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Century-old doctrine haunts fire litigation

3 developments in inverse condemnation in 2019 posed many more questions for 2020.

By Gina Kim
Daily Journal Staff Writer

Plaintiffs' lawyers use it to fight for their clients. Utilities are being crushed by it due to mounting debts — one even filed for bankruptcy in January — and balk at efforts on the Legislature to change it. Federal and state courts for years have refused to entertain it, and deflected the responsibility to lawmakers.

Inverse condemnation is a strict liability doctrine which holds that just compensation be provided when a private property is taken or damaged for public use. It's a no-fault theory of liability pursued against utilities facing wildfire claims that have been on the rise in California .

The doctrine's purpose was to socialize burdens that should be undertaken by the community. *Holtz v. Superior Court*, 3Cal.3d 296, 303 (1970). The doctrine emphasizes that the whole community benefits from public improvement, therefore it would be unfair for affected individuals to be burdened with costs of the public improvement or service.

The doctrine serves its purpose well for public utilities operated by the government as they are free to set rates and can be reimbursed for damages from the community via rate hikes. The doctrine however, doesn't seem to function well for privately-owned public utilities in the context of wildfires, and courts have struggled to strike a balance as California energy companies act as monopolies and power the majority of the state.

Private utilities are not free to set their own rates, and any requests to pass through liability costs to customers must be approved by the California Public Utilities Commission, which regulates private utilities and oversees rate-setting systems.

Inverse condemnation gained a considerable amount of attention in the wake of investor-owned utilities being blamed for several wildfires in California. However, courts presiding over mass tort wildfire litigation have all rebuffed challenges raised by utilities against the strict liability doctrine.

As the doctrine has become more prominent in a state where the majority of power supply comes from private, investor-owned utilities that provide a public service, should the law be re-examined?

Craig S. Simon, managing partner at Berger Kahn who fights for insurance companies, has argued for years in wildfire litigation that inverse condemnation doesn't need to be changed.

"The law of inverse condemnation is grounded in the California Constitution, and the case law that has existed for decades doesn't need any changes," Simon said. The California Public Utilities Commission already allows a return on equity that is fair in light of the current inverse, he said. Only imprudent actions lead to liability that doesn't allow for costs to be socialized among ratepayers, he said.

The issue garnered much attention this year within the California government, from birthing a $21.5 billion wildfire fund to help offset liabilities to weakening the prudent manager standard and even issuing its first inverse condemnation opinion in more than 20 years. *City of Oroville v. Superior Court of Butte County*, S243247.

San Diego Gas & Electric Co. even went to the nation's highest court in April to challenge the doctrine in its quest for a reversal of a decision by the CPUC disallowing the utility from socializing $379 million of uninsured wildfire liabilities. In October, the U.S. Supreme Court elected to not hear the writ.

CPUC in its response argued that SDG&E imprudently managed its facilities that caused the Witch, Guejito and Rice fires in 2007. SDG&E had already paid $2.4 billion to claimants before it went to CPUC holding up the $379 million left over.

The utility sought to reverse CPUC's denial of socializing costs under inverse condemnation by raising a federal issue for the U.S. Supreme Court to consider: that CPUC's denial was an unconstitutional regulatory taking under the Fifth and Fourteenth Amendments. The takings clause of the Fifth Amendment holds that compensation must be paid when a private property is taken or damaged for public use.

Michael J. Aguirre, partner at Aguirre Severson LLP in San Diego, who represented ratepayers against SDG&E, maintained that the inverse condemnation challenge is a red herring raised by private utilities facing wildfire claims and distracts from the real issue: unreasonable conduct by utilities that spend money lobbying legislators instead of investing in infrastructure.

"If you weren't a prudent manager, you have to compensate fire victims irrespective of inverse," he said. "Utilities are usually held accountable under negligence and inverse condemnation, but as long as they prove they are prudent they don't have to worry about inverse liability because customers can help pay."

"Utilities are creating a phony issue arguing that the prudent manager standard is unfair, when it's been settled law for hundreds of years," he said. "You have to take a step back and realize what's happening now. Utilities are painting a very practical problem to regulators, ar-

