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Energy Division
Attention: Tariff Unit
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

SUBJECT: Reply of Southern California Edison Company to The Utility Reform Network and Office of Ratepayer Advocates' Joint Protest to Advice 3768-E, Request for Z-Factor Recovery of the Revenue Requirement Associated with Incremental Wildfire-Related Liability Insurance

Dear Energy Division Tariff Unit:

Pursuant to General Order (GO) 96-B, General Rule 7.4.3, Southern California Edison (SCE) submits this reply in support of Advice Letter 3768-E.

SCE's Advice Letter Should Be Approved Expeditiously

In a recent webinar, Commissioners made comments recognizing the extraordinary consequences of the 2017 wildfires.[1] For example, President Picker commented that the Commission was "already seeing that it's hard for the utilities to obtain insurance to be able to cover the risk of fire both to their infrastructure and from their infrastructure."[2] After Steve Kempsey, U.S. Casualty Leader for the insurance broker Marsh, provided

[1] *See* California Public Utilities Commission (CPUC) Commissioner Informational Webinar on Impacts of Climate Change and Resulting Resiliency Challenges (February 7, 2018) at 42:51 ("[C]limate change is creating a new normal in California and communities around the world"). The recorded webinar is available at http://www.adminmonitor.com/ca/cpuc/other/20180207/. *Id.* at 45:11 ("There's no question in my mind that the climate is changing rapidly and that we're going to have to adapt to this new environment rapidly. We had an en banc last week just after we adopted new fire maps that actually expanded the amount of land mass here in California that's within … areas designated as severe or extreme fire risk areas as […] 44% of the state's land mass. That's up from a fraction ten years before […] so we are aware that the fire hazard is growing."); *Id.* at 52:30 ("[W]e recognize that the recent fires are having an impact on the public's perception of the utilities, and we know that it's becoming difficult for the utilities to insure against fire risk.").

[2] *Id.* at 48:25.

public comments about the contracting of the wildfire insurance market (meaning that the availability of insurance was decreasing while the cost of obtaining insurance was increasing), President Picker commented that the Commission has "heard this several times before," and that it was well aware of the situation that utilities like SCE were facing.[3] Commissioners also affirmed that the Commission has established processes to address recovery of extraordinary costs resulting from events such as wildfires.[4]

SCE's Advice Letter invokes these established processes and calls on the Commission to act expeditiously to authorize recovery of unforeseen, exogenous wildfire insurance costs. The Commission should approve SCE's Advice Letter, consistent with the assurances given to the investment community regarding the Commission's preparedness to follow its established practices and procedures in this crisis situation. Failure to do so would be profoundly destabilizing at a time when the dependability and predictability of the Commission's regulatory framework is most needed.[5]

SCE's Procurement of Supplemental Insurance Was Necessary and Prudent

For the reasons explained in the pending Advice Letter, SCE found itself in the position in late 2017 of needing to replenish its wildfire insurance for 2018 to mitigate the risk of uninsured claims in the event of another fire event. As explained in the declaration of John Butler that accompanied SCE's Advice Letter, SCE asked Marsh, an insurance broker that the Commission has previously recognized as "seasoned" and capable of quickly canvassing "the global insurance market to reach qualified insurers,"[6] to survey the insurance landscape on its behalf.[7] Marsh responded in mid-December 2017 with an assessment that only one insurance carrier was willing to provide insurance of the kind, and with the extent of coverage, that SCE needed to obtain.[8] Marsh further informed SCE it needed to act quickly, as coverage of this kind would likely not be available in 2018; if it were available, Marsh explained, the contracting insurance market meant that the cost of such insurance would be substantially higher.[9]

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3 *Id.* at 1:04:45.

4 *Id.* at 33:57 (detailing the "large number of balancing and memo accounts" used by the Commission to "provide the utilities with certainty" despite effects of climate change).

5 *Id.* at 29:30 (noting that Commission is "exerting a tremendous amount of intellectual effort to think about what the utility revenue model looks like in the face of climate change").

