

# BURNING DOWN THE HOUSE: ANALYZING CALIFORNIA'S INVERSE CONDEMNATION STRICT LIABILITY RULE FOR UTILITY-CAUSED WILDFIRES

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## I. INTRODUCTION

California's wildfire season, once confined to the hottest and driest months between June and October, is now a year-round phenomenon.<sup>1</sup> In recent years, California wildfires have become more frequent, more destructive, and deadlier than ever before—and by all indications, this trajectory is unlikely to change. Indeed, the scientific community seems to be in agreement that California's wildfire problem will only worsen, as experts predict that California is likely to continue encountering “conditions that are more conducive to larger, more intense fires in the years ahead.”<sup>2</sup>

As California wildfires grow in severity and frequency, so do the costs of wildfire-caused damage. According to estimates from AccuWeather, the total economic damage to California from the 2018 wildfire season alone could reach as high as \$400 billion, including losses in property damage, property values, taxes, lost jobs and wages, health impacts, and fire suppression efforts,

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<sup>1</sup> Hazel Kelly, *Understanding Wildfire in California: What the CSU is Learning*, THE CSU SYS., <https://www.calstate.edu/csu-system/news/Pages/understanding-fire.aspx> [<https://perma.cc/8VWX-YKHJ>] (last visited Dec. 11, 2020).

<sup>2</sup> Paul Rogers, *California Fires: Is Climate Change Making the Winds Stronger?*, THE MERCURY NEWS, <https://www.mercurynews.com/2019/10/28/california-fires-is-climate-change-making-the-winds-stronger> (last updated Oct. 29, 2019, 6:45 PM); see also Ezra David Romero, *Wildfires In California Will 'Continue To Get Worse,' Climate Change Experts Explore Why*, CAPRADIO (Sept. 3, 2020), <https://www.capradio.org/articles/2020/09/03/wildfires-in-california-will-continue-to-get-worse-climate-change-experts-explore-why> [<https://perma.cc/X4ZN-6S3R>].

with a correlated \$50 billion in economic growth to surrounding states as more and more people move out of California.<sup>3</sup> Wildfire costs are ultimately spread across a number of different parties, but in California, public utility companies are particularly vulnerable to a disproportionate cost burden under a unique brand of strict liability that has threatened to impair the state's energy industry, increasing costs for all parties and hindering collective efforts to implement the risk-mitigation solutions that are desperately needed to effectively address the wildfire problem in the long term.

This Note will address the ill-advised application of inverse condemnation to investor-owned utility companies when a destructive wildfire has been ignited by the utility companies' equipment. Inverse condemnation is a constitutional remedy rooted in the Takings Clause of the California Constitution, allowing citizens to bring suit against the government when public actors effect a "taking" by damaging private property. The fundamental purpose of the doctrine is to equitably socialize the costs of public improvements among those who benefit from the improvement, rather than putting a disproportionate cost burden on a few individuals. In many cases where the government is responsible for private property damage, inverse condemnation may be the best and only available avenue of recovery for an injured citizen, as sovereign immunity tends to protect public entities from traditional civil suits.

Although all states and the federal government have some form of an inverse condemnation remedy, California's inverse condemnation rule is unique in two important ways. First, California jurisprudence has developed the doctrine into a strict liability rule, imposing liability regardless of

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<sup>3</sup> 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).

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fault or reasonableness on the part of the public actor.<sup>4</sup> Second, California courts have not restricted this constitutional remedy to the actions of public actors, extending its reach to certain private entities who damage property in their provision of services for public benefit. In particular, California appellate courts have held that inverse condemnation is validly applied to privately-owned utility companies when their electrical equipment sparks a wildfire and causes private property damage,<sup>5</sup> notwithstanding the fact that these companies are private entities and therefore subject to additional regulatory requirements that limit their ability to spread costs among ratepayers who benefit from their services.

Part II of this Note will discuss the origins, claim requirements, and public policy of inverse condemnation in California, as well as the evolution of the strict liability rule applied by California courts in inverse condemnation claims.

Part III briefly introduces the wildfire crisis in California, using the deadly Camp Fire of 2018 as a case study to illustrate how inverse condemnation has been applied to investor-owned utilities (“IOUs”), such as Pacific Gas & Electric (“PG&E”), imposing unprecedented liabilities on the utility and leading them to file for Chapter 11 bankruptcy. This section will also explore the regulatory restraints on the utility companies’ cost-recovery process, explaining the most problematic and controversial aspects of the regulatory environment facing IOUs.

In Part IV, California’s wildfire crisis is explored in more depth, attempting to provide a big-picture view of the wildfire risks of the state. Though utility company equipment may be responsible for igniting the most destructive wildfires in the state, human activity as a whole is

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<sup>4</sup> There is an exception for floodwater-related cases, which are subject to a six-part reasonableness assessment the California Supreme Court laid out in *Locklin v. City of Lafayette*, 7 Cal. 4th 327 (1994).

<sup>5</sup> See, e.g., *Barham v. S. Cal. Edison Co.*, 74 Cal. App. 4th 744 (1999).

amplifying the conditions that lead to the fires blazing out of control. Almost 15% of the 13.5 million homes in California are located in regions known to face severe fire risk, higher than in any other state.<sup>6</sup> Not only does the population growth in high-risk regions increase the frequency of wildfire ignitions, it also makes the wildfires that occur more destructive, more dangerous, and more costly to fight. Part IV will explore how climate change and human migratory patterns to high-risk areas of California are contributing greatly to the increased risk and magnitude of utility-caused wildfires, and will also describe the mitigation efforts that all involved parties must undertake in order to reduce this risk in the long term.

Part V considers the arguments commonly cited to support continued application of strict liability to IOUs whose equipment ignites wildfires, but ultimately concludes that strict liability is inappropriate to regulate the provision of electrical services because of its tendency to create externalities and allocate risk inequitably. As the growing specter of wildfire liability continues to make it more expensive for utility companies to provide electricity to consumers in California, all ratepayers see an increase in electrical rates, notwithstanding the fact that consumers in wildfire-prone regions disproportionately contribute to the hazard by their choice to live in areas known to be at high risk of wildfires. Using traditional legal frameworks, economic principles, and an analysis of IOU capital structures, this Note will advocate a fault-based negligence rule as the most efficient liability rule under inverse condemnation claims to allocate the risks and costs associated with the activity of providing electricity in California. The passage of Assembly Bill 1054 will also be acknowledged as a positive development in alleviating some of the adverse effects of strict

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<sup>6</sup> *More Than 2 Million California Homes Exposed to High Wildfire Danger*, ATMOSPHERIC AND ENV'T. RSCH., <https://www.aer.com/news-events/press-releases/2012/more-2-million-california-homes-exposed-high-wildfire-danger> [<https://perma.cc/T59C-GDA7>] (last accessed Mar. 20, 2021).

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liability, but also recognized for its shortcomings in failing to fully achieve the equitable cost-spreading purpose that is the fundamental purpose of inverse condemnation.

Part VI contains concluding remarks.

## II. INVERSE CONDEMNATION IN CALIFORNIA

### A. ORIGINS OF THE DOCTRINE

The California Tort Claims Act (“Tort Claims Act”) provides that “a public entity is not liable for an injury, whether such injury arises out of an act or omission of the public entity or a public employee or any other person.”<sup>7</sup> This statute codifies the general rule of sovereign immunity, limiting state liability for civil claims filed by private citizens for “money or damages,” subject to certain exceptions.<sup>8</sup> Among the most important exceptions to sovereign immunity are claims of inverse condemnation, which, as a constitutional remedy, are not subject to the Tort Claims Act.<sup>9</sup> Thus, if a property owner suffers property damage caused by government actions, the Tort Claims Act would typically prevent the property owner from suing the public actor under traditional tort liability (via a nuisance or negligence claim), but the owner may be able to recover under a claim for inverse condemnation in order to circumvent this limitation. As the court explained in *Pacific Bell v. City of San Diego*, 81 Cal. App. 4th 596 (2000), “the constitutional provisions requiring compensation for property taken or damaged by a public use overrides the Tort Claims Act and its statutory immunities . . . . Thus, a plaintiff who establishes the elements of

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<sup>7</sup> California Tort Claims Act, CAL. GOV’T CODE § 815 (Deering 2021).

<sup>8</sup> David Goguen, *Making an Injury Claim Under the California Tort Claims Act*, NOLO, <https://www.nolo.com/legal-encyclopedia/making-injury-claim-under-the-california-tort-claims-act.html> [<https://perma.cc/CS6Z-CMBY>] (last visited Dec. 11, 2020).

<sup>9</sup> David Ligtenberg, *Inverse Condemnation: California’s Widening Loophole*, 10 CAL. LEGAL HIST. J. 209, 228 (2015).

an inverse condemnation claim may recover for property damage even though his tort claim has been rejected.”<sup>10</sup>

Inverse condemnation is a constitutional remedy that allows citizens to bring suit against government entities who damage private property in furtherance of a public use. The doctrine has its roots in the Fifth Amendment of the U.S. Constitution, which states that private property shall not “be taken for public use, without just compensation.”<sup>11</sup> This constitutional provision, known as the “Takings Clause,” highlights the dominance of private property ownership in American jurisprudence, striking a balance by enabling the federal government to seize property in advancement of a worthy public goal while ensuring that this is not done at the expense of individual private citizens. In California, inverse condemnation actions are predicated upon Article 1 § 19 of the state constitution, which similarly states that “[p]rivate property may be taken or damaged for a public use and only when just compensation . . . has first been paid to, or into court for, the owner.”<sup>12</sup> Under the original California Constitution of 1849, the government was required to pay “just compensation” to an individual property owner only if the government physically invaded the property.<sup>13</sup> When the California legislature revised the state’s constitution in 1879, it expanded the scope of the doctrine by adding the words “or damaged” to the takings provision.<sup>14</sup> In this sense, the California Takings Clause goes further than its federal counterpart, clarifying that the requirement of “just compensation” is not limited to physical invasions by the government,

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<sup>10</sup> *Pac. Bell v. City of San Diego*, 81 Cal. App. 4th 596, 602–03 (2000).

<sup>11</sup> U.S. CONST. amend. V.

<sup>12</sup> CAL. CONST. art. I, § 19(a).

<sup>13</sup> *Customer Co. v. City of Sacramento*, 10 Cal. 4th 368, 378-79 (1995).

<sup>14</sup> *Id.*

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“but also encompasses special and direct damage to adjacent property resulting from the construction of public improvements.”<sup>15</sup>

Inverse condemnation can be understood in comparison to the more familiar concept of eminent domain; both stem from the same constitutional provision regarding government takings. In eminent domain, the government initiates the action by forcing the sale of private land that has been identified for a public use, in which case the Takings Clause requires the payment of “just compensation” to the owner. In contrast, inverse condemnation proceedings are initiated by private citizens against government entities when the state has enacted a taking of private property without meeting the constitutional requirement of just compensation. As explained by the California Supreme Court in *Customer Co. v. City of Sacramento*, 10 Cal. 4th 368 (1995),

[T]he ‘just compensation’ clause is concerned, most directly, with the state’s exercise of its traditional eminent domain power, guaranteeing that when the state proposes to take private property for public use, the owner of the property promptly will receive just compensation. And, as the words suggest, an ‘inverse condemnation’ action may be pursued when the state or other public entity improperly has taken private property for public use without following the requisite condemnation procedures—as when the state, in constructing a public project, occupies land that it has not taken by eminent domain, or when the state takes other action that effectively circumvents the constitutional requirement that just compensation be paid before private property is taken for public use.<sup>16</sup>

Though eminent domain and inverse condemnation are conceptually similar in that both doctrines require the payment of just compensation to property owners when there has been a public taking of land, California courts have emphasized that “[e]minent domain and inverse

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<sup>15</sup> *Id.* at 380; *see, e.g.*, *HFH, Ltd. v. Sup. Ct. of L.A. Cnty.*, 15 Cal. 3d 508, 517 (1975) (“This court has recognized the broader protections granted landowners by the addition of ‘or damaged’ to the language of our state’s compensation clause.”); *Reardon v. S.F.*, 66 Cal. 492, 501 (1885) (“If the word ‘damaged’ only embraced physical invasions of property, the right secured by this word would add nothing to the guaranty as it formerly stood.”).

<sup>16</sup> *Customer Co.*, 10 Cal. 4th at 368.

condemnation are related but distinct areas of law.”<sup>17</sup> Eminent domain proceedings can be understood as forward-looking in the sense that the relevant statutory requirements generally must be met before the government may seize the land at stake. As a result, most eminent domain-related litigation stems from competing definitions of what constitutes “just compensation.” In contrast, inverse condemnation actions may only be brought after a public taking has already occurred. This chronological discrepancy means that inverse condemnation claimants must “first clear the hurdle of establishing that the public entity has . . . taken [or damaged] his or her property before he or she can reach the issue of ‘just compensation.’ ”<sup>18</sup>

## B. ELEMENTS OF THE DOCTRINE

In order to state a claim for inverse condemnation, a California property owner must demonstrate that the state has enacted a constitutionally recognized taking without payment of just compensation. The two essential elements for a valid inverse condemnation claim are (1) a public use and (2) tangential harm to the owner.<sup>19</sup>

### 1. Public Use Requirement

Inverse condemnation is intended to prevent individual citizens from being forced to bear a disproportionate cost for damage caused by public improvements that benefit the community. Accordingly, a plaintiff must establish that “the public entity’s conduct . . . [was] in pursuance of

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<sup>17</sup> *Weiss v. People ex rel. Dep’t. of Transp.*, 20 Cal. App. 5th 1156, 1166 (2018). In California the rules prescribing eminent domain are codified in Title 7 of the California Code of Civil Procedure, while “the law of inverse condemnation [has been] left for determination by judicial development;” thus, the courts have made it clear that these doctrines are not subject to the same rules. *Id.* at 1167.