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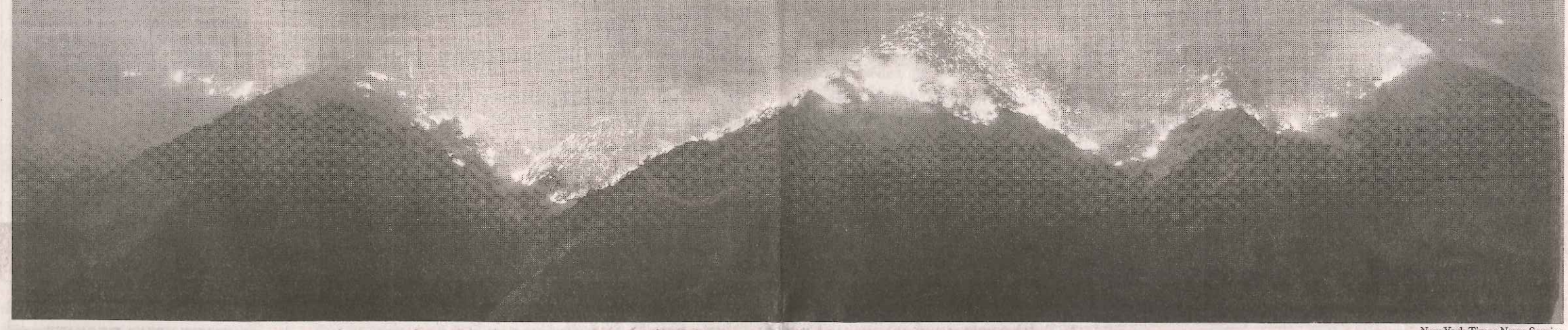

New York Times News Service

The Getty fire burns a hillside next to the 405 freeway in Los Angeles on Monday, Oct. 28, 2019.

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guing that safety rules are so strict which could result in more fires."

Assembly Bill 1054, passed into law July 12, created a multi-billion-dollar fund for utilities that cause future wildfires and helped weaken the prudent manager standard. At least $13.5 billion of the fund would come from taxpayers and customers. The point of the bill was to ensure utilities' financial stability.

Aguirre has challenged the bill in federal court, claiming it was a constitutional violation by having taxpayers foot the majority of the bill while bailing out utilities that spent thousands of dollars in political contributions to sway lawmakers, including Gov. Gavin Newsom.

"Instead of maintaining and replacing systems, utilities have transferred billions of dollars to dividend stocks, and it'll come back to haunt us," Aguirre said. California is facing a massive crisis because the infrastructure that delivers natural gas and power has eroded, he said.

"If electricity and gas pipeline infrastructure deteriorated to the point where it takes billions of dollars to ensure safety of those systems, we shouldn't be talking about profit right now," Aguirre said. "Should we repair the horse and buggy, or transform ourselves to a more modern electricity distribution and transportation of natural gas?"

Bradford B. Kuhn, chair of Nossaman LLP's Eminent Domain and Valuation Practice Group, said the inverse doctrine in and of itself is problematic because it doesn't involve any concept of foreseeability or fault.

"In some respects, you have potentially no boundaries of liability limitations," he said. "For example, a tree branch somehow breaks off, flies in the wind and hits an electrical line belonging to [the Los Angeles Department of Water and Power], and now the city is strictly liable and has to pay for damages caused by something as small as that? It's somewhat crazy to me."

"I understand the need to do a cost spreading and not have individual property owners bear the burden of damages caused by public improvements, but I also think that's what homeowner's insurance is for."

The second piece of the doctrine gets trickier, according to Kuhn, when applied to investor-owned utilities, from Southern California Edison Co., Sempra Energy and Pacific Gas & Electric Co., all of which face claims for devastating wildfires and could only modify rates if approved by CPUC.

While some of the legislation passed this year helped streamline the process and watered down the prudent manager standard for utilities, "it's still a different burden," Kuhn added.

"That's why you see PG&E file for bankruptcy, and it's difficult to raise revenue," he said. "Those companies are in difficult positions and they also fight the uphill battle anytime they attempt to pass through costs. They get push back from consumer advocacy groups."

PG&E has been a poster child for a bad actor given its roles in the 2015, 2016, 2017 and 2018 wildfires in Northern California, Kuhn said, which creates an impression that companies only care about shareholders, which he said he doesn't believe is the case.

Kuhn pointed out that SDG&E argued in its Supreme Court writ that if the CPUC won't allow it to pass wildfire costs to customers, "they are essentially preventing the whole concept of inverse from playing it the way it was supposed to."

"The underlying premise of inverse is to take the costs of a public project or improvement and spread

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it among everyone," Kuhn said.

While he doesn't believe CPUC's denial of a rate pass through is an unlawful taking, "it's just an interpretation of the purpose of inverse condemnation and how you can make the doctrine match with the CPUC's prudent manager standard," Kuhn said.

"How do those two concepts align? The CPUC has already stated those two don't work very well but it's up to the Legislature to deal with it and fix it," Kuhn said.