6 Decision (D.)10-12-053, p. 36.

7 Declaration of John W. Butler (Butler Decl.) at ¶ 8.

8 *Id.* By this "kind" of insurance, SCE means this much capacity of sufficiently broad insurance coverage this low in the insurance tower for a California private electric utility. *See* Advice Letter 3768-E, p. 1.

9 *Id.* at ¶ 10.

SCE prudently acquired the necessary insurance (effective December 31, 2017) for a premium cost of $120.9 million. Consistent with its tariffs,[10] SCE promptly notified the Commission that it would utilize the Z-Factor process approved by the Commission for recovery of unanticipated, exogenous expenses in order to recover the cost—less the FERC-jurisdictional allocation and $10 million "deductible" to be borne by SCE's shareholders—associated with this supplementation of SCE's insurance.

The Utility Reform Network (TURN) and Office of Ratepayer Advocates (ORA) (jointly, Protestors) speculate, with no factual basis, that SCE might have been able to obtain "alternative" forms of insurance. Such speculation does not meet the requirement that protests "identify material disputed facts."[11] Further, the Butler declaration attached to SCE's Advice Letter establishes that no alternative insurance was available.[12] SCE's choice was no insurance or the insurance it procured. Protestors do not suggest that SCE was imprudent in procuring insurance, and since no other insurance could have been procured at the time, there is no basis to dispute the prudence of SCE's action.

Protestors nonetheless attack SCE's Advice Letter on several other grounds. But they do not—and cannot—contest the basic fact that SCE needed supplemental wildfire insurance in the wake of an unprecedented wildfire season, nor do they point to any other insurance that SCE could have purchased at all, let alone at a lower price.

An Advice Letter Is the Proper Procedural Mechanism

Protestors' primary argument is that SCE should file an application, rather than an advice letter, to recover the costs at issue. This argument should be rejected.

SCE's Advice Letter implements SCE's tariff, which sets forth the Z-Factor process.[13] In D.15-11-021, the Commission expressly approved the Z-factor tariff, noting that "[t]he Z-Factor mechanism provides SCE with the assurance that there is a clear process for it to request cost recovery for unanticipated events that have a significant financial impact on SCE."[14] Consistent with its tariff and D.15-11-021, SCE followed that "clear process" by filing this advice letter. Protestors' argument that an application should be filed is contrary to the governing tariff and is an improper collateral attack on D.15-11-021 and

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10 SCE Tariff Preliminary Statement, Section AAA, Sheet 3, Section 5.b.

11 GO 96-B, General Rule 7.4.1.

12 Butler Decl. ¶¶ 8-9.

13 SCE Tariff Preliminary Statement, Section AAA, Sheet 3, Section 5.b (requiring that "[i]n order to receive recovery of a Z-Factor, SCE shall include its request for recovery of the revenue requirement associated with the Potential Z-Factor in an Advice Filing").

14 D.15-11-021, p. 385. ORA opposed some parts of SCE's tariff, but specifically agreed that "the Z-factor mechanism has protected both SCE and the ratepayers by allowing revenue adjustments for unexpected and uncontrollable events." *Id.* at p. 387.

Commission decisions stretching back to 2004 that established SCE's Z-Factor mechanism.[15]

Protestors argue that San Diego Gas & Electric Company's (SDG&E) decision to file an application for recovery of costs associated with unexpected liability insurance premiums in Application (A.)09-08-019 in 2009 should bind SCE to following the same process eight years later. But the Commission's decision granting SDG&E's application was "the first time" that it was "considering the application of Z-factor criteria" in the context of cost-of-service ratemaking, as opposed to the incentive-based ratemaking from which it originated.[16] Once it reviewed and approved SDG&E's request, which relied on the same factors upon which SCE now relies, the Commission explicitly rejected a proposed requirement "that SDG&E file new applications for Z-factor treatment and recovery in subsequent years."[17] Instead, the Commission explained that if a Z-factor event relating to an unexpected cost increase in liability insurance occurred in the future, SDG&E could "file a Tier 3 Advice Letter and upon approval utilize a memorandum account to record applicable costs; however, recovery would be subject to an annual deductible amount."[18] In short, the precedent cited by Protestors further bolsters SCE's argument that advice letters, not applications, are the appropriate way to seek relief in these circumstances.