<sup>18</sup> *Id.*

<sup>19</sup> *See* 5 California Torts § 61.63 (2021).



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a public use.”<sup>20</sup> The California Supreme Court has defined “public use” as “a use which concerns the whole community or promotes the general interest in its relation to any legitimate object of government.”<sup>21</sup> The public use requirement thus limits the scope of inverse condemnation actions to claims for property damage “proximately caused by a public improvement as deliberately designed and constructed.”<sup>22</sup>

In *City of Pasadena v. Superior Court*, 228 Cal. App. 4th 1228 (2014), the court formulated a two-pronged test to determine what qualifies as a public improvement for purposes of inverse condemnation: “(1) a deliberate action by the state (2) taken in furtherance of public purposes.”<sup>23</sup> The first part of this test holds that there is no inverse condemnation liability unless the government’s action “amount[s] to ‘substantial participation’ in a public project or improvement.”<sup>24</sup> This also requires that the government had some level of control “over the instrumentality that caused the damages.”<sup>25</sup> The second part of this test simply holds that the action must be “in furtherance of public purposes,”<sup>26</sup> which courts have construed broadly to include everything from the construction of public transportation<sup>27</sup> and public roads,<sup>28</sup> to the development of sewage systems,<sup>29</sup> and even to the planting of trees for public beautification projects.<sup>30</sup>

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<sup>20</sup> *Yox v. City of Whittier*, 182 Cal. App. 3d 347, 352 (1986).

<sup>21</sup> *Bauer v. County of Ventura*, 45 Cal. 2d 276, 284 (1955).

<sup>22</sup> *Yox*, 182 Cal. App. 3d at 352.

<sup>23</sup> *City of Pasadena v. Super. Ct.*, 228 Cal. App. 4th 1228, 1234 (2014).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at 1235.

<sup>26</sup> *Id.* at 1234.

<sup>27</sup> *Holtz v. Super. Ct. of S.F.*, 3 Cal. 3d 296, 299 (1970).

<sup>28</sup> *Albers v. County of Los Angeles*, 62 Cal. 2d 250, 263–64 (1965).

<sup>29</sup> *Cal. State Auto. Ass’n. v. City of Palo Alto*, 138 Cal. App. 4th 474, 484 (2006).

<sup>30</sup> *Regency Outdoor Advert., Inc. v. City of Los Angeles*, 39 Cal. 4th 507, 516 (2006).

## 2. Tangential Harm Requirement

In order to state a claim for inverse condemnation, the property owner must assert that there has been “an invasion of property which directly, substantially, and peculiarly burdens plaintiff to his detriment.”<sup>31</sup> This means that the harm must subject the owner to particular “injury different from other owners in the area,” and California courts have held that in order to recover in inverse condemnation, “there must be an invasion or an appropriation of some valuable property right which the landowner possesses and the invasion or appropriation must directly and specially affect the landowner to his injury.”<sup>32</sup>

This detriment is not limited to strict physical harm but can also include substantial interference with the use and enjoyment of property, as well as impairments to a compensable property right. For example, in *Bacich v. Board of Control*, 23 Cal. 2d 343 (1943), the plaintiff prevailed in his claim for inverse condemnation when a bridge construction project cut off one of the intersecting roads leading to his street, allowing him to only access his property from one direction.<sup>33</sup> California courts have also granted damages under inverse condemnation based on the noise resulting from municipal airports operating in the vicinity of a property, so long as “the owner . . . can show a measurable reduction in market value resulting from the operation of the airport in such manner that the noise from aircraft using the airport causes a substantial interference with the use and enjoyment of the property.”<sup>34</sup> These cases tend to show a broad construal of the kinds of harm that might enable a property owner to bring an inverse condemnation.

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<sup>31</sup> *Harding v. California ex rel. Dep’t of Transp.*, 159 Cal. App. 3d 359, 364 (1984).

<sup>32</sup> *Border Bus. Park, Inc. v. City of San Diego*, 142 Cal. App. 4th 1538, 1548 (2006).

<sup>33</sup> *Bacich v. Bd. of Control*, 23 Cal. 2d 343, 355–56 (1943).

<sup>34</sup> *Aaron v. City of Los Angeles*, 40 Cal. App. 3d 471, 483–84 (1974).

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While a property owner need not show physical damage to state a cause of action for inverse condemnation, courts have limited such claims absent a showing of actual damage beyond market value diminution. For example, in *HFH, Ltd. v. Superior Court of Los Angeles County*, 15 Cal. 3d 508 (1975), the court denied inverse condemnation for a zoning law that allegedly decreased the value of the plaintiff's property. Finding that "incidental damages to property resulting from . . . laws passed in the promotion of the public welfare" do not qualify as the kind of damage compensable under inverse condemnation, the court narrowly construed the harm requirement to exclude mere diminution in market value of undamaged land.<sup>35</sup> Similarly, in *Kavanau v. Santa Monica Rent Control Board*, 16 Cal. 4th 761 (1997), the court rejected the landlord plaintiff's claim that a local rent control ordinance could establish a taking because the economic impact "was not significant when compared to the benefits he continued to receive from his property."<sup>36</sup>

### C. PUBLIC POLICY AND THE EVOLUTION OF INVERSE CONDEMNATION LIABILITY RULES

California courts have repeatedly emphasized that the rationale behind the doctrine of inverse condemnation is equity and fairness, noting that "the fundamental policy underlying inverse condemnation is to distribute the costs of the public benefit among those benefited by the public improvement rather than imposing a disproportionate burden on the person damaged by the operation of the improvement."<sup>37</sup> In other words, the purpose of inverse condemnation is "to spread among the benefitting community any burden disproportionately borne by a member of that

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<sup>35</sup> *HFH, Ltd. v. Super. Ct. of L.A. Cnty.*, 15 Cal. 3d 508, 515 (1975).

<sup>36</sup> *Kavanau v. Santa Monica Rent Control Bd.*, 16 Cal. 4th 761, 780 (1997).

<sup>37</sup> *Barham v. S. Cal. Edison Co.*, 74 Cal. App. 4th 744, 752 (1999).

community, to establish a public undertaking for the benefit of all.”<sup>38</sup> This cost-spreading function of inverse condemnation “to socialize the burden . . . that should be assumed by society” has been consistently endorsed by judicial interpretation from California courts as “the fundamental policy” of the doctrine.<sup>39</sup>

Understanding the cost-spreading purpose of inverse condemnation is also essential to appreciate how California’s doctrine developed into a strict liability rule over the years. As explained in the decisions of the California Supreme Court, “[h]istorically, courts [had] analyzed inverse condemnation liability issues by referring to traditional tort and property law concepts”<sup>40</sup> such that inverse condemnation claimants could only recover for injuries that would be “actionable at common law . . . if done by a private individual.”<sup>41</sup> In the landmark decision *Albers v. County of Los Angeles*, 62 Cal. 2d 250 (1965), the Court rejected the common law approach to inverse condemnation, holding that the plaintiff companies and residents were entitled to recover under this constitutional remedy for “physical damage . . . caused to their property by a public improvement deliberately planned and built, whether such damage was foreseeable or not,” notwithstanding the fact that “a private party would not be liable for damages similarly inflicted.”<sup>42</sup> By shifting “the focus in inverse condemnation cases from the common law to the Constitution,” the *Albers* court laid forth a strict liability rule for inverse condemnation claims based on the understanding that “the underlying purpose of our constitutional provision in inverse—as well as

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<sup>38</sup> *Id.*

<sup>39</sup> *Holtz v. Super. Ct. of S.F.*, 3 Cal. 3d. 296, 303 (quoting Daniel R. Mandelker, *Inverse Condemnation: The Constitutional Limits of Public Responsibility*, 1966 WIS. L. REV. 3, 8).

<sup>40</sup> *Bunch v. Coachella Valley Water Dist.*, 15 Cal. 4th 432, 439 (1997).

<sup>41</sup> *Albers v. County of Los Angeles*, 62 Cal. 2d 250, 259 (1965) (quoting 2 Nichols on Eminent Domain § 6.441(2) (3d ed. 1963)).

<sup>42</sup> *Id.* at 250, 262.

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ordinary—condemnation is ‘to distribute throughout the community the loss inflicted upon the individual . . . .’<sup>43</sup> The strict liability rule of inverse condemnation is thus based on the constitutional requirement of just compensation rather than traditional tort principles of negligence, and the “decisive consideration is whether the owner of the damaged property if uncompensated would contribute more than his proper share to the public undertaking.”<sup>44</sup>

Under the strict liability rule of inverse condemnation, “any actual physical injury to real property proximately caused by the improvement as deliberately designed and constructed is compensable under article I, section 14, of [the California] Constitution.”<sup>45</sup> Unlike negligence, which requires a plaintiff to put forward evidence showing that there was a duty that was breached by the defendant in order to prevail, the strict liability rule of “inverse condemnation does not require any breach of a standard of care, nor foreseeability of the harm.”<sup>46</sup> As long as there is a causal relationship between the government’s act or omission and the loss, a plaintiff in inverse condemnation need only show that there was “a deliberate act by a public entity which has as its object the direct or indirect accomplishment of the purpose for which the improvement was constructed and which causes a taking or damaging of private property.”<sup>47</sup> Accordingly, “liability may exist on inverse condemnation grounds in the absence of fault” by the government actor.<sup>48</sup>

The key to triggering this liability rule is the deliberate action of the government, discussed *supra*, which is satisfied when “a public improvement that as designed and constructed presents inherent risks of damage to private property, and the inherent risks materialize and cause

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<sup>43</sup> *Bunch*, 15 Cal. 4th at 440 (citing *Holtz*, 3 Cal. 3d at 303).

<sup>44</sup> *Albers*, 62 Cal. 2d at 262 (quoting *Clement v. State Reclamation Bd.*, 25 Cal. 2d 628, 642 (1950)).

<sup>45</sup> *Id.*

<sup>46</sup> *Aetna Life & Cas. Co v. City of Los Angeles*, 170 Cal. App. 3d 865, 873 (1985).

<sup>47</sup> *Id.* at 874.

<sup>48</sup> Arvo Van Alstyne, *Inverse Condemnation: Unintended Physical Damage*, 20 HASTINGS L. J. 431, 433(1969).

damage.”<sup>49</sup> Under inverse condemnation principles, there is an expectation that “if an improvement is ‘inherently dangerous to private property,’ the public entity . . . undertakes the responsibility ‘to compensate property owners for injury to their property arising from the inherent dangers of the public improvement or originating ‘from the wrongful plan or character of the work.’ ”<sup>50</sup>

However, even while enforcing the strict liability rule, courts have expressed hesitation about allowing the rule to be taken too far, voicing the concern that “compensation allowed too liberally will seriously impede, if not stop, beneficial public improvements because of the greatly increased cost.”<sup>51</sup> Even if the public improvement was only one of several concurrent causes contributing to a particular harm, an overly broad application of the strict liability rule would allow a property owner to establish inverse condemnation liability as long as there existed a sufficiently robust “causal nexus between the risks inherent in the public improvement and the harm in question.”<sup>52</sup>

### 1. Clarifying the Strict Liability Standard

In response to this perceived tension, in *City of Oroville v. Superior Court*, 7 Cal. 5th 1091 (2019), the California Supreme Court articulated a narrower causation requirement for inverse condemnation claims. *City of Oroville* involved a claim for damages resulting from raw sewage backing up into the plaintiff’s building, which the plaintiffs alleged was caused by the public sewer

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<sup>49</sup> Pac. Bell v. City of San Diego, 81 Cal. App. 4th 596, 607 (2000).

<sup>50</sup> City of Oroville v. Super. Ct., 7 Cal. 5th 1091, 1103 (2019) (quoting House v. L.A. Cnty. Flood Control Dist., 25 Cal. 2d 384, 396 (1944)).

<sup>51</sup> Albers v. County of Los Angeles, 62 Cal. 2d 250, 263 (quoting Bacich v. Bd. of Control, 23 Cal. 2d 343, 350 (1943)).

<sup>52</sup> *City of Oroville*, 7 Cal. 5th at 1104.

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system’s failure to function as intended, therefore creating a legal obligation to compensate the property owners. The court rejected the claim of the property owners, who had failed to install a legally required backwater valve that would have siphoned away the waste in the event of a sewer main backup. Noting that the damage that occurred would have been “prevented or substantially diminished” had the property owners installed the backwater valve—as was legally required—the court deemed the property owners’ noncompliance with this “reasonable” planning code requirement to be “a significant secondary cause” of the damage, and therefore declined to find that the design of the sewer system was the “substantial cause of the damage to the private property.”<sup>53</sup>

In its holding, the court declared that public entities should not be “strictly or otherwise automatically liable for any conceivable damage bearing some kind of connection, however remote, to a public improvement.”<sup>54</sup> Instead, the court clarified that both “inherent risk” and “substantial causation” must be present to uphold a claim for inverse condemnation, observing that this causation standard would both “protect[] private property owners by allocating the financial losses resulting from the public improvement across the community and provide public entities with an incentive to internalize the reasonable risks of their public improvements.”<sup>55</sup>

## 2. The Inherent Risk Element

The inherent risk element of the *City of Oroville* test requires an inverse condemnation claimant to show that their injury arose “from the inherent dangers of the public improvement as deliberately designed, constructed, or maintained,” thus protecting public entities from open-ended

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<sup>53</sup> *Id.* at 1098, 1105, 1111.

<sup>54</sup> *Id.* at 1098.