PG&E made similar arguments in its Chapter 11 proceedings before bankruptcy Judge Dennis J. Montali; the utility claimed that it wasn't allowed to socialize inverse condemnation costs because it does not match with the constitutional premise, Kuhn said. Montali struck it down anyway but certified his decision to be directly appealed to the 9th U.S. Circuit Court of Appeals in December. *In re: PG&E Corporation,* 3:2019-bk-30088 (N.D. Cal., filed Jan. 29, 2019)

Montali noted that California courts haven't limited the application of inverse condemnation to public entities for over a century, but agreed it is the Legislature's job to clarify issues of inverse condemnation. He urged a prompt consideration as there is no controlling authority on whether the doctrine applies to investor-owned utilities.

Two other developments occurred this year that drew attention to the century-old law: a state court judge asked CPUC to weigh in on the Woolsey Fire litigation and a California Supreme Court decision, *City of Oroville v. Superior Court of Butte County* 2019DJDAR7729, published Aug. 16.

While every judge in California has rebuffed any utility challenge to the doctrine in mass wildfire cases, Los Angeles County Judge William F. Highberger, presiding over the 2018 Woolsey wildfire litigation, postponed his decision for months, citing the SDG&E writ at the U.S. Supreme Court.

Highberger wondered whether the liability doctrine should be applied to Edison in the Woolsey litigation, and cited *Barham v. Southern California Edison Co.* 1999DJDAR9119, in which the court applied inverse liability to the utility for property damages from a wildfire caused by a downed power line.

The *Barham* court said utilities act similarly to a public agency and provide a similar public service; therefore, strict liability should be applied to private utilities as if they are public agencies.

Highberger mulled in prior Woolsey Fire hearings whether *Barham* was decided correctly while acknowledging that the financial liabilities in the pending Woolsey litigation were much larger.

Pacific Bell Telephone Co. v. Southern California Edison 2012DJDAR12351, oft cited by Woolsey plaintiffs' lawyers, also ruled that Edison had to pay for damage caused to telephone cables after a bird crashed into the company's power lines and decided that inverse condemnation could be applied to the utility.

Neither case has been considered by the California Supreme Court.

Mike S. Danko, partner at Redwood Shores-based law firm Danko Meredith PC who represents plaintiffs in the wildfire cases against PG&E pointed out that the state high court clearly found no constitutional dispute to consider in either case.

The high court had two opportunities to review the decisions and change the law, and yet did nothing, Danko said.

"That's a strong indication they're in agreement with the opinion," Danko said. "There's a reason why there is no controlling authority. The fact the court hasn't taken the issues up given there have been two opinions out there for the last 20 years suggests they're okay with them."

But, in August 2019, the state high court came the closest it had to taking up the issue of inverse condemnation in more than 20 years, according to Kuhn.

The *City of Oroville* case involved a single commercial building with a dentist office that flooded due to a clogged sewer main. The plaintiff sued the city for inverse condemnation for damaging his private property. The trial court and court of appeal agreed it was a public project, and held the city liable for all damages.

The California Supreme Court overturned the decision and found the city wasn't liable. The private property owner failed to install a backup valve which was required under city ordinance, the high court said. The opinion, authored by Justice Mariano-Florentino Cuellar, found that Oroville was not liable for inverse condemnation because sewage backup was not an unavoidable consequence of a sewer system. Plaintiffs also lacked a legally required backwater valve and had to show more than just a causational link between the existing public infrastructure and damages to the office, Cuellar wrote.

"The court looked a lot more closely at the actions of the plaintiffs and of other third parties, and considered whether or not the city was reasonable in its conduct," Kuhn said. "Those are somewhat newer approaches that hadn't been looked at as heavily in the past."

Simon said utility defenders think *Oroville* changes the landscape, but argues there is no real change, as the case had to do with causation.

"A customer did not have a backup vent or valve on his sewer line to a dentist office," said Simon. "The city was responsible for a backup of the sewer. The backup went into the building because there was no

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backup valve."

The lower court found inverse liability against the city, saying it was one of the causes of the backup, with the other cause being the missing valve.

But, the high court said the whole plan had to be examined — the damage would not have happened if the valve was working as it was supposed to work, Simon said, which was why the city was off the hook.

"*Oroville* has more to do with a case with multiple causes for a loss," said Simon. "Of course, it has zero to do with a private utility versus a public utility."

Kuhn said the high court's decision still raised the bar on what property owners must demonstrate to prove liability by moving away from an automatic strict liability assessment, and instead, utilize a much more stringent analysis focused on the reasonableness of the entity's conduct while also looking for responsibility of a private property owner.

"The reason the state Supreme Court looked at this was to see if the doctrine can continue to be applied broadly going forward," Kuhn said. "There is a risk that some public improvements and infrastructure won't be built. Plus, no funding will be available if every agency is strictly liable regardless of fault. It'll be inordinately expensive to build anything going forward."

"It's going to be a fascinating year in 2020 on what comes out of all of this, and how PG&E's bankruptcy shakes out, how wildfires will continue and what the future holds for climate change," Kuhn said.

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