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# Trends in Public Utility Regulation: Five "Innovations" from California with Increased Regulatory Risk

*By Charles C. Read*

The California Public Utilities Commission (CPUC) has the biggest staff of any state utilities commission. It has issued fines and penalties in excess of $1 billion; it has enforced the state's renewable energy mandate; and it has even found ways to exert substantial regulatory control over disruptive innovators in transportation. Because of the CPUC's outsized influence on commissioners, staff, and public advocates in other states, public utility management and counsel should be aware of five of the CPUC's most recent regulatory innovations.

### 1. Scorched Earth Policy? Who Pays for Inverse Condemnation?

***Utilities facing wildfire damage are trapped between strict liability in civil litigation and proving prudent management for cost recovery at the CPUC.***

Read

Subjecting investor-owned utilities (IOUs) to inverse condemnation (strict liability for property damage caused by utility facilities) attracted little notice or concern as long as costs were modest and insurable. But with utility facilities implicated in the ignition of ever-larger and more frequent wildfires, the implications of inverse condemnation truly became an existential threat to California electric utilities.

Financial markets have hammered the stock of California's investor-owned electric utilities markets since 2017, which is when analysts realized the Catch-22 position created by the interplay of the judicial doctrine of inverse condemnation and the CPUC's aggressive search for imprudent utility conduct. The origins of inverse condemnation were situations in which government agencies with the power of eminent domain damaged or diminished the value of private property. Fault was not an issue, and compensation for the individual's loss was "socialized" among the many tax-paying constituents. In 1999, the California courts extended the doctrine to

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# Trends in Public Utility Regulation

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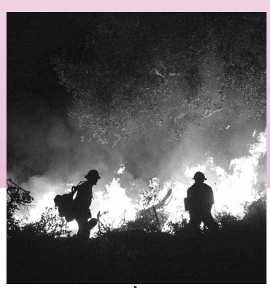
investor-owned utilities, reasoning that they, like governmental enterprises, have the power of eminent domain and a large customer base over which the cost of property damage can be spread. The inverse condemnation costs in these early cases were modest and insurable.

But in 2007, after a set of fires in San Diego County, insurance was not sufficient to cover all the inverse condemnation costs. So San Diego Gas & Electric (SDG&E) applied to the CPUC to recover the uninsured costs from its ratepayers. The CPUC conducted full evidentiary hearings with testimony from its own staff and ratepayer advocates arguing that the utility had not monitored high fire-danger risks adequately and had not trimmed vegetation properly and timely. The CPUC rejected SDG&E's application because the fire costs were linked to imprudent utility conduct. Specifically, the CPUC argued that the fact these costs were the result of the inverse condemnation doctrine was irrelevant, as the Commission has a statutory obligation to ensure that ratepayers paid only costs that were just and reasonable.

The 2017 and 2018 wildfires have painfully demonstrated the predicament of the IOUs. On the one hand, they stand a high risk of having their facilities cited as at least one of the causes of the fires (CalFire, the investigating state agency, has already reached this conclusion in a number of the 2017 fires in PG&E's service territory). On the other hand, the utilities stand a similarly high risk of facing the CPUC's judgment that at least some aspects of the IOUs' operations were imprudent, which will leave investors to absorb such costs. Insurers have taken note and either withdrawn from the marketplace or offered limited coverage at enormous premiums.

In September 2018, California Governor Jerry Brown signed Senate Bill 901, which included a passel of new utility fire safety obligations. It did not alter inverse condemnation law (although it created a new body to study legal changes), but it did throw IOUs a lifeline. The CPUC is to determine the maximum amount utility shareholders can pay for 2017 wildfires without harming ratepayers or impairing the utility's ability to provide safe and adequate service. Any disallowance of wildfire costs due to utility imprudence cannot exceed that amount. Senate Bill 901 also permits utilities to finance the cost of wildfires, provided that the CPUC has found those costs to be reasonable or beyond the maximum amount the utility is able to pay without jeopardizing service. In return, the utilities must operate their systems to "minimize" the risk of wildfires, prepare and submit for CPUC approval an annual wildfire mitigation plan, and hire independent evaluators of their plans as part of the CPUC annual compliance review. Revenues authorized to implement these plans will be tracked in a memorandum account and cannot be used for other purposes. Utilities will be assessed monetary penalties for noncompliance with their plans. Recovery of wildfire costs after January 1, 2019, will require Commission consideration of 12 specific categories of utility conduct. In short, Senate Bill 901 gives the CPUC multiple new opportunities to disallow utility wildfire costs, subject only to a one-time cap for costs of fires occurring in 2017.