<sup>55</sup> *Id.* at 1105–06.

liability for “private property damage that is arguably connected to a public improvement but is not the result of the improvement’s inherent risks.”<sup>56</sup> The court reasoned that in making a decision to pursue any specific public improvement, the government entity, as the “public ‘locus of responsibility,’ ” is presumed to have acted reasonably in weighing the costs and risks of the improvement.<sup>57</sup> Under this assessment, the public entity may have been reasonable in choosing to adopt a “comparatively lower[-]cost plan to create the public improvement . . . . [where] the likelihood of damage is remote, but the expense of additional protection is great.”<sup>58</sup> However, “[i]n those circumstances, private property owners should be compensated for the damage to their property resulting from the inherent risks posed by the public improvement as reasonably undertaken at the lower cost because the public entity ‘is in a better position to evaluate the nature and extent of the risks of public improvement than are potentially affected property owners.’ ”<sup>59</sup>

### 3. The Substantial Causation Element

The substantial causation element adds another requirement to the *City of Oroville* inverse condemnation standard, requiring that “the injury to private property [be] an ‘inescapable or unavoidable consequence’ of the public improvement as planned and constructed.”<sup>60</sup> To satisfy this element, a plaintiff must show that their damages “‘followed in the normal course of subsequent events’ and were ‘predominantly’ produced by the improvement,” allowing a court to “consider a plaintiff’s act or omission in the chain of causation” and impose liability for inverse condemnation “only in instances where there is a sufficiently meaningful causal relationship

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<sup>56</sup> *Id.* at 1106.

<sup>57</sup> *Id.* at 1107.

<sup>58</sup> *Id.* at 1106.

<sup>59</sup> *Id.* at 1107 (quoting *Holtz v. Super. Ct. of S.F.*, 3 Cal. 3d 296, 311 (1970)).

<sup>60</sup> *Id.* at 1108 (quoting *Van Alstyne*, *supra* note 48, at 437 n.32).



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between the damage to private property and the inherent risks posed by the public improvement as designed, constructed, or maintained.”<sup>61</sup>

#### 4. Impact of City of Oroville

The *City of Oroville* decision drew much attention because it was the first time the California Supreme Court had dealt with inverse condemnation in decades.<sup>62</sup> However, the significance of the decision should not be misconstrued as an overhaul of the strict liability rule associated with California’s inverse condemnation law. Though the decision was notable in that it permitted courts to account for the actions of owners of damaged property who may have contributed to their own injuries in the chain of causation, it did not reflect any sort of dramatic departure from the strict liability rule that has been applied in inverse condemnation claims. To the contrary, the court reaffirmed that as long as the causation factors are met, a government entity will still be liable for damage caused by a public improvement, even if they acted reasonably and without any fault. Instead, the case can best be understood as making the point that a plaintiff’s own negligent actions may prevent them from making a prima facie case for inverse condemnation, and clarifying that both inherent risks and substantial causation must be present in order to succeed on an inverse condemnation claim in California.<sup>63</sup>

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<sup>61</sup> *Id.*

<sup>62</sup> See, e.g., Nossaman LLP, *California Supreme Court Provides Rare Update on Inverse Condemnation Doctrine*, LEXOLOGY (Aug. 18, 2019), <https://www.lexology.com/library/detail.aspx?g=b65f06b1-71cd-4509-989f-a108bd9b7fdc> [<https://perma.cc/MJT5-ADXX>]; Evan Walker, *What is Inverse Condemnation in California After City of Oroville?*, EVAN W. WALKER BLOG (Aug. 30, 2019), <https://www.evanwalkerlaw.com/blog/what-is-inverse-condemnation-in-california-after-city-of-oroville> [<https://perma.cc/5BEF-VY7E>].

<sup>63</sup> See Hannah Myers, *Oroville’s Effect on Inverse Condemnation Claims*, DESMOND, NOLAN, LIVAICH & CUNNINGHAM BLOG (Nov. 8, 2019), <https://www.dnlc.net/orovilles-effect-on-inverse-condemnation-claims> [<https://perma.cc/7MHL-P737>].

## III. INVERSE CONDEMNATION AND WILDFIRE LITIGATION IN CALIFORNIA

## A. THE CAMP FIRE

In the early morning hours of November 8, 2018, on Camp Creek Road in Butte County, California, electrical transmission lines owned by utility company PG&E sparked at two ignition points.<sup>64</sup> Fueled by hot, dry conditions and strong winds, these ignition points erupted into what became known as the Camp Fire, which has been designated as the “deadliest and most destructive fire in California history.”<sup>65</sup> By the time the wildfire was contained, seventeen days later, it had blazed through more than 150,000 acres, destroying more than 18,000 buildings, and killing eighty-five people.<sup>66</sup>

PG&E is the largest utility company in California, providing electricity and gas to more than 16 million California residents via 125,147 miles of electric and transmission lines over a 70,000 square mile service area.<sup>67</sup> Over the past few years, PG&E electrical equipment has sparked over 1,500 fires in California, and though most of those were suppressed before they could reach one hundred acres, authorities connected PG&E to at least seventeen major wildfires in the year 2017 alone.<sup>68</sup> Although the company has taken steps to make its system safer and reduce fire risks,

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<sup>64</sup> Adi Robertson, *Investigators Confirm that PG&E Power Lines Started the Deadly Camp Fire*, THE VERGE (May 15, 2019, 6:16 PM), <https://www.theverge.com/2019/5/15/18626819/cal-fire-pacific-gas-and-electric-camp-fire-power-lines-cause> [https://perma.cc/P2ZX-DA6N].

<sup>65</sup> *Id.*

<sup>66</sup> Colleen Hagerty, *The Survivors*, VOX, <https://www.vox.com/the-highlight/2019/10/16/20908291/camp-fire-wildfire-california-paradise-survivors> [https://perma.cc/5A99-ZEYU] (last updated Oct. 23, 2019, 7:15 AM).

<sup>67</sup> *Company Profile*, PG&E, [https://www.pge.com/en\\_US/about-pge/company-information/profile/profile.page](https://www.pge.com/en_US/about-pge/company-information/profile/profile.page) [https://perma.cc/N269-QEAB ] (last visited Dec. 11, 2020).

<sup>68</sup> Russell Gold, Katherine Blunt & Rebecca Smith, *PG&E Sparked at Least 1,500 California Fires. Now the Utility Faces Collapse.*, WALL ST. J. (Jan. 13, 2019, 3:19 PM), <https://www.wsj.com/articles/pg-e-sparked-at-least-1-500-california-fires-now-the-utility-faces-collapse-11547410768> [https://perma.cc/5GKD-GVQ7].

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its efforts have not kept pace with California's increased fire risk, which has worsened as a result of drought and other factors.<sup>69</sup>

The Camp Fire resulted in unprecedented liabilities for PG&E, which faced dozens of lawsuits for wildfire damages from residents and insurers seeking an estimated \$30 billion in damages, more than triple the power company's market value of \$9.12 billion at the time.<sup>70</sup> After the fire, ratings agencies reduced its stock to "junk" status.<sup>71</sup> The company also faced criminal charges for the deaths caused by the fire, and ultimately pled guilty to eighty-four counts of involuntary manslaughter, resulting in an additional \$3.5 million fine.<sup>72</sup> This was the maximum penalty that could be imposed for such charges, and although many denounced this amount as being unsatisfyingly small, it was notable in that it marked the first time that any major utility company had been charged with homicide as a result of causing a fire.<sup>73</sup> In January of 2019, PG&E filed for Chapter 11 bankruptcy, claiming that it could no longer meet its financial obligations, a move that was criticized as "a significant and unwelcome development" that signaled the company was "more concerned with [their] shareholders than [they were with their] customers."<sup>74</sup>

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<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> Eric Westervelt & Matthew S. Schwartz, *California Power Provider PG&E Files for Bankruptcy in Wake of Fire Lawsuits*, NPR (Jan. 29, 2019, 7:06 AM), <https://www.npr.org/2019/01/29/689591066/california-power-provider-pg-e-files-for-bankruptcy-in-wake-of-fire-lawsuits> [<https://perma.cc/4D6U-Q52Y>].

<sup>72</sup> Ivan Penn & Peter Eavis, *PG&E Pleads Guilty to 84 Counts of Manslaughter in Camp Fire Case*, N.Y. TIMES, <https://www.nytimes.com/2020/06/16/business/energy-environment/pg-e-camp-fire-california-wildfires.html> [<https://perma.cc/TF38-SSBD>] (last updated June 18, 2020).

<sup>73</sup> Vanessa Romo, *PG&E Pleads Guilty on 2018 California Camp Fire: 'Our Equipment Started That Fire,'* NPR (June 16, 2020, 11:09 PM), <https://www.npr.org/2020/06/16/879008760/pg-e-pleads-guilty-on-2018-california-camp-fire-our-equipment-started-that-fire> [<https://perma.cc/4H7F-VZ9N>].

<sup>74</sup> Westervelt & Schwartz, *supra* note 71.

## B. IOUs AND INVERSE CONDEMNATION

PG&E is an IOU. The three largest IOUs in California—PG&E, San Diego Gas and Electric (“SDG&E”), and Southern California Edison (“SCE”)—control approximately seventy-five percent of the electricity transmission in the state.<sup>75</sup> Unlike public utilities (“POUs”), IOUs are for-profit companies owned by shareholders, and their earnings and operations are regulated by the California Public Utilities Commission (“CPUC”).<sup>76</sup> One thing that IOUs and POU have in common is that both are covered by California’s inverse condemnation doctrine and subject to the strict liability rule for damage caused by their electric equipment, whether or not they acted reasonably and followed all applicable safety standards.<sup>77</sup>

California courts have held that IOUs should be treated as public entities subject to the constitutional doctrine of inverse condemnation, notwithstanding the fact that IOUs are private actors, because they are granted quasi-monopoly status and eminent domain power by the state, raising the inference that “the state generally expects a public utility to conduct its affairs more like a governmental entity than like a private corporation.”<sup>78</sup> In *Barham v. Southern California Edison Co.*, 74 Cal. App. 4th 744 (1999), the court grappled with how to assign liability given the private ownership status of IOUs, ultimately concluding that the determining factor in this assessment was not the nature of the entity, but the fact that providing electrical power was a public

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<sup>75</sup> *Utilities*, CAL. ISO, <http://www.aiso.com/about/Pages/IndustryInsights/IndustryLinks/Utilities.aspx> [<https://perma.cc/VVX8-4M3L>] (last visited Dec. 15, 2020).

<sup>76</sup> *Learn PG&E Terms and Definitions*, PG&E, [https://www.pge.com/en\\_US/residential/your-account/your-bill/understand-your-bill/important-definitions/common-rate-terms.page?](https://www.pge.com/en_US/residential/your-account/your-bill/understand-your-bill/important-definitions/common-rate-terms.page?) (last visited Dec. 16, 2020).

<sup>77</sup> Letter from California Municipal Utilities Association, the Southern California Public Power Authority, the Northern California Power Agency, and Golden State Power Cooperative on behalf of Publicly Owned Electric Utilities and Electrical Cooperatives to Commission on Catastrophic Wildfire Cost and Recovery (Apr. 22, 2019), at 2.

<sup>78</sup> *Barham v. S. Cal. Edison Co.*, 74 Cal. App. 4th at 744, 753 (1999) (citing *Gay Law Students Ass’n v. Pac. Tel. & Tel. Co.*, 24 Cal. 3d 458, 469 (1979)).

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use.<sup>79</sup> In reaching this decision, the court also reasoned that IOUs, similarly to government entities, have a large customer base over which they could spread the costs of compensating wildfire victims.<sup>80</sup>

Unfortunately, this reasoning has since been shown to be unsound, as the private ownership status of IOUs means they are subject to cost-recovery restrictions that limit their ability to raise electrical rates and spread costs among their customer base. The strict liability regime associated with California's inverse condemnation rule "casts a wider net than ordinary negligence" on these companies in that all damage substantially caused by the inherent risks associated with the public improvement "falls within the scope of liability" regardless of the actor's amount of care.<sup>81</sup> As discussed in Part II, the strict liability rule of inverse condemnation developed out of fairness principles, based on the idea that "individual property owners should not have to contribute disproportionately to the risks [or costs] from public improvements made to benefit the community as a whole."<sup>82</sup> However, most inverse condemnation cases involve claims against public entities that can recoup such costs through increased taxation. It makes sense for public entities to be held liable regardless of negligence because they are in a position to spread these costs among taxpayers who benefit from the public improvement. In contrast, IOUs facing millions or billions of dollars in wildfire liability are not guaranteed the ability to raise their rates in order to spread the costs among electricity users who benefit from the services they provide.<sup>83</sup>

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<sup>79</sup> *Id.*

<sup>80</sup> *See id.*

<sup>81</sup> Ligtenberg, *supra* note 9, at 232.

<sup>82</sup> *Pac. Bell Tel. Co. v. S. Cal. Edison Co.*, 208 Cal. App. 4th 1400,1407 (2012).

<sup>83</sup> CAROLYN KOUSKY, KATHERINE GREIG, BRETT LINGLE & HOWARD KUNREUTHER, WILDFIRE COSTS IN CALIFORNIA: THE ROLE OF ELECTRIC UTILITIES, WHARTON RISK MGMT & DECISION PROCESSES CTR. 3, 10 (Aug. 2018), <https://riskcenter.wharton.upenn.edu/wp-content/uploads/2018/08/Wildfire-Cost-in-CA-Role-of-Utilities-1.pdf> [<https://perma.cc/3UZK-NKYD>].

