utility's ratepayers, and (v) the CPUC has determined that the reorganization plan and other documents resolving the insolvency proceeding recognize the contributions of ratepayers, if any, and compensate them accordingly through mechanisms approved by the CPUC (which may include sharing of value appreciation).

If a utility is currently the subject of an insolvency proceeding on the effective date of the legislation (such as PG&E), and the utility wishes to participate in the fund, the utility must (i) provide written notice within 15 days of the effective date of the legislation to the CPUC of its election to participate in the fund and (ii) obtain approval from the bankruptcy court, or a court of competent jurisdiction, within 60 days of the effective date of the legislation, of the utility's election and payment of its initial contribution to the Wildfire Fund and its annual contributions to the Wildfire Fund as they become due. The contributions from any such utility will not be due to the Wildfire Fund until the date that the utility exits the insolvency proceeding. The new law also specifies that PG&E would have to emerge from bankruptcy by June 30, 2020 to be eligible to utilize the Wildfire Fund.

Utility Safety Certifications and Reimbursements

AB 1054 encourages the utilities to implement safety precautions by providing for a cap on a utility's obligations to reimburse the Wildfire Fund and a presumption of reasonableness if a utility develops and maintains a valid safety certification from the Wildfire Safety Division. In connection with the valid safety certification, each utility must develop and implement an approved wildfire mitigation plan, implement the findings of its safety culture assessments, establish a safety committee of its board of directors, establish board-of-director level reporting to the CPUC on safety issues, tie executive compensation to safety performance, and spend the amounts necessary to implement its wildfire mitigation plan, as approved and supervised by the Wildfire Safety Division.

In paying for the implementation of its respective wildfire mitigation plan, no utility may include in its rate base its share, as determined by the Wildfire Fund allocation metric, of the first \$5 billion expended on fire risk mitigation. The CPUC may also authorize utility borrowings to cover wildfire costs determined to be recoverable from ratepayers and to finance fire safety improvements.

Once a utility has used the Wildfire Fund, the CPUC must review a utility's use of the Wildfire Fund to determine if the utility acted reasonably and to what extent the utility must reimburse the Wildfire Fund for such use. The CPUC determination will be guided by a new reasonableness standard that requires a utility to prove that, based on the preponderance of the evidence, its conduct was consistent with actions that a reasonable utility would have undertaken in good faith under similar circumstances, at the relevant point in time and based on the information available to the utility at the time. If the utility had a valid safety certification for the period when the subject fire took place, the utility's conduct will be deemed reasonable unless a party to the applicable proceeding creates a serious doubt as to the reasonableness of the utility's conduct. Once serious doubt has been established, the utility has the burden of dispelling that doubt and proving its conduct to have been reasonable.

A utility that acted reasonably will be allowed to recover in rates costs of fire liabilities. Unless the Wildfire Fund has been increased with additional contributions from utilities, a utility using the fund is obligated to reimburse the Wildfire Fund for the full amount of payments received within six months and may then seek to recover from its ratepayers the costs and expenses, subject to approval by the CPUC.

If the CPUC determines that a utility did not act reasonably, or determines that any amounts received from the Wildfire Fund are disallowed, then, (1) if the utilities did not upsize the Wildfire Fund beyond the initial \$10.5 billion in state funding, the affected utility will not be able to recover in rates any costs and expenses following its reimbursement of the Wildfire Fund of all amounts drawn or (2) if the utilities have upsized the Wildfire Fund, the utility will be required to reimburse the Wildfire Fund in an amount not to exceed the lesser of (a) any amounts CPUC disallowed or (b) the amount equal to the difference of (i) 20% of the utility's equity base rate minus (ii) the sum of (y) the amounts the utility actually reimbursed the Wildfire Fund in the prior three-calendar-year period plus (z) the amounts still to be reimbursed to the Wildfire Fund by the utility for such prior three-calendar-year period. The upsized Wildfire Fund reimbursement cap does not apply if such utility either acted with conscious or willful disregard of the rights and safety of others or did not maintain a valid safety certification.

Exclusions from Coverage

The Wildfire Fund will be available to cover eligible future wildfire costs but will not cover liabilities arising from the 2017 Wine Country fires, which burned at least 240,000 acres and resulted in 44 deaths, the 2018 Camp Fire, which burned at least 150,000 acres and resulted in 85 deaths, nor any other past fires. The new law is intended to stabilize the utilities' finances by giving more certainty regarding liquidity to cover the cost of future fires. Although the law lacks coverage for prior or existing wildfire liabilities, AB 1054 is intended to remove uncertainty about the impact of future fires on utility solvency so that the utilities can today raise new financing as needed to settle pending or probable claims from past fires.

The new law leaves unresolved larger issues as California grapples with increased wildfire risks from drought, climate change and suburban sprawl. AB 1054 does not include spending to protect homes in high risk areas, nor does it mandate statewide land use limits on developments in wildland-urban interface fire zones. The law also contains no mitigating measures to address the rising costs and decreasing availability of fire insurance in fire-prone areas. Lastly, the new law keeps in place California's "inverse condemnation" doctrine under which public utilities may be held strictly liable for casualty losses resulting from fires sparked by transmission lines or other power facilities, regardless of fault.

Passage of AB 1054 represents a major legislative achievement for California's new governor. In a public statement on July 11, 2019, upon the bill's passage, Governor Gavin Newsom said:

"I want to thank the Legislature for taking thoughtful and decisive action to move our state toward a safer, affordable and reliable energy future, provide certainty for wildfire victims and continue California's progress toward meeting our clean energy goals.

"The rise in catastrophic wildfires fueled by climate change is a direct threat to Californians. Strengthening our state's wildfire prevention, preparedness and mitigation efforts will continue to be a top priority for my administration and our work with the Legislature."

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Project, Energy and Infrastructure Finance Group

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