Protestors' Arguments Are Procedurally Improper

Protestors do not contest that the cost at issue meets at least seven of the eight criteria for Z-factors set forth in SCE's tariff. They contest only whether the cost meets the eighth criterion—whether the costs at issue are reasonable—and their arguments premised on their unsubstantiated speculation regarding the insurance market, as explained above, lack merit. All of Protestors' remaining arguments are procedurally improper because they seek to impose additional conditions or requirements on Z-factor recovery not set forth in the operative tariff.

GO 96-B provides that protests "may not rely on policy objections to an advice letter."[19] Thus, Protestors' arguments which seek to reject SCE's Advice Letter for reasons unrelated to the criteria stated within SCE's tariff—such as the argument that SCE's lack of previous need to avail itself of the Z-factor process counsels against approval of the Advice Letter, that the Commission should read into the tariff some unspecified (and unwritten) cap on the dollar amount of any recovery, or that the $10 million in costs

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15 Rule 16.4 of the Commission's Rules of Practice and Procedure provides that a party requesting to make changes to an issued decision must file a petition for modification with the Commission.
16 D.10-12-053, p. 4.
17 *Id.* at p. 37.
18 *Id.* at pp. 37-38.
19 GO 96-B, Rule 7.4.2.

shareholders bear under the Z-factor mechanism somehow should be discounted or ignored—are policy arguments inconsistent with the tariff and, as such, should be rejected.

Protestors' Arguments Are Meritless

Besides being procedurally improper attacks on the tariff, Protestors' arguments are substantively without merit.

First, Protestors argue that the fact that SCE has not needed to use the Z-factor process in the past counsels against allowing SCE to use that process today. This is exactly backwards. As Protestors explain, SCE has had a Z-factor in its tariffs since the mid-1990s.[20] SCE's ability to manage costs and risks successfully over this long period of time, avoiding the need to invoke the Z-Factor up to now, should be commended; it is certainly not a basis for refusing to apply the Z-Factor tariff now that a qualifying event has finally occurred after so many years. As Protestors themselves concede, SCE had only one prior instance in which it noticed a potential Z-Factor event—in connection with increasing wildfire insurance premiums in the wake of the 2007 wildfires—but never filed for recovery because these increased costs did not exceed the $10 million deductible applicable to Z-Factor events.[21]

Second, Protestors' argument that the amount that SCE seeks to recover is too high for an advice letter is flatly contradicted by prior Commission decisions approving, but subsequently removing, a cap for post-test year ratemaking advice letter filings. In D.04-07-022, the Commission established a requirement that if the post-test year ratemaking revenue requirement increase exceeded $150 million or 5%, an application would be required instead of an advice letter.[22] But the Commission removed this requirement in D.06-05-016, adopting SCE's proposed advice letter procedure.[23] Protestors cite no authority—legal principle, tariff document, decision of the Commission, or otherwise—that supports their attempt to (re)impose a dollar cap into the advice letter requirements, particularly given the Commission's previous approval of advice letters involving far larger amounts cited in SCE's Advice Letter.[24]

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[20] Protest Letter, p. 4. SCE notes the current form of the Z-Factor mechanism, with the advice letter feature, was established in 2004,

[21] Protest Letter, p. 4, fn. 9.

[22] D.04-07-022, p. 281.

[23] D.06-05-016, p. 308.

[24] Protestors complain that the advice letters referenced in SCE's Advice Letter "are the last step in a process" that is laid out by Commission precedent and statute. But the same is true of the Commission's Z-Factor process for SCE. The Commission has prescribed a specific dollar threshold for recovery (i.e., the $10 million deductible), criteria for recovery, notice requirements and recovery via a Tier 3 advice letter process approved in prior GRC decisions and set forth in SCE's tariffs.