## C. COST RECOVERY AND THE CPUC

When an IOU in California faces unexpected costs, such as those arising from wildfire liability, it is unable to unilaterally raise prices to ratepayers.<sup>84</sup> Instead, it must apply to the CPUC for approval in order to recover costs from ratepayers.<sup>85</sup> Until the 2019 passage of Assembly Bill 1054, discussed *infra*, the CPUC evaluated petitions by IOUs to raise rates based on a discretionary “prudent manager” standard. Under this standard, when IOU equipment contributed to a wildfire, the CPUC assessed the utility company’s behavior to determine whether they acted imprudently.<sup>86</sup> If the company was found to have acted imprudently, the CPUC would deny their request to raise rates. Notably, even when the CPUC did allow an IOU to raise rates, the inefficiency associated with the regulatory decision-making process meant that, in some instances, many years would pass before the CPUC finally approved a rate hike.<sup>87</sup> For example, in 2017 the CPUC rejected SDG&E’s application to recover \$379 million in wildfire costs by raising electricity rates after determining that the utility “did not reasonably and prudently operate its facilities.”<sup>88</sup> The wildfires in question had taken place in 2007, and there had been no utility-caused fires in SDG&E’s service territory since then.<sup>89</sup>

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<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> EVAN JOHNSON, CARLA PETERMAN, DAVE JONES, MICHAEL KAHN, PEDRO NAVA & MICHAEL WARA, GOVERNOR’S OFF. OF PLAN. AND RSCH., FINAL REPORT OF THE COMMISSION ON CATASTROPHIC WILDFIRE COST AND RECOVERY 4–5 (June 17, 2019), [https://opr.ca.gov/docs/20190618-Commission\\_on\\_Catastrophic\\_Wildfire\\_Report\\_FINAL\\_for\\_transmittal.pdf](https://opr.ca.gov/docs/20190618-Commission_on_Catastrophic_Wildfire_Report_FINAL_for_transmittal.pdf) [<https://perma.cc/UHN7-3KQZ>] (“When utility equipment contributed to a wildfire, the CPUC must determine that the utility prudently managed its system before IOUs can recover liability costs .... This determination may be years after the fire has occurred due to the length of the civil litigation process to determine liability...and subsequent CPUC cost recovery proceeding, which begins only after the civil process is complete.”).

<sup>88</sup> Lelaine, *CPUC Denies Rehearing Requests Related to SDG&E Cost Recovery for 2007 Wildfires*; CPUC NEWS BLOG (July 16, 2018, 11:52 AM), <https://www.cpuc.ca.gov/cpublog.aspx?id=6442458187&bloginid=1551> [<http://web.archive.org/web/20201225020917/https://www.cpuc.ca.gov/cpublog.aspx?id=6442458187&bloginid=1551>].

<sup>89</sup> JOHNSON ET AL., *supra* note 87, at 41.

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The “prudent manager” standard faced significant criticism over its lack of transparency and consistency in cost-recovery mechanisms for IOUs and failure to take into account the strict liability regime imposed by California’s inverse condemnation rule. Even commissioners on the CPUC expressed dissatisfaction at the inflexibility the standard provided. In their 2017 denial of the SDGE cost-recovery application, although the CPUC ultimately declined to consider the strict liability rule when deciding whether or not to approve rate hike applications related to inverse condemnations, the Commission voiced concern that “the application of inverse condemnation to utilities in all events of private property loss would fail to recognize important distinctions between public and private utilities” and urged the California Legislature to “address the issues of liability calculation and cost allocation in instances when utility infrastructure is implicated in private property loss.”<sup>90</sup>

In July 2019, the California Legislature passed Assembly Bill 1054,<sup>91</sup> which greatly ameliorated the harshness of California’s strict liability inverse condemnation regime and will be discussed in more detail in Part V of this Note. With respect to the cost-recovery mechanisms imposed by the CPUC, the relevant provisions of this bill added much-needed clarity to the process by allowing utility companies to earn a presumption of prudence if they hold a valid safety certification with the CPUC.<sup>92</sup> In order to obtain a valid safety certification, the IOUs must meet certain standards to invest in safety,<sup>93</sup> including new requirements that the IOUs tie their executive

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<sup>90</sup> Decision Regarding Application of San Diego Gas & Electric Company for Authorization to Recover Costs Related to the 2007 Southern California Wildfires Recorded in the Wildfire Expense Memorandum Account, CAL. PUB. UTIL. COMM’N (Dec. 26, 2017) (Picker & Aceves, concurring), at 7.

<sup>91</sup> Assemb. 1054, 2019 Reg. Sess. (Cal. 2019).

<sup>92</sup> Myanna Dellinger, *Electric Utility Wildfire Liability Reform in California*, 49 ENV’T L. REP. 11003, 11009 (Nov. 2019).

<sup>93</sup> In a separate legislative act, each IOU is also required to develop and present to the CPUC a comprehensive wildfire mitigation plan to ensure they are adequately investing in making their operations safer. *See* S. 901, 2017 Reg. Sess. (2018).

compensation to annual safety performance, establish well-functioning safety committees within their boards of directors, and conduct annual safety culture assessments.<sup>94</sup>

While the IOUs are still subject to strict liability for wildfire damages caused by their equipment, under Assembly Bill 1054, if the IOU holds a valid safety certification at the time the fire begins, the CPUC is required to find that “the electrical corporation’s conduct . . . . [is] reasonable unless a party to the proceeding creates a serious doubt as to the reasonableness of the electrical corporation’s conduct.”<sup>95</sup> This shifting of the burden of proof is significant, as, under the prior “prudent manager” standard, the burden was on the utility company to prove that they had acted prudently, with the CPUC providing very little guidance regarding the standard of behavior required of IOUs before a wildfire occurs.<sup>96</sup>

The passage of Assembly Bill 1054 was a very positive development, as it signaled cooperation and collaboration between public and private actors in responding to California’s increasing wildfire risk. Part IV will further explore the contributing factors, costs, and current risk allocations associated with the state’s wildfire crisis.

#### IV. UNDERSTANDING WILDFIRE COSTS AND RISKS

The wildfire problem in California has reached epic proportions in recent years. Nine of the ten largest wildfires in California’s recorded history have occurred in the last two decades. In 2020, an estimated 9,279 wildfires scorched a record-breaking 4.2 million acres, more than the

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<sup>94</sup> Cal. Assemb. 1054 (Cal. 2019).

<sup>95</sup> *Id.*

<sup>96</sup> Dellinger, *supra* note 92, at 11004.



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previous 3 years combined,<sup>97</sup> destroying more than 8,400 buildings and killing 31 people.<sup>98</sup> California's largest recorded wildfire, the 2020 August Complex fire, crossed seven counties and burned an area larger than the state of Rhode Island, becoming known as the world's first "gigafire" in that it burned over a million acres in a single fire event.<sup>99</sup> These statistics underscore the grim reality of what many consider to be the "new normal" in California: an extreme wildfire epidemic that is costing billions and billions of dollars every year.<sup>100</sup>

As California wildfires continue to intensify, so do the costs associated with wildfire destruction. A recent assessment report predicted that as climate change intensifies, wildfires will cost the U.S. economy \$500 billion per year, and lead to an annual 10% reduction in GDP by 2100.<sup>101</sup> Fighting wildfires has become more expensive as well, with annual federal fire suppression costs surpassing \$1 billion in 13 of the last 16 years, and states spending almost \$2 billion in 2014.<sup>102</sup>

A. HUMAN ACTIVITY IS A KEY CONTRIBUTOR TO WILDFIRE RISK AND SEVERITY

There are many factors driving "[t]his explosive growth in fire activity."<sup>103</sup> Climate change has created unusually extreme weather patterns in the state, with most years seeing increasingly hotter and longer dry seasons, interspersed with years of extreme precipitation.<sup>104</sup> During the

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<sup>97</sup> *2020 North American Wildfire Season*, CTR FOR DISASTER PHILANTHROPY (Dec. 7, 2020), <https://disasterphilanthropy.org/disaster/2020-california-wildfires> [<https://perma.cc/GX9S-GMX3>].

<sup>98</sup> Associated Press, *Record-Breaking California Wildfires Surpass 4 Million Acres*, U.S. NEWS (Oct. 5, 2020, 12:15 AM), <https://www.usnews.com/news/politics/articles/2020-10-04/record-breaking-california-wildfires-surpass-4-million-acres>.

<sup>99</sup> *2020 Incident Archive*, CAL FIRE, <https://www.fire.ca.gov/incidents/2020> [<https://perma.cc/3JNF-88SW>] (last visited Mar. 19, 2021).

<sup>100</sup> See Romero, *supra* note 2.

<sup>101</sup> Shelley Ross Saxer, *Paying for Disasters*, 68 KAN. L. REV. 413, 492 (2020).

<sup>102</sup> *Id.* at 488.

<sup>103</sup> JOHNSON ET AL., *supra* note 87, at 9.

<sup>104</sup> *Id.*

wetter years, California's vegetation grows in abundance, only to dry out when the weather returns to the usual arid conditions.<sup>105</sup> This has led to a buildup of highly combustible vegetation that acts as the perfect fuel to enable wildfires to burn out of control.<sup>106</sup> Regional conditions such as these make it easy for a small spark to ignite into a flame, and the addition of California's infamous Santa Ana and Diablo winds "can easily turn a small fire into a conflagration."<sup>107</sup>

These combustible conditions are made more threatening by the increasing migration of Californians to the wildland-urban interface ("WUI"), defined by the National Wildfire Coordinating Group as "[t]he line, area, or zone where structures and other human development meet or intermingle with undeveloped wildland or vegetation fuels."<sup>108</sup> Despite the fact that these areas are understood to be particularly vulnerable to wildfires, the WUI is the fastest growing land use type in the contiguous US, with millions of residents moving out of cities to enjoy greater affordability, space, and proximity to nature.<sup>109</sup> Unsurprisingly, the population and building density growth in these high-risk regions has "coincided with an increase in frequency and magnitude of destructive wildfires."<sup>110</sup>

Development in the WUI exacerbates wildfire destruction in two major ways. First, the increase in human activity creates a considerably higher risk of wildfire ignitions. Although

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<sup>105</sup> *Id.*

<sup>106</sup> Kelly, *supra* note 1.

<sup>107</sup> Alejandra Borunda, *Santa Ana and Diablo Winds Propel Raging Wildfires in California*, NAT'L GEOGRAPHIC (Sept. 10, 2020), <https://www.nationalgeographic.com/science/2020/09/santa-ana-diablo-winds-propel-fire-season-california-risk/#close> [<https://perma.cc/A4BL-37NJ>].

<sup>108</sup> *Wildland Urban Interface (WUI)*, NAT'L WILDFIRE COORDINATING GRP., <https://www.nwcg.gov/term/glossary/wildland-urban-interface-wui> [<https://perma.cc/YXY9-24BF>] (last visited Dec. 15, 2020).

<sup>109</sup> Dellinger, *supra* note 92, at 11006-07.

<sup>110</sup> Sean Kennedy & Stephanie Pincetl, *Political and Economic Drivers of Wildland-Urban Interface (WUI) Development in California*, CAL. CTR. FOR SUSTAINABLE COMMUNITIES AT UCLA, [https://www.ioes.ucla.edu/wp-content/uploads/Political-and-Economic-Drivers-of-Wildland-Urban-Interface-in-CA\\_.pdf](https://www.ioes.ucla.edu/wp-content/uploads/Political-and-Economic-Drivers-of-Wildland-Urban-Interface-in-CA_.pdf) [<https://perma.cc/D77A-KJVB>] (last visited Dec. 15, 2020).

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wildfires can start naturally from any spark, ninety-five percent of wildfires in California are caused by human activity, including electrical failures, campfires, debris burning, smoking, fireworks, and arson.<sup>111</sup> Second, wildfires that start near WUI areas tend to be more destructive than wildfires in undeveloped regions. Because of the proximity to WUI communities, such wildfires threaten resident safety and are more likely to damage buildings, making them more difficult to fight and eliminating the possibility of allowing natural fires to burn.<sup>112</sup> With more than two million properties facing high to extreme risk of wildfires,<sup>113</sup> California already has the greatest number of threatened and destroyed buildings of any state, and the steady WUI growth trends are likely to correlate to an increased frequency and magnitude of wildfires in the future.<sup>114</sup>

#### B. MITIGATING THE RISKS OF WILDFIRES

Addressing California's wildfire crisis calls for a proactive approach to reduce the incidence of wildfires igniting in the first place and limiting the conditions that allow small fires to blaze out of control. The effective mitigation of wildfire risk requires coordinated efforts from all "major players" in the wildfire crisis, including local governments, regulatory agencies, electric utility companies, and individual homeowners living in high-risk areas. Such mitigation efforts should include measures such as increasing funding for forest management, imposing stricter building codes in high-risk areas, and burying power lines underground.<sup>115</sup>

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<sup>111</sup> Isabella Isaacs-Thomas, *California's Catastrophic Wildfires in 3 Charts*, PBS (Sept. 14, 2020, 4:15 PM), <https://www.pbs.org/newshour/science/californias-catastrophic-wildfires-in-3-charts> [<https://perma.cc/KF38-CCBT>].

<sup>112</sup> Volker C. Radeloff et al., *Rapid Growth of the US Wildland-Urban Interface Raises Wildfire Risk*, 115 PROC. NAT'L ACAD. SCI. 3314, 3314 (2018).

<sup>113</sup> *Verisk Wildfire Risk Report Analysis*, VERISK, <https://www.verisk.com/insurance/campaigns/location-fireline-state-risk-report> [<https://perma.cc/V4RN-NGHQ>] (last visited Mar. 19, 2021).

<sup>114</sup> *Id.*; Radeloff, *supra* note 112.

<sup>115</sup> *See* Saxer, *supra* note 101, at 485.

