

Proceeding No.: A.15-09-010
Exhibit No.: SDG&E-01-Phase 1
Witness: Schavrien

**AMENDED DIRECT TESTIMONY OF
LEE SCHAVRIEN
ON BEHALF OF
SAN DIEGO GAS & ELECTRIC COMPANY**

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

January 23, 2017



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AMENDED TESTIMONY OF LEE SCHAVRIEN
ON BEHALF OF SAN DIEGO GAS & ELECTRIC COMPANY

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Lee Schavrien. My business address is 8330 Century Park Court, San Diego, CA 92123.

Q. What is your current position?

A. I am currently the Chief Administrative Officer of San Diego Gas & Electric Company (“SDG&E”) and Southern California Gas Company, a position I assumed in June, 2015. Prior to assuming that position, I served for many years in a variety of roles that involved overseeing all of SDG&E’s regulatory matters before this Commission and the Federal Energy Regulatory Commission (“FERC”), including as Senior Vice President of Regulatory Affairs. My qualifications are set forth in Appendix 1 hereto.

Q. Have you previously submitted testimony before the Commission?

A. Yes, on several occasions.

~~**H. PURPOSE OF TESTIMONY**~~

~~Q. What is the purpose of your direct testimony?~~

~~A. I am testifying as an overview witness for SDG&E’s Wildfire Expense Memorandum Account (“WEMA”) Application. Through this WEMA Application, SDG&E requests authorization to recover approximately \$379 million (“WEMA Costs”). Because of SDG&E’s effective cost management, the WEMA Costs represent a small portion of the asserted \$4 billion in claims and the \$2.4 billion in paid claims and associated legal fees arising from three wildfires—the Witch Fire, the Guejito Fire and the Rice Fire—that occurred in SDG&E’s service territory~~

1 ~~in late 2007 (“Wildfire Costs”). The Commission has determined that SDG&E may file an~~
2 ~~application for recovery of the amounts recorded to the WEMA, “subject to [a] reasonableness~~
3 ~~review.”¹ The purpose of my testimony is to show that the WEMA Costs are appropriate for~~
4 ~~recovery in rates and are reasonable and prudent.~~

5 Q. — Why is SDG&E filing this WEMA Application at the present time?

6 A. — In short, because the Wildfire Costs are now virtually certain. The Wildfire Costs were
7 ~~incurred in connection with resolving more than 2,500 lawsuits that were filed against SDG&E~~
8 ~~in San Diego Superior Court by residential property owners, commercial property owners and~~
9 ~~governmental entities as a result of the Witch, Guejito, and Rice Fires (“Wildfire Litigation”).~~
10 ~~To ensure the reasonableness of paid claims, the process required by SDG&E to resolve these~~
11 ~~claims was complicated and lengthy, but at present, all but one of the Superior Court lawsuits~~
12 ~~have settled or been dismissed. Additionally, SDG&E has recovered \$824 million as a result of~~
13 ~~its now resolved claims against third parties and \$1.1 billion under its own liability insurance~~
14 ~~coverage. SDG&E has also secured authorization from the FERC to recover a portion of the~~
15 ~~Wildfire Costs. These amounts represent deductions from the total \$2.4 billion of Wildfire~~
16 ~~Costs. Because the total cost and the total deductions are now virtually certain,² SDG&E can~~
17 ~~now calculate the WEMA Costs.~~

18 Q. — How is the remainder of your testimony organized?

19 A. — In Section III, I provide an overview of the key issues presented by SDG&E’s WEMA
20 Application. Next, in Section IV, I provide background information that provides historical and

¹ — Decision (“D.”) 12-12-029.

² — As discussed by SDG&E witness Mr. Craig Gentes, the \$379 million of WEMA Costs includes estimated costs of approximately \$10 million and estimated deductions of approximately \$15 million, which, in total, reduce the WEMA Costs by \$5 million. Once those estimates become actuals, SDG&E will submit an update.