Protestors' attempt to (re)impose a cap also fails as a matter of logic. Protestors' only argument to support such a cap is SCE's lack of "prior experience with an actual Z-Factor cost recovery request;"[25] however, as explained above, that factor supports SCE's Advice Letter.

Third, and similarly inapposite, is Protestors' suggestion that the costs of the insurance premium should be allocated between customers and shareholders. This, too, is a policy argument out of bounds in this setting. For example, in D.12-11-051, the Commission approved SCE's request to recover in rates increasing wildfire insurance premiums, recognizing how factors such as the application of inverse condemnation were negatively impacting the wildfire insurance markets.[26] More generally, the Commission has repeatedly and consistently authorized rate recovery of the full cost of liability insurance.[27] Protestors' suggestion that the Commission should adopt a different view is a collateral attack on this longstanding precedent and should be rejected. Further, the Commission's policy of allowing recovery of the full cost of insurance against negligence claims does not limit the Commission's authority to conduct a prudence review of the utility's conduct after an event has occurred.

In addition, Protestors' suggestion that SCE should have sought a policy that covered all risks other than negligence, based on the premise that customers should not pay for insurance that covers claims arising from utility negligence, is misplaced. Insurance to cover general liability risks (principally property damage and personal injury) is generally acquired on an "all risk" basis, and it would have been imprudent for SCE to have not done likewise here, particularly given the uncertainties in advance of an incident regarding who as between ratepayers and shareholders will ultimately bear the cost of an uninsured loss. Here, SCE purchased insurance that follows, and adds capacity to, the standard AEGIS policy — the same policy that SCE, and other California energy utilities, have purchased for many years. That policy does not distinguish between claims based on negligence versus strict liability. And, even more importantly, Protestors fail to recognize that the contraction in the wildfire insurance market for California utilities is to a large extent driven by courts' application of inverse condemnation—a strict liability theory—not negligence.[28]

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[25] Protest Letter, p. 6.

[26] *See* D.12-11-051, p. 513.

[27] *See, e.g.*, D.15-11-021, pp. 300-301 (approving SCE's full recovery of liability and property insurance costs); D.14-08-032, pp. 547-51 (approving utility's full recovery of insurance costs and noting that "[p]rocuring excess liability insurance is a reasonable business practice"); D.12-11-05, p. 513 (approving utility's full recovery of liability and property insurance costs); D.09-03-025, p. 166 (same); D.07-04-046, p. 20 (same); D.07-03-044, p. 167 (same); D.06-05-016 (same); D.04-07-22, p. 173 (same); D.91-12-076, p. 72 (same); and D.89-12-021, p. 25 (same).

[28] It is also worth noting that the very essence of a liability insurance policy is to cover various forms of negligence.

Protestors' further claim that director and officer (D&O) insurance provides support for their request is inaccurate. California and other states require shareholders to share D&O insurance costs because, among other things, shareholders elect directors and, in the event of a shareholder lawsuit, receive payments made under these policies.[29]

Fourth, SCE pointed out in its advice letter that, as required by its tariff, $10 million of the cost associated with replenishing its insurance would be borne by SCE's shareholders. In response, Protestors suggest this cost should somehow be discounted or disregarded because it is a condition of SCE's Z-Factor. Protestors' position is without merit. Consistent with its tariff, SCE is absorbing a substantial portion of the cost of reinsurance, which the Commission has already determined (through its approval of SCE's Z-Factor tariff) is the appropriate share of the cost for SCE to shoulder. Protestors' "policy objections" to that result are not a proper basis for disputing SCE's advice letter.[30]

For the foregoing reasons, as well as the reasons set forth in SCE's Advice Letter, Advice Letter 3768-E should be approved.

Southern California Edison Company

/s/ Gary A. Stern
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GAS:cf:cm
Enclosure

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[29] *See, e.g.,* D.96-01-011, pp. 140-141. D&O insurance provides a mechanism for aggrieved shareholders to collect funds under certain circumstances like misleading disclosures; without it, shareholder collections from such actions would be below the line for ratepayers.

[30] GO 96-B, General Rule 7.4.2.