Managing wildfire risk effectively depends on participation at all levels, and it has been demonstrated that there are a number of cost-effective measures that individual homeowners can undertake to efficiently mitigate this risk in their communities.<sup>116</sup> Several commentators have urged that, in addition to placing limitations on further development in wildfire-prone regions, governments should require communities living in the WUI to take more responsibility in reducing wildfire risks in their surrounding areas.<sup>117</sup> In its *Final Report*, the California Commission on Catastrophic Wildfire Cost and Recovery emphasized the importance of setting standards for home and community fire risk reduction, pointing to the success of the *Boulder County Wildfire Partners Mitigation Program* as a model for California communities to emulate.<sup>118</sup> An integral part of the Boulder County program recognized a greater role for communities and homeowners in managing wildfire risks, incorporating stricter risk reduction standards and county-level building codes for communities and incentivizing individual homeowners to take steps to reduce their vulnerability to wildfires.<sup>119</sup>

Of course, it is also essential that electric utilities take a leadership position in wildfire mitigation efforts, since utility-caused fires have been shown to spread more quickly than other types of fires and are often the most destructive.<sup>120</sup> One of the critical provisions of Senate Bill 901, passed in 2018, was a new requirement that the main electric utility companies in California develop annual Wildfire Mitigation Plans (“WMPs”).<sup>121</sup> The WMPs, which are submitted to the

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<sup>116</sup> See COLO. STATE FOREST SERV., PROTECTING YOUR HOME FROM WILDFIRE: CREATING WILDFIRE-DEFENSIBLE ZONES 5–11 (Oct. 2012), [https://static.colostate.edu/client-files/csfs/pdfs/FIRE2012\\_1\\_DspaceQuickGuide.pdf](https://static.colostate.edu/client-files/csfs/pdfs/FIRE2012_1_DspaceQuickGuide.pdf).

<sup>117</sup> *Id.*

<sup>118</sup> JOHNSON ET AL., *supra* note 87, at 75–76.

<sup>119</sup> Howard Kunreuther & Erin St. Peter, *Reducing California Wildfire Losses*, WHARTON RISK MGMT. & DECISION PROCESSES CTR. (Aug. 27, 2020).

<sup>120</sup> JOHNSON ET AL., *supra* note 87, at 10.

<sup>121</sup> S. 901, 2017 Reg. Sess. (Cal. 2018).

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CPUC, require utility companies to describe in great detail how they plan to reduce the risk that their equipment will spark wildfires. In their WMPs, utility companies are also required to provide an evaluation of specific mitigation efforts to ensure “risk-spend efficiency,” demonstrating that “ratepayers’ funds are only being spent on mitigation measures that are effective in reducing utility-caused wildfire risk.”<sup>122</sup> This new mandate was met with enthusiasm by the utility companies; in February 2020, the major utility companies submitted their 2020 WMPs to the CPUC, each presenting hundreds of pages of mitigation plans, findings, and lessons learned from the 2019 wildfire season to improve their efforts.<sup>123</sup> While this should certainly be viewed as a positive development, the utility companies’ ability to implement their ambitious plans is contingent on the availability of financing, which is becoming less and less certain.

### C. CAPITAL MARKETS AND FUNDING

The effectiveness of major safety improvements on the part of the IOUs often requires large-scale investments in utility infrastructure, and utility companies rely on debt and equity financing in order to finance such ongoing capital-intensive mitigation projects.<sup>124</sup> However, the strict liability rule of inverse condemnation, combined with uncertainty about utility companies’ ability to recover inverse condemnation-related losses if the CPUC rejects a requested rate increase, leads to heightened risk perception by investors and creditors, making it more expensive

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<sup>122</sup> See Alice Stebbins et al., *Resolution WSD-002*, CAL. PUB. UTIL. COMM’N 2 (June 19, 2020), <https://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M340/K859/340859823.PDF> [<https://perma.cc/L365-DUSP>].

<sup>123</sup> *2021 Wildfire Mitigation Plan*, PG&E, [https://www.pge.com/en\\_US/safety/emergency-preparedness/natural-disaster/wildfires/wildfire-mitigation-plan.page?WT.mc\\_id=Vanity\\_wildfiremitigationplan](https://www.pge.com/en_US/safety/emergency-preparedness/natural-disaster/wildfires/wildfire-mitigation-plan.page?WT.mc_id=Vanity_wildfiremitigationplan) (last visited Dec. 15, 2020).

<sup>124</sup> See Saxer, *supra* note 101.

for the utilities to acquire the capital needed to finance these infrastructure projects. This capital structure dramatically raises the costs of any future mitigation efforts.<sup>125</sup>

Investor concerns about electric utility creditworthiness were summed up by a senior director at Standard & Poor, who stated in 2019 that “California’s regulatory process to recover fire costs is unpredictable, untested and lacks transparency in cost recovery,” and indicated the possibility of downgrading several major IOUs to “below investment grade if the regulatory situation doesn’t improve prior to the next fire season.”<sup>126</sup> This suggests that one result of applying a strict liability rule to private utility companies is that mitigation efforts are made needlessly more expensive because creditors and investors are less willing to provide utility infrastructure financing without higher interest rates, an increased cost that does not correlate to any increase in effectiveness or efficiency of such mitigation projects.

#### D. THE MISGUIDED STRICT LIABILITY RULE

In *Barham*, the California Court of Appeal established that California’s inverse condemnation doctrine and the traditional strict liability rule applied to privately-owned utility companies whose equipment damaged private property.<sup>127</sup> The precedent established in this landmark case continues to be the primary justification for applying strict liability to IOUs in the context of wildfire litigation. In addition to adherence to California jurisprudence, those who advocate the continued application of strict liability to IOUs whose equipment causes wildfire damage argue that strict liability is the proper standard in this context because it protects wildfire

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<sup>125</sup> See JOHNSON ET AL., *supra* note 87.

<sup>126</sup> Keely Webster, *California Wildfire Rating Risks Spread to Public Utilities*, THE BOND BUYER (Mar. 28, 2019, 1:38 PM), <https://www.bondbuyer.com/news/california-wildfire-rating-risks-spread-to-public-utilities> [<https://perma.cc/3ZCA-UU67>].

<sup>127</sup> *Barham v. S. Cal. Edison Co.*, 74 Cal. App. 4th 744, 751 (1999).

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victims' access to recovery.<sup>128</sup> Proponents argue that the “strict liability standard is necessary to ensure that aggrieved homeowners receive just compensation after suffering wildfire damages,” emphasizing that the strict liability rule “is straightforward and simple, promoting efficiency and predictability” as compared to a negligence rule that would require that “injured property owners demonstrate a public entity’s unreasonableness.”<sup>129</sup>

However, these arguments do not provide adequate justification as to why private utility companies should be subject to liability for wildfire damages even in the absence of fault. With one exception, California is the only state in the Union that applies strict liability in the context of wildfire inverse condemnation claims, imposing liability regardless of whether the public actor is at fault.<sup>130</sup> Though a strict liability rule is likely to be more efficient in guaranteeing victims’ recovery, the same could be said of any tort claim; efficiency alone does not justify the imposition of strict liability in cases where the injurer has followed all necessary precautions.

Furthermore, blind reliance on the precedent established in *Barham* should be tempered by recognizing other important case law in California’s inverse condemnation jurisprudence. This Note argues that application of a strict liability rule in wildfire inverse condemnation claims is unsound and unprincipled, especially considering the fact that, in floodwater-related inverse condemnation claims, California courts have adopted a reasonableness test to analyze the government’s actions, only finding liability where the public entity was determined to have some

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<sup>128</sup> See Response Brief of the Official Committee of Tort Claimants Concerning the Applicability of Inverse Condemnation, In re PG&E Corp. and Pac. Gas & Elec. at 34–35, Debtors, Bankr. N.D. Cal. 19-30088 (2019) (No. 4773).

<sup>129</sup> Jeremy Gradwohl, *Electric Utility-Caused Wildfire Damages: Strict Liability Under Article I, Section 19 of the California Constitution*, 92 TEMP. L. REV. 595, 620 (2020).

<sup>130</sup> KOUSKY ET AL., *supra* note 83, at 6.

level of fault.<sup>131</sup> In *Belair v. Riverside County Flood Control District*, 47 Cal. 3d 550 (1988), the California Supreme Court articulated the rationale behind applying this different standard to flood cases as a balance of several competing tensions. The court recognized that “a public agency that undertakes to construct or operate a flood control project clearly must not be made the absolute insurer of those lands provided protection,” but acknowledged that “the damage potential of a defective public flood control project is clearly enormous.”<sup>132</sup> Further noting that in some cases “an extraordinary storm would constitute an intervening cause which supersedes the public improvement in the chain of causation,” the court concluded that inverse condemnation claims in this context should be evaluated under a reasonableness rule rather than a strict liability rule that assigns liability based on causation alone.<sup>133</sup>

The tensions noted in *Belair* in arriving at this conclusion seem to apply with comparable force in the context of utility-caused wildfire claims. As will be discussed in the following sections, a strict liability rule has a tendency to make utility companies who undertake to provide electrical services in California the de facto insurer against any wildfire damage originating from their equipment, even if that equipment was reasonably maintained. The damage potential of resulting wildfires is astronomical and widespread, and the more that external factors outside of the utility companies’ control, such as extreme weather patterns and WUI regional growth, contribute to the

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<sup>131</sup> When an inverse condemnation claim involves damage arising from government flood control projects, courts in qualifying floodwater cases will only impose liability if the public entity is found to have acted unreasonably. Rather than apply the traditional strict liability rule of inverse condemnation, the court will apply a six-factor test to evaluate the state’s actions to determine whether the system’s design, construction, and maintenance were reasonable under the circumstances. *See, e.g., Belair v. Riverside Cnty. Flood Control Dist.*, 47 Cal. 3d 550, 564, 566 (1988); *Locklin v. City of Lafayette*, 7 Cal. 4th 327, 364 (1994) (“The rule of strict liability generally followed in inverse condemnation is not applicable in this context.”); *Bunch v. Coachella Valley Water Dist.*, 15 Cal. 4th 432, 441–42 (1997).

<sup>132</sup> *Belair*, 47 Cal. 3d at 565.

<sup>133</sup> *Id.* at 560.



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combustible conditions for wildfire ignition, the more these factors can be argued to be an “intervening cause” in the chain of causation. Based on these parallels to the floodwater project concerns articulated in *Belair*, it stands to reason that a similar reasonableness approach ought to be the standard for inverse condemnation claims stemming from wildfire damages.

#### V. IT IS IMPROPER TO APPLY CALIFORNIA’S STRICT LIABILITY RULE OF INVERSE CONDEMNATION TO INVESTOR-OWNED UTILITIES IN WILDFIRE CLAIMS

In comparing liability rules for IOUs in the context of utility-caused wildfires, it is critical to note how different liability standards effectively shift costs and risks among parties. If a strict liability rule is applied, the utility companies are forced to bear the direct costs of compensating victims for damage when it does occur, even if they acted responsibly in managing their equipment, as well as the indirect costs of the risk that they may not be able to recover these damages. If the CPUC approves rate increases, the utility company can pass these costs onto their ratepayers, which would require all ratepayers to pay increased premiums for electricity—even ratepayers who did not contribute to the risk of such damage by living in areas known to be especially vulnerable to wildfires. Alternatively, a negligence rule would shift much of the cost burden to wildfire victims, who would have no remedy for damages caused by wildfires in cases where the utility company is found not to be negligent. In such cases the victims are still likely to be able to recover, at least partially, by passing these costs onto their insurance carriers, resulting in more expensive and less available insurance for entire classes of insured parties, or through government disaster relief aid. However, as insurance markets respond to the heightened risk of wildfire, it is becoming more challenging and more expensive for homeowners in high-risk areas to find coverage at all. Homeowners living in the highest-risk areas are estimated to see insurance costs

rise by 18% by 2055.<sup>134</sup> As a result of the Camp Fire and other severe wildfires, the California Department of Insurance noted that “an increasing number of homeowners struggle to find coverage,” with homeowners living in the WUI seeing increasing premiums and non-renewal of policies as covered wildfire losses repeatedly exceed the premiums collected by insurance companies.<sup>135</sup>

The reality is that, in cases where wildfire damage is caused by utility equipment without any fault on the part of the utility company, either a strict liability rule or a negligence rule would have the undesirable effect of imposing massive costs on parties who are not directly culpable for the damage caused. Against this backdrop, the best liability rule is the one that most efficiently reduces overall costs and equitably allocates risk. This Note argues that, based on these considerations, strict liability is not the proper liability rule to apply to IOUs in claims of inverse condemnation because it is contrary to foundational legal principles, is inefficient in terms of risk allocation, creates a greater economic burden overall, and results in inequitable cost-spreading, thus frustrating the “fundamental purpose” of inverse condemnation as articulated by California courts.

A. INVERSE CONDEMNATION POLICY AND TRADITIONAL TORT PRINCIPLES SHOW THAT STRICT LIABILITY IS AN INAPPROPRIATE RULE FOR REGULATING PROVISION OF ELECTRICAL SERVICES

Although inverse condemnation is a constitutional remedy, the doctrine has been “traditionally regarded as [operating] in the field of tortious conduct,” which provides “a useful

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<sup>134</sup> *California’s Fourth Climate Change Assessment :California’s Changing Climate 2018*, CAL. ENERGY COMM’N (2018), [https://www.energy.ca.gov/sites/default/files/2019-11/20180827\\_Summary\\_Brochure\\_ADA.pdf](https://www.energy.ca.gov/sites/default/files/2019-11/20180827_Summary_Brochure_ADA.pdf) [<https://perma.cc/844B-D3UG>].

<sup>135</sup> Press Release, Cal. Dep’t of Ins., Wildfire Insurance Crisis Leads Commissioner to Call for First-Ever Statewide Non-Renewal Moratorium (Dec. 5, 2019), <http://www.insurance.ca.gov/0400-news/0100-press-releases/2019/release092-19.cfm> [<https://perma.cc/BYF3-WQ38>].