**In California, uninsured costs must now face a reasonableness review.**



Meanwhile, aspects of this problem are surfacing elsewhere. Even if subject to a negligence, rather than strict liability, standard, other investor- and publicly-owned utilities in the Western United States are facing ruinous damage claims. And if there is a judicial finding of negligence on the part of utilities, passing costs on to ratepayers (or even taxpayers) may not be viable. Regulators should recognize the real core of the issue: the costs of ordinary utility operational negligence have always been appropriate costs to recover from ratepayers even if made more palatable by insurance. But in California, uninsured costs must now face a reasonableness review.

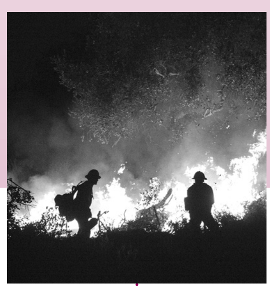
### 2. Regulators RAMP Up Risk Assessment in General Rate Cases

***Utilities must enumerate and quantify the cost of risks and mitigation, which in itself may increase the risk of litigation.***

The CPUC has recently issued a series of decisions aimed at formally incorporating quantitative, risk-based decision-making and safety risk assessment as part of energy utilities' general rate cases (GRCs). Known as the Risk Assessment Mitigation Phase (RAMP), the process was born out of the severe criticism of the CPUC for its lack of safety oversight following the 2010 PG&E gas pipeline explosion in San Bruno, California, that killed nine people and destroyed 59 homes. RAMP is intended to require energy utilities to think in advance about the safety risks they face and then propose mitigation measures that are quantifiably cost-effective. When a safety incident occurs, the CPUC's Safety Enforcement Division (SED) expects to be able to review the RAMP filings of the utility involved to see if the risk was identified. If it was, SED will then inquire about whether the risk was appropriately mitigated as proposed. If not, the utility will have to explain why this particular risk was not identified and yet occurred anyway.

San Diego Gas & Electric Company and Southern California Gas Company (the Sempra utilities) were the first of the large energy utilities to undergo the RAMP process as part of their GRC. The Sempra utilities identified 28 risks across a range of severity. SED reviewed the Sempra utilities' RAMP submission and issued a RAMP report, but it cautioned that this RAMP report was not a definitive evaluation, given that the filing was the first of its kind. The Sempra utilities integrated SED's RAMP evaluation and comments into their GRC applications, which remain pending.

**There is a risk CPUC officials may believe the RAMP process will eliminate serious safety incidents.**



PG&E is currently undergoing the RAMP process. On November 30, 2017, PG&E filed its RAMP submission. On March 30, 2018, SED filed its report on PG&E's RAMP filing and held workshops throughout April 2018. SED's advance evaluation will inform PG&E's next GRC, which is scheduled to be filed in September 2018. Southern California Edison Company (SCE) is last in the RAMP sequence. SCE will file its RAMP reports in November 2018 as the initial phase of its 2021 GRC.

RAMP is a major new regulatory undertaking for both the utilities and CPUC staff. But there is a real risk that the staff and the commissioners believe it can, over time, eliminate serious safety incidents. Or if it does not, then the utility can be faulted for failing to include the risk in the first place or not appropriately mitigating that risk. Meanwhile, as the risk and mitigation descriptions become more detailed, plaintiffs' counsel may find these filings to be very useful when safety incidents do occur. If the risk of such an incident was identified, then why was it not mitigated? If the risk was identified but the specific recommended mitigation measure was not considered as cost-effective as other mitigation measures, that will be characterized as the utility's conscious disregard of a risk that actually materialized. And of course, if the risk was not identified, that will also show indifference or negligence in safety planning. Notwithstanding these practical problems, the quantification of safety risk and mitigation is a growing area of planning, expenditure, and disclosure for utilities. The RAMP program will be followed closely and is likely to be replicated in other states and expanded to other nonenergy utilities.

### 3. CPUC Drives Utility Regulation into New Areas

***The CPUC seizes new territory to regulate service quality, rather than rates, among transportation network carriers.***

Transportation network carriers (TNCs)—as the CPUC calls app-based ridesharing services—started in California. Very quickly, this new frontier presented a Wild West of regulation with the CPUC, as well as assertions of regulatory authority by city- and county-based taxi commissions. Some of the dust has now settled: the CPUC wrested regulatory control from taxi authorities by classifying the services as TNCs, rather than taxis. While the CPUC has clarified that it will not assert controls over pricing and services, TNCs are finding that they are certainly not "unregulated."