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basis for recovery of damages in circumstances where the defendant public entity [is] . . . immune from liability.”<sup>136</sup> Tort law recognizes that almost every activity comes with some risk of harm, but while most activities fall under the rule of negligence liability, activities that are regarded as “abnormally dangerous” are commonly governed by a strict liability rule that imposes liability on the person engaging in the activity regardless of the precautions they took. As explained in comment (d) to Section 519 of the Restatement (Second) of Torts,

The liability arises out of the abnormal danger of the activity itself, and the risk that it creates, of harm to those in the vicinity. It is founded upon a policy of the law that imposes upon anyone who for his own purposes creates an abnormal risk of harm to his neighbors, the responsibility of relieving against that harm when it does in fact occur. The defendant's enterprise, in other words, is required to pay its way by compensating for the harm it causes, because of its special, abnormal and dangerous character.<sup>137</sup>

The strict liability rule for “abnormally dangerous” activities has its roots in the landmark case *Rylands v. Fletcher*, 1 L.R.-Ex. 265 (1866), which established the American common law foundation for situations in which the plaintiff need not prove fault in order to show liability. Incorporating the reasoning laid out in this case,<sup>138</sup> Section 520 of the Restatement (Second) of Torts lists 6 factors to consider in determining whether an activity should be considered “abnormally dangerous” and therefore subject to a strict liability standard:

- (a) existence of a high degree of risk of some harm to the person, land, or chattels of others;
- (b) likelihood that the harm that results from it will be great;
- (c) inability to eliminate the risk by the exercise of reasonable care;
- (d) extent to which the activity is not a matter of common usage;
- (e) inappropriateness of the activity to the place where it is carried on; and

<sup>136</sup> Arvo Van Alstyne, *Statutory Modification of Inverse Condemnation: The Scope of Legislative Power*, 19 STAN. L. REV. 727, 731–32 (1967).

<sup>137</sup> RESTATEMENT (SECOND) OF TORTS § 519 cmt. d (Am. L. Inst. 1977).

<sup>138</sup> J.W. Looney, *Rylands v. Fletcher Revisited: A Comparison of English, Australian, and American Approaches to Common Law Liability for Dangerous Agricultural Activities*, 1 DRAKE J. AGRIC. L. 149 (1996).

(f) extent to which its value to the community is outweighed by its dangerous attributes.<sup>139</sup>

In order to determine whether the provision of electrical services should be deemed an “abnormally dangerous” activity subject to a strict liability rule, this Note will examine each of the Restatement factors in the context of wildfires started by electric utility companies.

Under the first factor in Section 520, it is unclear to what extent the provision of electrical services generally creates a “high degree of risk of some harm,”<sup>140</sup> but the past decade of experience has shown us that providing electricity to the WUI does carry with it a substantial risk that the equipment used to provide such services will spark an ignition that becomes a destructive wildfire. Empirical data also shows that California has more WUI areas than any other state, in terms of land area, population, and building density. Data trends indicate that, absent external interference, WUI growth in California will continue to increase, thereby increasing the risk of destructive wildfires.<sup>141</sup> Decades of reliable climate change data also predict future weather patterns that will continue to amplify the hot and dry conditions that allow wildfires to spread. Based on this analysis, it appears that the first factor of the Restatement test is met since providing electricity in high-risk wildfire regions is shown to create a high risk of such harm.

There is also substantial evidence that provision of electrical services in high-risk areas does meet the second factor of Section 520: “likelihood that the harm that results from it will be great.”<sup>142</sup> Although only five percent of wildfire ignitions in California are caused by utility equipment, utility-caused wildfires have a much greater magnitude of destruction because they

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<sup>139</sup> RESTATEMENT (SECOND) OF TORTS §§ 520(a)–(f) (AM. L. INST. 1977).

<sup>140</sup> RESTATEMENT (SECOND) OF TORTS § 520(a) (AM. L. INST. 1977).

<sup>141</sup> See Radeloff et al., *supra* note 112, at 3314.

<sup>142</sup> RESTATEMENT (SECOND) OF TORTS § 520(b) (AM. L. INST. 1977).

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typically occur near communities, and the windy conditions that often contribute to wildfire-causing equipment malfunctions are also “the exact same conditions that make them spread rapidly and make them hard to contain.”<sup>143</sup> The direct costs associated with wildfires are widespread and extreme, often including property destruction, injury and loss of life, and fire suppression costs, as well as a number of indirect costs such as temporary sheltering costs, business interruption costs, and loss of communities. This factor of the Restatement test is likely met.

The third factor of Section 520 is the “inability to eliminate the risk by the exercise of reasonable care.”<sup>144</sup> However, there appears to be ample evidence that the exercise of reasonable care in providing electrical services does substantially reduce, if not completely eliminate, the risk of wildfires caused by utility equipment. For example, the Camp Fire was started by electrical equipment that had not been updated in decades.<sup>145</sup> While the sheer scale of the IOUs’ electrical grids makes full inspection and repair of electric power lines cost-prohibitive, such investments are nevertheless likely to be cost-justified if they are effective in preventing future wildfire destruction. Still, the increasing prevalence of high-risk wildfire conditions caused by climate change and WUI growth lend support to the argument that there is no reasonable way for IOUs to completely eliminate the risk of utility-caused wildfires. It is unclear whether this factor is met.

The fourth factor of Section 520 requires consideration of the “extent to which the activity is not a matter of common usage.”<sup>146</sup> The comments to the Restatement section provide guidance in applying this standard, stating that the “usual dangers resulting from an activity that is one of common usage are not regarded as abnormal, even though a serious risk of harm cannot be

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<sup>143</sup> KOUSKY et al., *supra* note 83, at 3.

<sup>144</sup> RESTATEMENT (SECOND) OF TORTS § 520(c) (AM. L. INST. 1977).

<sup>145</sup> Gold et al., *supra* note 68.

<sup>146</sup> RESTATEMENT (SECOND) OF TORTS § 520(d) (AM. L. INST. 1977).

eliminated by all reasonable care.”<sup>147</sup> It simply cannot be argued that provision of electricity is not a matter of common usage in modern society. In fact, the extent to which the provision of electrical services *is* a matter of common usage could be argued to be a major contributing factor to the high degree of risk, as evidenced by the millions of customers utilizing electricity throughout their homes, businesses, and infrastructure, whose access to electricity requires installation of hundreds of thousands of miles of power lines that span the state and have the potential to ignite a wildfire. Based on the omnipresence of electrical services and comments to the Restatement, this factor clearly weighs against classifying the activity of providing such services as an “abnormally dangerous activity,” notwithstanding the fact that this activity does create a high risk of wildfire harm.

Similarly, the fifth and sixth factors, “inappropriateness of the activity to the place where it is carried on”<sup>148</sup> and “extent to which its value to the community is outweighed by its dangerous attributes,”<sup>149</sup> also weigh heavily, if not decisively,<sup>150</sup> against a finding of electricity provision as an “abnormally dangerous activity.” The reason why utility companies are providing electricity in high-risk areas is that the people living there demand it; not only do these individuals implicitly consent to the activity “in the place where it is carried on,” but they also affirmatively request that the electrical companies specifically conduct this activity in their areas. In fact, these utility companies have “an obligation to serve all who want service” as a result of their quasi-monopoly granted by the state.<sup>150</sup> As for the final factor, it is nearly impossible to argue that the dangerous

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<sup>147</sup> RESTATEMENT (SECOND) OF TORTS § 520 cmt. i (AM. L. INST. 1977).

<sup>148</sup> RESTATEMENT (SECOND) OF TORTS § 520(e) (AM. L. INST. 1977).

<sup>149</sup> RESTATEMENT (SECOND) OF TORTS § 520(f) (AM. L. INST. 1977).

<sup>150</sup> Theodore Kury, *Many Electric Utilities Are Struggling—Will More Go Bankrupt?*, GREENBIZ (May 16, 2019), <https://www.greenbiz.com/article/many-electric-utilities-are-struggling-will-more-go-bankrupt> [<https://perma.cc/33SP-A2KU>].

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attributes of electricity outweigh its value. The invention of electricity is widely regarded as one of the most important developments in human history, and there is a wealth of evidence suggesting that electricity consumption is directly related to longer life expectancy and overall better quality of life.<sup>151</sup> Electricity is a prerequisite to meaningful economic development, and in modern American society, electricity has become so inextricably integrated into our infrastructure that it is difficult to fully appreciate the value that it provides.

Any remaining suspicion that providing electrical services is not an “abnormally dangerous activity” should be dispelled by the Restatement comments, which state “[e]ven though the activity involves a serious risk of harm that cannot be eliminated with reasonable care and it is not a matter of common usage, its value to the community may be such that the danger will not be regarded as an abnormal one”<sup>152</sup> and “[t]here are some highly dangerous activities, that necessarily involve a risk of serious harm in spite of all possible care, that can be carried on only in a particular place.”<sup>153</sup> According to the Restatement, “if these activities are of sufficient value to the community . . . they may not be regarded as abnormally dangerous when they are so located, since the only place where the activity can be carried on must necessarily be regarded as an appropriate one.”<sup>154</sup>

Though the text of the Restatement states that “it is not necessary that each of . . . [the factors] be present, especially if others weigh heavily,” the comments to Section 520 appear to suggest that the absence of any of these particular factors should preclude a finding of strict liability. In other words, an activity that creates a high degree of risk of substantial harm that cannot

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<sup>151</sup> See BAHMAN ZOHURI & PATRICK MCDANIEL, *ADVANCED SMALLER MODULAR REACTORS 1* (Springer Nature Switzerland AG 2019).

<sup>152</sup> RESTATEMENT (SECOND) OF TORTS § 520 cmt. k. (AM. L. INST. 1977).

<sup>153</sup> *Id.*

<sup>154</sup> RESTATEMENT (SECOND) OF TORTS § 520 cmt. j (AM. L. INST. 1977).

be eliminated through reasonable care should not be subject to strict liability “(1) if the activity is a matter of common usage, *or* (2) if it is appropriate to the place carried on, *or* (3) if it is of great value to the community.”<sup>155</sup>

The foregoing analysis, considered in light of the Restatement commentary, necessarily leads to a conclusion that the provision of electricity services is not an activity so abnormally dangerous as to require the imposition of strict liability upon those who engage in it. While providing electrical services in high-risk areas creates a not-insubstantial risk of wildfires and high magnitude of harm, its value to the community greatly outweighs its potential danger. Additionally, the existence of effective mitigation tactics suggest that the potential harm can be greatly reduced by an enhanced standard of care. Under these traditional tort principles, which have historically guided the application of inverse condemnation, utility companies should not be held to a strict liability standard.

B. ECONOMIC MODELS REVEAL THAT STRICT LIABILITY IS AN INEFFICIENT RULE TO ALLOCATE WILDFIRE RISK

Economic theory can provide a useful framework to evaluate how legal rules influence the behavior of individuals and entities, informing which policy decisions are most likely to maximize efficiency in terms of overall economic value to society.<sup>156</sup> Achieving economic efficiency “means exploiting economic resources in such a way that . . . human satisfaction *as measured by aggregated consumer willingness to pay for goods and services . . . is maximized.*”<sup>157</sup> Tort law, which requires injurers to compensate victims for the costs of their harmful behavior, is intended

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<sup>155</sup> 1 California Torts § 7.04 (2021).

<sup>156</sup> ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 189 (Berkeley Law Books 6th ed. 2012).

<sup>157</sup> RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 4-10 (1977).



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to create efficient outcomes by imposing liability on the party deemed to be responsible for the harm, thus incentivizing risk-takers to invest in the optimal level of safety to avoid potential injury.<sup>158</sup>

In the context of tort law, economic principles can be used to understand how liability rules encourage parties to engage in optimal levels of activity and precautions such that the net economic welfare of society is maximized.<sup>159</sup> Strict liability rules, which require only that the plaintiff prove that they suffered harm as a result of the activity, are often regarded as “the best way to govern highly risky activities, such as environmentally dangerous production,” because they are assumed to incentivize both an efficient level of precaution as well as an efficient level of activity.<sup>160</sup> The idea is that when activities create a significant risk of harm that cannot be substantially eliminated even when all precautions are taken, the best way to reduce the risk is to reduce the level of activity itself, and holding those who wish to engage in that activity strictly liable ensures that such parties will only do so if the value of the activity outweighs the potential costs. When both injurer and victim are risk-neutral and there is no market relationship between injurer and victim, strict liability appears to be better suited to reduce potential harms because it causes the injurer to internalize the entire liability risk, thus incentivizing the optimal level of care and the most efficient level of the activity itself.<sup>161</sup>

However, this understanding fails to account for two major inefficiencies that tend to result from the strict liability rule: first, that it causes potential victims to engage in suboptimal levels of precaution, thus increasing the risk of moral hazard; and second, that it creates the potential of

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<sup>158</sup> COOTER & ULEN, *supra* note 156, at 3.

<sup>159</sup> *Id.* at 4.

<sup>160</sup> *Id.*

<sup>161</sup> *Id.* at 201–04.

“risk accumulation” for the injurer, prompting them to reduce their activity levels beyond what is optimal for society.<sup>162</sup>

In cases of “bilateral precaution,” defined as situations in which efficiency requires that precautions be undertaken by both the potential injurer and victim, a strict liability rule leads to inefficient outcomes by placing the entire risk burden on the potential injurer, thus disincentivizing the potential victim to take optimal precautions.<sup>163</sup> Because victims know they will be compensated whether or not they take care in their own behavior, strict liability makes victims economically indifferent as to whether or not an accident occurs. The strict liability rule thus creates potential for “moral hazard” on the part of the victims, who are more likely to reduce their own levels of precaution or engage in risky behavior in which they otherwise would not. Accordingly, in situations in which “the victim has access to precautions that reduce the probability and magnitude of harm,” a negligence rule is preferable to the extent that it more effectively encourages victims to engage in behavior that reduces their own risk of injury.<sup>164</sup>

Furthermore, highly risky activities typically affect a large number of individuals, often requiring the injuring party to compensate a large number of victims stemming from a single incident. This potential for risk accumulation, combined with a strict liability requirement that the injurer compensate the victims regardless of any precautions they took to avoid such injury, means that the injurer will often be incentivized to reduce their activity levels below what society would prefer as their best way to avoid liability.<sup>165</sup> However, when there is a market relationship between

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<sup>162</sup> Martin Nell & Andreas Richter, *The Design of Liability Rules for Highly Risky Activities*, 23 INT’L REV. L. & ECON. 31 (2003).

<sup>163</sup> Robert D. Cooter, *Economic Theories of Legal Liability*, 5 J. ECON. PERSP. 11–30 (1991).

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*

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risk-averse injurers and their victims, the negligence rule with a standard of due care is superior to strict liability in governing highly risky activities because the market will determine the optimal activity levels and efficient levels of precaution on the part of the injurer, while also compelling potential victims to take into account the cost of risk for their demand decisions.<sup>166</sup>

We have seen both of these inefficiencies play out in the context of California's strict liability rule for IOUs in the context of wildfire damage. The major costs of wildfire damage occur when a wildfire spreads and causes property damage to hundreds of parties, and as California's wildfire risk continues to be exacerbated by climate change, and increasing numbers of Californians move to high-risk WUI regions, the utility companies are forced to shoulder this increased risk. Utility companies have responded to the accumulation of risk in part by more frequently turning to widespread public safety power shutoffs (PSPS) to preemptively reduce their exposure to strict liability for any ignitions that are outside of their direct control.<sup>167</sup> Typically, this occurs when utility companies detect risky weather conditions such as high winds, low humidity, and high temperatures,<sup>168</sup> which increase the risk of liability for an equipment-caused ignition whose prevention may be out of their control.

There have been about forty public safety power shutoffs since 2017, with the largest affecting more than two million customers.<sup>169</sup> As utility companies scramble to implement mitigation plans and system upgrades over the coming years, planned power outages are expected

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<sup>166</sup> *Id.*

<sup>167</sup> The CPUC ruled in 2012 that utilities have the right to shut off power for public safety purposes and each utility makes its own decision about when and how to implement a PSPS in certain service areas. Robert Jablon, *How Power Shutoffs Prevent California Wildfires*, KPBS (Oct. 28, 2020), <https://www.kpbs.org/news/2020/oct/28/power-shutoffs-to-prevent-california> [<https://perma.cc/5SJA-VZZX>].

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

to continue.<sup>170</sup> These power shutoffs not only frustrate customers and politicians, but they also create substantial and widespread economic effects. For example, a researcher at Stanford used power interruption cost data to estimate that PG&E's power shutoffs in October 2019, which affected 800 thousand customers, created economic costs of \$2.5 billion, based on power interruption cost data.<sup>171</sup> These power shutoffs forced businesses and school districts to close, with experts estimating millions of dollars in non-obvious costs such as spoiled food and reduced consumer spending.<sup>172</sup> In other words, the improper liability rule has indeed caused the injurer, the utility company, to engage in suboptimal levels of the activity, an inefficient outcome that has created additional externalities.

The strict liability rule in this context has also failed to create proper incentives for potential wildfire victims to engage in cautious behavior, which has, in turn, elevated the level of risk and the potential harm of wildfires. Indeed, the rapid growth of the WUI in California has been recognized as contributing substantially to both increased wildfire risk and the increased cost of this risk. California spends more on fire suppression costs than any other state,<sup>173</sup> and a principal reason for this is the fact that California has higher building densities in WUI areas than anywhere else in the country.<sup>174</sup> Fighting fires costs significantly more in the WUI, where wildfires threaten buildings, homes, and infrastructure. For example, a 2015 Forest Service audit showed that the

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<sup>170</sup> J.R. Reed, *A Rising Number of US Companies Are Flagging Wildfire Risk as Suppression Costs Climb*, CNBC (Nov. 10, 2019, 9:00 AM), <https://www.cnbc.com/2019/11/10/more-companies-are-flagging-wildfire-risk-as-suppression-costs-climb.html> [<https://perma.cc/MM33-VMHH>].

<sup>171</sup> Pippa Stevens, *PG&E Power Outage Could Cost the California Economy More than \$2 Billion*, CNBC (Oct. 10, 2019, 12:56 PM), <https://www.cnbc.com/2019/10/10/pge-power-outage-could-cost-the-california-economy-more-than-2-billion.html> [<https://perma.cc/YFB2-ANHR>].

<sup>172</sup> Reed, *supra* note 170.

<sup>173</sup> Bay City News, *Wildland Development Escalates California Fire Costs*, KQED (Dec. 18, 2018), <https://www.kqed.org/news/11713393/wildland-development-escalates-california-fire-costs> [<https://perma.cc/X6CS-FQAP>].

<sup>174</sup> *Id.*

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cost of fire suppression in the WUI costs \$1,695 per acre, more than twice the cost of firefighting in a forest, and nearly thirty times the cost of putting out fires in undeveloped grassland areas.<sup>175</sup> Currently, the government pays more to fight fires than the fair market value of the structures protected,<sup>176</sup> and the more money that must be spent on fire suppression, the less of a budget there is for fire prevention activities to help communities in the WUI reduce their wildfire risk.<sup>177</sup>

With less public funding for community risk-mitigation efforts, there ought to be greater responsibility for individual homeowners to take steps to minimize their wildfire risk. As has been noted, “[p]lacing full liability for damages from a wildfire on the party responsible for the ignition fails to incentivize activities that other parties—such as land managers and homeowners—could undertake to mitigate damages when fires do occur.”<sup>178</sup> There are a number of cost-effective precautions that individual homeowners living in these areas could take to reduce their vulnerability to wildfire damage, such as building fire-resistant homes, increasing defensible spaces, and reducing vegetation near their houses; yet “many WUI owners do not take these relatively inexpensive measures.”<sup>179</sup> Effectively reducing wildfire risk in California requires large-scale cooperation among all parties who contribute to the risk, but potential victims living in the WUI are disincentivized to engage in mitigation efforts to harden their homes against wildfire risk because the state’s strict liability rule shifts the cost of property damage to utility companies, effectively acting as insurance for these homeowners in the event that utility equipment ignites a

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<sup>175</sup> *Id.*

<sup>176</sup> Saxer, *supra* note 101, at 485.

<sup>177</sup> Lawrence J. McQuillan et al., *California Wildfires: Key Recommendations to Prevent Future Disasters*, INDEP. INST. (June 25, 2019), <https://www.independent.org/publications/article.asp?id=12834> [<https://perma.cc/M8GL-UUTV>].

<sup>178</sup> Matthew Wibbenmeyer, *Contributing Factors, Responsibility, and Liability in California’s Wildfire Disasters*, RES. MAG. (Mar. 19, 2019), <https://www.resourcemag.org/archives/contributing-factors-responsibility-and-liability-in-californias-wildfire-disasters> [<https://perma.cc/MYK4-P722>].

<sup>179</sup> Saxer, *supra* note 101, at 488.

wildfire that damages their homes. As noted by the Catastrophic Wildfire Report, the strict liability rule thus incentivizes “the risks many Californians take by continuing to move into the most fire-prone areas of the WUI; by remaining un- or underinsured; or by neglecting to maintain proper home hardening and fire safety standards.”<sup>180</sup>

In the context of California’s wildfires, a negligence rule would be more efficient in that it creates proper incentives to encourage bilateral precautions taken by both the utility companies and homeowners in high-risk areas. The potential injurers, no longer facing potentially unlimited liability for accidents over which they had little control, will maintain efficient activity levels based on market demand. Under a negligence rule, once a utility company meets their standard of care by taking efficient precautions, it can avoid legal liability and all accident costs will necessarily fall upon the potential victims.<sup>181</sup> The potential victims, faced with this “residual liability,” will be incentivized to take efficient precaution in order to reduce the magnitude of harm that remains after the potential injurer has reached their respective efficient level of precaution.<sup>182</sup> In contrast, the application of strict liability to IOUs in the context of wildfire litigation has failed to induce efficient behavior by the parties involved and is therefore the inferior liability rule in terms of maximizing economic efficiency.

One alternative to replacing California’s strict liability rule with a negligence-based liability rule would be to allow inverse condemnation defendants to claim comparative negligence of plaintiff property owners who live in areas that are known to be at high risk of wildfire damage yet fail to take basic precautions to mitigate their property’s wildfire risk. Applying California’s

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<sup>180</sup> JOHNSON ET AL., *supra* note 87.

<sup>181</sup> Cooter, *supra* note 163.

<sup>182</sup> *Id.*

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doctrine of comparative fault<sup>183</sup> to a strict liability inverse condemnation rule for wildfire damages would be economically efficient because it would allow courts to proportionately reduce victims' recoverable damages if a factfinder were to determine that the victim's own failure to take precautions contributed to their property damage. This approach, which comports with California's strict liability jurisprudence for products liability,<sup>184</sup> would both encourage WUI property owners to take cost-justified levels measures to reduce their own risk but, unlike a pure negligence rule, would not leave wildfire victims without recovery in the event that the IOU whose equipment sparked a wildfire is found to have taken all reasonable precautions. Indeed, a strict liability rule coupled with comparative fault seems to achieve a middle ground that incentivizes efficient behavior by both parties, unlike a pure strict liability rule, and acknowledges that the initial spark may be one of many "but for" causes that lead to severe wildfire property damage. There is also evidence that such a liability rule for inverse condemnation would find legislative support: in 2013, California Assemblyman Reggie Jones-Sawyer introduced a bill that proposed to amend California's Code of Civil Procedure to require courts to apply the doctrine of comparative fault in inverse condemnation actions.<sup>185</sup> Although the bill died when the first Senate hearing was cancelled at the request of the author, it had previously passed in the Assembly with fifty-one votes in favor and only twenty-six votes opposed,<sup>186</sup> which suggests that the comparative fault approach to inverse condemnation actions has found at least some political support in the past, though it is unclear how successful such a measure would be today.

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<sup>183</sup> CAL. CIV. CODE § 5985 (Deering 2021).

<sup>184</sup> *CACI No. 1207A. Strict Liability–Comparative Fault of Plaintiff*, JUDICIAL COUNCIL OF CALIFORNIA CIVIL JURY INSTRUCTIONS (2020).

<sup>185</sup> Inverse Condemnation: Comparative Fault, A.B. 436, 2013–14 Reg. Sess. (Cal. 2013), [https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill\\_id=201320140AB436](https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201320140AB436).

<sup>186</sup> *Id.*

C. IMPOSITION OF STRICT LIABILITY TO IOUS CREATES ADDITIONAL AND UNNECESSARY COSTS FOR EVERYONE

California’s “uniquely dysfunctional strict liability rules for utilities with fault-based standards” have also contributed significantly to the destabilization of private utility companies and their capital markets,<sup>187</sup> and in doing so have created additional costs that are not inherent to the nature of wildfire damages and could likely be avoided through a more appropriate fault-based approach to wildfire liability.

Inverse condemnation and its strict liability rule in California are applied to IOUs as though they are an extension of the government, but this treatment ignores that there are important distinctions between the two types of entities. Utility companies require massive amounts of capital to pay for ongoing maintenance and necessary infrastructure updates, and IOUs rely in large part on outside investors to fund these expenses through issuance of debt and equity instruments. This capital structure puts investor risk perceptions front and center in determining whether the IOUs will have access to favorable financing, or whether they must pay millions of dollars more in high interest rates. Compared to individual and community efforts to reduce wildfire risk, electric utility investments in fire prevention activities are astronomically expensive. The mitigation plans from the three largest utility companies in the state—PG&E, SDG&E, and SCE—call for an estimated \$13.1 billion in wildfire mitigation investments over the next three years.<sup>188</sup> Large-scale investments and capital funding are absolutely critical to realizing this

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<sup>187</sup> Alex Jackson, *California Enacts Major Utility Wildfire Reforms*, NRDC (July 11, 2019), <https://www.nrdc.org/experts/alex-jackson/california-enacts-major-utility-wildfire-reforms> [<https://perma.cc/C73X-WTCB>].

<sup>188</sup> Jeff St. John, *California Utilities Look to Spend \$10B Reducing Threat of Grid-Sparked Fires*, GREENTECH MEDIA (Feb. 10, 2020), <https://www.greentechmedia.com/articles/read/california-utilities-propose-billions-of-dollars-in-wildfire-prevention-plans> [<https://perma.cc/F2XX-3XHS>].



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important goal, and the strict liability rule has made acquiring such financing much more expensive because investors perceive the no-fault liability regime, in which “utilities face inverse condemnation related claims irrespective of whether [they] acted negligently or violated regulations,” as effectively making utility companies the “default insurance provider for wildfire liabilities, a risk that is outside the scope of . . . [and] substantially increases the risk spectrum for utilities.”<sup>189</sup>

The strict liability regime has thus increased the cost for California-based IOUs to obtain the necessary capital for them to make their operations safer and reduce future wildfire ignitions.<sup>190</sup> Outside investors provide funding to the IOUs at low costs when they are confident that “they will have the opportunity to earn a reasonable, risk-adjusted rate of return on their invested capital.” The inability of utility companies to raise their rates without CPUC approval has severely deteriorated investor confidence because of the potential for “massive, unbounded liability”<sup>191</sup> when utilities are forced to pay for fire damage that exceeds their assets, with no guarantee of cost recovery. In 2017, when the CPUC rejected SDG&E’s cost recovery request for the 2007 wildfires, ratings agencies responded by downgrading the credit quality of several California utilities and placed them on negative watch or negative outlook.<sup>192</sup> Moody’s, a prominent ratings agency, stated that the “downgrade . . . reflects [utility companies’] exposure to sizeable potential liabilities in connection with California wildfires which results in a higher business and financial risk profile

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<sup>189</sup> Letter from the of the California Municipal Utilities Association et al., *supra* note 77, at 3.

<sup>190</sup> Southern California Edison Company’s (U 338-E) Opening Comments on Order Instituting Rulemaking at 2, Order Instituting Rulemaking to Implement Public Utilities Code Section 451.2 Regarding Criteria and Methodology for Wildfire Cost Recovery Pursuant to Senate Bill 901 (2018) (Rulemaking 19-01-006).