The CPUC has taken several actions that reflect its assertion that TNCs rightly fall under the CPUC's jurisdiction. Those actions include:

- issuing a decision on background check requirements for TNC providers;
- beginning an adjudicatory proceeding after a staff investigation found that a major TNC failed to either suspend promptly and/or investigate drivers in a sample of 151 complaints that the Commission had categorized as serious enough to allow "zero tolerance";
- requiring TNCs to submit periodic reports containing large volumes of data about their businesses that will enable the Commission to study such topics as service to low-income areas and the disabled; and
- closely monitoring TNC service performance and independently receiving and investigating customer complaints.

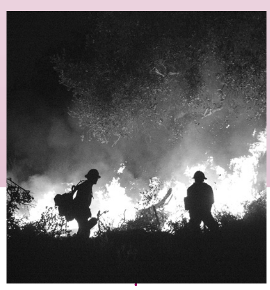
TNC regulation, while still in its early stages at the CPUC, looks like the pattern that developed in the CPUC's regulation of wireless carriers. Though prohibited by federal law from price regulation, the CPUC found substantial oversight authority in the form of consumer protection investigations and penalties, universal service enforcement, data collection, and the need for CPUC approval of mergers and reorganizations. Most other states have followed California's lead in placing TNC regulatory authority with state public service commissions. Many are taking a "light-handed" approach thus far, but a few sufficiently high-profile incidents involving public safety or consumer fraud could be enough to prompt other commissions to exercise more regulatory control.

**4. Community Choice Aggregation Brings Renewable Power to the People and Away from IOUs**

***The CPUC's favorable treatment of CCAs has led to uncertainty and difficulties for investor-owned utilities.***

The CPUC first implemented community choice aggregation (CCA) in 2004. CCA is essentially an energy service provider (ESP) program through which either a city, a county, or a collection of cities or counties can qualify as an ESP. Once the relevant government body authorizes a CCA, then all electricity end-users within that jurisdiction are considered part of the CCA unless they affirmatively opt out. The combination of local governmental accountability and the opt-out requirement provided CCAs with two advantages that a private enterprise ESP lacked. IOUs were further marginalized by the CPUC's heavy restrictions on IOUs attempting to provide any counter-publicity to pro-CCA campaigns. In 2010, Marin Clean Energy, serving the affluent county just north of San Francisco, formed the first CCA. But since then, CCAs have grown exponentially. And while places like Berkeley, Santa Monica, and San Francisco have also established CCAs, so have blue-collar communities like Fresno and Riverside. Los Angeles County has created a CCA, which offers an opt-in that is easy for any city in the county to join, from affluent Beverly Hills to more modest cities like Bell Gardens and Compton. By the end of 2018, there will be 19 CCAs in operation in the state; these are projected to serve more than 2.5 million customer accounts.

**The annual IC proceeding has become an acrimonious debate.**



Any new program that experiences explosive growth like the CCA movement will create regulatory conflict. From the outset, the CPUC established the principle that the departure of load from electric utilities should not create any negative impact on those customers who continued to buy their power from the utility rather than from a CCA. This gave rise to the calculation of the indifference charge (IC), which was assessed on every customer departing the utility and buying CCA power. The annual IC proceeding in which the charge is determined has become an acrimonious debate among the utilities, remaining bundled customers (who are often low-income), CCAs, and their proponents. And the prospect of annually recalculating the IC is rapidly becoming unrealistic, even though setting the IC can often determine if a CCA's business plan is viable or not.

The CPUC has done much in recent years to make the utilities indifferent as to whether they purchase power for their bundled customers or provide only distribution or "wires" charges. But the aggregate size of CCAs has triggered matching, precipitous drops in utility power purchase projections. Long-term IOU portfolios have required restructuring, price renegotiations, and pricing for CCA customers who wish or must return to utility service. This last point is nearly as contentious as setting the IC for departing customers. These and other issues have prompted the CPUC president to wonder publicly if the Commission hasn't created an unintended threat to the reliability of electricity delivery that might compare to the service disruptions of 2000–2001, California's self-inflicted "energy crisis."

However, CCA is enormously popular. The CPUC will encounter political difficulties if it tries to cap CCA providers as it did ESPs. The more likely resolution will be played out in the IC and re-entry price calculation proceedings. Meanwhile, watch for at least some CCAs to fold or never emerge from the planning stages in California, as occurred with ESPs. In other states, there is no reason not to expect the CCA movement to press forward. As one might expect, a substantial cottage industry has arisen to advise and operate CCAs as they contemplate entering into 20- and 30-year power purchase agreements. These forces will push CCAs, which have obvious attractions on the front end but a host of tough issues on the back end.

**5. Public Records Act Requests Facilitate Public Scrutiny of Commission Utility Communications**

***As the pendulum swings from extreme confidentiality to extreme transparency, utilities struggle to find balance before the CPUC while avoiding resort to the courts.***

The CPUC's new effort to provide for prompt compliance with Public Records Act (PRA) requests has caused the release of communications between the Commission and the utilities it regulates that were cited by ratepayer advocates and the press as evidence of just how cozy that relationship is.

California's PRA is fairly typical of PRA statutes in other states. However, the CPUC had a long tradition of considering itself entitled to determine PRA compliance on its own terms, and it often turned away requestors by noting that the utilities had designated the material as confidential. For its own documents, the CPUC routinely invoked investigatory and work product privilege. One of the categories of requests thus never produced to the public was that of documents referencing communications between CPUC commissioners and utility executives that might or might not violate the ex parte rules. The CPUC's ex parte rules have already received much attention as traps for the unwary. Combining exceptions within exceptions, the ex parte rules are largely self-executing. In the past, if the utility considered a communication to be not reportable or not prohibited as an ex parte communication, that was the end of the matter. There was no further visibility for third parties or the press.

The 2011 San Bruno gas explosion set the PRA on a collision course with the ex parte rules. The devastated city hired aggressive plaintiff's counsel who naturally turned to the PRA. But plaintiff's counsel did not accept the CPUC's traditional approach; instead, they sued the CPUC in superior court and eventually received a trove of communications between PG&E and commissioners and staff. Ensuing headlines highlighted that at least some of these contacts were either prohibited under ex parte rules or required disclosures that had not been made. The fallout included PG&E executive resignations, commissioner apologies, and multimillion-dollar penalties for the utility. In the aftermath, the CPUC issued a general order setting out how the Commission would deal with PRAs in the future. Now the CPUC would err on the side of disclosure; utilities submitting information would be required to identify the protected material by line. If the nondisclosure request was rejected, the utility would be advised immediately and would be required to pursue the claim at the Commission and in the courts, or the confidentiality claim would be lost.

So today, California utilities submitting information to the CPUC must designate and provide specific support for keeping any material confidential. Commission staff will immediately review and accept or reject such designations. Unless the CPUC agrees with the confidentiality designation, the CPUC will grant any subsequent PRA requests. Furthermore, the CPUC has greatly reduced its claims of confidentiality for its own internal communications. As a result, a PRA request can quickly pick up CPUC documents reflecting utility communications that may or may not present ex parte issues.

In other states, utilities would be well-advised to consider the interplay between PRA statutes and ex parte rules. Even if a state commission does not have substantial ex parte rules, a more aggressive approach to PRA authority can turn up communications that may not read well in a newspaper headline.

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The California Public Utilities Commission continues to find innovative ways to regulate the enterprises that fall under its jurisdiction, as well as to expand that jurisdiction. The courts have largely deferred to the judgment and expertise of the Commission and not found the utilities to be in need of protection from regulatory overreach. Although often critical of the Commission as utility-friendly, the legislature continues to place more and more authority with the CPUC. And with all these forces aligned, utility regulation proceeds in one direction. Existing regulatory obligations never go away; they are simply joined by new mandates. inf

# Chair's Column

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of the Section that we are able to continue to publish the high-quality journal that *Infrastructure* has become. I would also like to thank Casey Wren, Chuck Patrizia, and, posthumously, Judge Richard Cudahy for having taken on the editorial responsibilities for *Infrastructure* over the past several years. This is Casey's and Chuck's last edition as co-editors, and I look forward to their continued contributions to the Section. I also would like to thank Bill Drexel for answering the call and agreeing to assume the editor responsibilities for *Infrastructure*, starting with the Fall issue. I am certain Bill will continue the tradition of providing thoughtful and timely articles that will be of interest to our members.

Lastly, as I begin my year as chair of the Section, I would like to mention new initiatives of the ABA and several that we will pursue as a Section this year. First, the ABA. As most of you know, the ABA has experienced a steady decline in membership over the past several years and recently adopted new measures to stem that loss. The ABA adopted a new dues structure that includes more free CLE content and is designed to attract new members, particularly younger members, to the Association. The ABA is also rolling out a new website that will be more user-friendly than prior versions.

Consistent with the ABA's overall objectives, I plan to focus on ways in which our Section can attract younger lawyers. The areas of law practiced by our Section members are important, interesting, and exciting, and I will continue the efforts of my predecessor and expose younger lawyers to our work and encourage them to become more engaged with the Section. One area that has not been adequately explored is the extent to which the Section uses social media. For all practical purposes, our Section does not use social media. This year,