<sup>191</sup> JOHNSON ET AL., *supra* note 87, at 36.

<sup>192</sup> DON WIDJAJA, SAN DIEGO GAS & ELECTRIC COMPANY: PREPARED DIRECT TESTIMONY OF DON WIDJAJA COMPANY RISK 12–13 (April 2019).

compared to utilities operating outside of California.”<sup>193</sup> They further noted that “[t]he resulting property damages have an outsized effect on the utilities in the state because of the California courts’ application of the inverse condemnation legal doctrine.”<sup>194</sup>

To illustrate the widespread impact of the increased cost of capital, it has been estimated that “a 1% increase in the cost of debt occasioned by a ratings downgrade, coupled with an ensuing 3% increase in the cost of equity, would result in a 6.5% increase in the average monthly bill of [electrical utility] customers.”<sup>195</sup> As mentioned above, following the CPUC’s denial of SDG&E’s cost recovery for wildfire liability stemming from 2007, and the catastrophic wildfire seasons in 2017 and 2018, prominent credit ratings agencies including S&P, Moody’s, and Fitch downgraded the credit outlook for other utility companies in the state, including SCE.<sup>196</sup> SCE estimated that their decreased credit ratings would result in \$225 million in additional expense for each \$1 billion of bonds issued over the lifetime of those bonds.<sup>197</sup> Even non-investor owned utilities face risk of substantial additional costs as a result of the overall perceived risk of outsized utility liabilities, as POUs estimated that a downgrade in their investment grade utilities from AA to A would “result in \$3–4 million of additional interest costs annually for every \$1 billion of borrowing, or \$100 million over the life of the bonds.”<sup>198</sup>

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<sup>193</sup> *Rating Action: Moody's Downgrades San Diego Gas & Electric to Baa1 from A2; Outlook Negative*, MOODY’S INVS. SERV. (Mar. 5, 2019), [https://www.moody.com/research/Moody's-downgrades-San-Diego-Gas-Electric-to-Baa1-from-A2--PR\\_396110](https://www.moody.com/research/Moody's-downgrades-San-Diego-Gas-Electric-to-Baa1-from-A2--PR_396110) [<https://perma.cc/JQX9-ZB98>].

<sup>194</sup> *Id.*

<sup>195</sup> JOHNSON ET AL., *supra* note 87, at 41 n.13.

<sup>196</sup> *Id.* at 28; MOODY’S INVS. SERV., *supra* note 193; *Fitch Rates Southern California Edison Co.’s First & Refunding Mortgage Bonds ‘BBB+’; Outlook Stable*, FITCH RATINGS (Sept. 28, 2020, 12:40 PM), <https://www.fitchratings.com/research/corporate-finance/fitch-rates-southern-california-edison-co-first-refunding-mortgage-bonds-bbb-outlook-stable-28-09-2020> [<https://perma.cc/L39V-GAZ4>].

<sup>197</sup> Southern California Edison Company, *supra* note 190.

<sup>198</sup> Letter from of the California Municipal Utilities Association et al., *supra* note 77, at 3.

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In addition to the increased cost of capital, the extreme cost burden imposed on IOUs by the strict liability rule has amplified the risk of bankruptcy for these companies, as was seen with PG&E in 2019. Not only does this negatively impact ratepayers and shareholders, but it also makes recovery more difficult for wildfire victims since financially distressed and insolvent IOUs are less likely to actually compensate wildfire victims for their losses. As critics have pointed out, “[r]atepayers are not better off by having utilities in bankruptcy or near bankruptcy” and wildfire “victims are . . . not better off trying to recover their losses from bankrupt companies.”<sup>199</sup>

Furthermore, the strict liability rule has made insurance more expensive for IOUs, and this cost is passed directly onto ratepayers through higher electricity rates. The California Public Utilities Code requires electrical utility companies in the state, including PG&E and other IOUs, to “maintain reasonable insurance coverage.”<sup>200</sup> Utility companies consider insurance to be a regular cost of doing business, and they are ordinarily entitled to account for this cost in setting rates for electricity, thus passing insurance costs onto customers.<sup>201</sup> However, insurance companies are responding to the increased risk of wildfire liability by raising insurance premiums for the utilities.<sup>202</sup> For example, after settling their bankruptcy claim for a \$25.5 billion payout, PG&E had to pay \$750 million in order to secure \$1.4 billion of coverage over just the following twelve months, with more than half of that amount earmarked to cover potential wildfire claims.<sup>203</sup> Similarly, Southern California Edison, one of the other major IOUs in the state, was forced to pay

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<sup>199</sup> Dellinger, *supra* note 92, at 11009.

<sup>200</sup> CAL. PUB. UTIL. CODE § 3293 (West 2019).

<sup>201</sup> Mark Chediak, *PG&E Finds Fire Insurance Tough to Get and Costly After Bankruptcy, Fires*, INS. J. (July 31, 2020), <https://www.insurancejournal.com/news/west/2020/07/31/577566.htm> [<https://perma.cc/UFZ2-PQ87>].

<sup>202</sup> *Id.*

<sup>203</sup> *Id.*

about \$450 million in order to secure \$1 billion of insurance coverage through June 2021.<sup>204</sup> According to PG&E CFO Jason Wells, these costs are “a significant increase over what [utility companies] were doing several years ago,” representing “what will be an ongoing trend of higher liability insurance costs [for utility companies in California] going forward.”<sup>205</sup> These costs are then passed on to ratepayers.

Accordingly, the strict liability rule has impacted the financial viability of IOUs, resulting in millions of dollars in additional interest rates and insurance premiums, indirect costs that threaten to depress the entire energy market. These costs are felt by everyone. The Catastrophic Wildfire Report observed that “[t]he result of the application of strict liability for inverse condemnation is the risk of significantly increasing the already-high cost of electricity service to 75% of the state’s electricity customers either directly through cost-shifting or indirectly as a result of bankruptcy,”<sup>206</sup> explaining that “[t]he current process and standard for determining cost recovery contributes to the uncertainty that utilities face, often increasing costs to ratepayers while resulting in insufficient investment in wildfire mitigation.”<sup>207</sup> The strict liability rule has thus destabilized the entire energy market by creating greater financial risks for insurers, investors, and creditors, making electricity more expensive for consumers and reducing utility companies’ ability to afford needed safety investments. While a different liability rule may not reduce the actual costs of wildfire damage, a fault-based negligence rule that provides greater certainty for those who do business with the utility companies is likely to lower the overall economic burden associated with

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<sup>204</sup> *Id.*

<sup>205</sup> Kavya Balaraman, *PG&E Faces Soaring Insurance Costs, Leadership Changes in Rest of 2020*, UTIL. DIVE (July 31, 2020), <https://www.utilitydive.com/news/pge-faces-soaring-insurance-costs-leadership-changes-in-rest-of-2020/582655> [<https://perma.cc/SP7Y-NSMD>].

<sup>206</sup> JOHNSON ET AL., *supra* note 87, at 30.

<sup>207</sup> *Id.* at 13.

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wildfire damages by reducing these incidental costs, thus enhancing the utility companies' ability to invest in mitigation projects to make their operations safer.

D. STRICT LIABILITY FAILS TO ACHIEVE AN EQUITABLE ALLOCATION OF WILDFIRE RISKS AND COSTS AMONG SOCIETY AS IS REQUIRED BY INVERSE CONDEMNATION POLICY

The passage of Assembly Bill 1054 in 2019 alleviated some of the pressure on IOUs created by the strict liability rule. Those who opposed the inverse condemnation strict liability rule, including the IOUs and their investors,<sup>208</sup> praised the bill for replacing the muddled “prudent manager” standard with a presumption of prudence for utility companies who hold a valid safety certification. This shifting in the burden of proof was a significant win for the utility companies “since they obtain greater certainty about the ability to charge ratepayers for wildfire liabilities.”<sup>209</sup> In order to benefit from this revised cost recovery standard, IOUs are required to participate in a newly-established \$21 billion Wildfire Fund to help utilities pay future claims arising from wildfires more quickly.<sup>210</sup> The three largest IOUs—PG&E, SDG&E, and SCE—made initial contributions of \$10.5 billion, with ongoing annual contributions of more than \$200 million over the next ten years with the rest of the funding coming from the ratepayers.<sup>211</sup> Credit ratings agencies also responded favorably to the bill's passage by issuing upgrades to credit ratings for two of the three major IOUs in 2019, reflecting greater investor confidence and approval of the legislative measure.<sup>212</sup>

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<sup>208</sup> FITCH RATINGS, *supra* note 196.

<sup>209</sup> Dellinger, *supra* note 92, at 11,011.

<sup>210</sup> *Id.* at 11,003.

<sup>211</sup> *Assembly Bill 1054 Wildfire Fund Mechanics*, EDISON INT'L, <https://www.edison.com/content/dam/eix/documents/investors/wildfires-document-library/20191205-ab1054-wildfire-fund-summary.pdf> [<https://perma.cc/SUF4-PATG>] (last accessed Dec. 17, 2020).

<sup>212</sup> FITCH RATINGS, *supra* note 196.

However, despite these positive developments, it could be argued that the bill failed to achieve truly equitable cost spreading as is required by inverse condemnation. The application of a binary, black-and-white rule like strict liability in the context of wildfires is simply misaligned with the nuanced reality that “wildfire risk is created by multiple parties who should all be incentivized to reduce risk and share in paying for wildfire damages.”<sup>213</sup>

A truly equitable liability rule would recognize that the costs of wildfires should be internalized “to a greater extent by end-consumers who add to existing risks by demanding electricity to be delivered to an ever-increasing extent to the WUI in arid, hot areas.”<sup>214</sup> Despite the fact that the risks of living in the WUI are well-known and well-publicized, researchers have found that people who choose to reside in these areas tend to overestimate the positive aspects of living close to nature and undervalue the true risk of fire.<sup>215</sup> The strict liability rule only amplifies this effect by forcing utility companies and their ratepayers to act as insurers for WUI residents, who know that they will be compensated regardless of the utility company having followed all safety requirements, and whether or not they contributed to their own destruction by failing to harden their homes despite living in areas known to be at high wildfire risk.

“Environmental justice concerns call for the heaviest burden . . . to be placed on the parties that most directly benefit from the services provided (i.e., inhabitants of the WUI),” but the strict liability rule tends to impose higher electricity costs for all ratepayers, including people who do not benefit from the provision of electricity in high-risk areas.<sup>216</sup> In other words, because the largest IOU service areas typically span low-risk and high-risk regions, when the IOUs are permitted to

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<sup>213</sup> JOHNSON ET AL., *supra* note 87, at 13.

<sup>214</sup> *Id.*

<sup>215</sup> Kelly, *supra* note 1.

<sup>216</sup> Dellinger, *supra* note 92, at 11012.

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raise their rates to recover from strict wildfire liabilities (or contribute to the new Wildfire Fund), the ratepayers living in low-risk areas contribute to the costs of wildfires to the same extent as those inhabitants of the WUI who increase the risk and magnitude of wildfire costs. When IOUs raise their rates following wildfire liabilities, all ratepayers are forced to subsidize the risky decisions of the people demanding electricity in the WUI. This, in turn, creates an environmental justice issue of whether it is “fair for all ratepayers, and thus also those in neighborhoods that are not at great, if any, risk of wildfires to have to pay” for those who knowingly choose to live in high-risk wildfire areas.<sup>217</sup> As Dellinger points out:

Poorer people, less educated people, and often people of color in urban areas will have to pay [the increased costs] although they do not gain anything from doing so other than, at best, the continuation of electric services by an electric utility that might otherwise have gone out of business. Because the same people are also less politically connected, a significant risk of environmental injustice exists here . . . . Any fee imposed broadly on all electric utility ratepayers places a disproportionate burden on disadvantaged people . . . . Instead, higher fees for electricity delivery should be imposed on those people who live and build in the WUI [and in doing so,] voluntary accept known and worsening risks.<sup>218</sup>

In sum, a negligence rule that allows utility companies to avoid liability for wildfires when they meet an established level of due care would effectively force WUI homeowners to internalize the increased risk of living in wildfire-prone areas; without guaranteed recovery from the utility companies, WUI homeowners would be incentivized to either take steps to reduce their wildfire vulnerability, or move to areas with a lower overall wildfire risk. Unlike a strict liability rule that requires IOUs and their customers to “compensate victims whenever utility-owned equipment is involved, regardless of who else was responsible and to what degree,”<sup>219</sup> a fault-based liability rule

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<sup>217</sup> *Id.* at 11015. For further discussion of these environmental justice issues, see generally *id.*

<sup>218</sup> *Id.*

<sup>219</sup> Jackson, *supra* note 187.

is more likely to accomplish the equitable cost-spreading function of inverse condemnation by forcing WUI residents to account for their role in contributing to the heightened risk of wildfire damage and increased cost of wildfire suppression in these areas.

## VI. CONCLUSION

California's foundational inverse condemnation principles require that the costs associated with providing electricity to high-risk areas be distributed equitably, and equitable considerations demand a fault-based rule that imposes higher costs for those parties whose actions disproportionately contribute to the risk. Such a fault-based rule aligns with traditional tort law principles and can find further support in California's reasonableness approach to inverse condemnation in special cases of flood control projects. As climate change accelerates the intensity and frequency of high-risk wildfire conditions in California, a fault-based rule will more effectively incentivize mitigation efforts from all parties, as well as reduce the economic inefficiencies associated with the strict liability rule. As the more cost-efficient liability rule, a negligence-based liability regime for utility companies in the context of wildfire inverse condemnation claims will better enable California utility companies to proactively address the challenges of providing electricity in high-risk environments, while also encouraging California residents to take more accountability for their lifestyle decisions.