1 ~~factual context to this application. Specifically, I discuss the 2007 wildfires and the prior~~
2 ~~regulatory proceedings involving those fires that have led to this WEMA Application. In Section~~
3 ~~V, I explain why the Commission should authorize SDG&E to recover the WEMA Costs in~~
4 ~~rates.~~

5 ~~III. OVERVIEW OF SDG&E'S WEMA APPLICATION~~

6 ~~Q. Mr. Schavrien, please provide an overview of SDG&E's WEMA Application, including~~
7 ~~the key issues presented.~~

8 ~~A. The WEMA Costs resulted from SDG&E's settlement of claims asserted in the 2007~~
9 ~~Wildfire Litigation. Those claims, in turn, arose from damages caused by the Witch, Guejito and~~
10 ~~Rice Fires, the ignitions of which were attributed to SDG&E's facilities but which also involved~~
11 ~~other factors, including extreme Santa Ana winds, communications facilities and a sycamore tree~~
12 ~~limb. The magnitude of the damages caused by these three wildfires was also determined by~~
13 ~~factors beyond SDG&E's control, including weather and wind conditions, as well as the~~
14 ~~availability and effectiveness of San Diego County firefighting resources. The Commission~~
15 ~~permits utilities to recover the prudently incurred costs of claims and suits for injuries and~~
16 ~~property damages in rates as costs of providing service, and it should permit that recovery here.~~
17 ~~The Commission has indicated that SDG&E's application to recover WEMA Costs would be~~
18 ~~"subject to [a] reasonableness review." A reasonableness review focuses on whether a utility's~~
19 ~~management was prudent in decisions or actions in which it voluntarily incurred costs, based on~~
20 ~~what was known or reasonably should have been known by management at the time.~~
21 ~~Reasonableness reviews typically arise in Commission actions related to utility procurement~~
22 ~~decisions and decisions to take on large capital projects. It can also arise in special~~
23 ~~circumstances, like a utility's decision to decommission a nuclear power plant.~~

1 Reports issued by the California Department of Forestry and Fire Protection (“Cal Fire”) and the
2 Consumer Protection and Safety Division (“CPSD”) (now the Safety and Enforcement Division)
3 found that SDG&E facilities were involved in the ignition of the Witch, Guejito and Rice Fires.
4 As explained further below, SDG&E was thus required by California’s inverse condemnation
5 law to pay for damage caused by these fires. Thus, the Commission’s reasonableness review of
6 the WEMA Costs should focus on whether it was reasonable and prudent for SDG&E
7 management to: (1) undertake a rigorous process to voluntarily settle the claims asserted by
8 plaintiffs in the 2007 Wildfire Litigation, in light of the application of inverse condemnation and
9 strict liability by California courts to investor-owned utilities; (2) settle the claims for reasonable
10 amounts; and (3) institute extensive efforts to reduce the amount it seeks to recover in this
11 proceeding to a fraction of the total Wildfire Costs that were incurred. FERC has conducted this
12 same inquiry with respect to the reasonableness and prudence of the FERC jurisdictional portion
13 of the Wildfire Costs for which SDG&E has sought recovery, and approved SDG&E’s request.³
14 This is the appropriate inquiry here as well.

15 My testimony, along with the testimony of SDG&E witness Ms. Karen Sedgwick, shows that
16 SDG&E’s decisions regarding the settlement of wildfire claims and the mitigation of costs
17 through insurance and third party recoveries were reasonable and prudent. Mr. Craig Gentes
18 provides more detailed information about the accounting treatment of the WEMA Costs,
19 explaining the various credits and deductions that comprise those costs, including a voluntary
20 deduction of 10% that I instructed him to make.⁴ Ms. Cynthia Fang then discusses the
21 ratemaking treatment of the WEMA Costs and calculates rates based on SDG&E’s proposed

³— *San Diego Gas & Elec. Co.*, 146 FERC ¶ 63,017 (2014).

⁴— As I discuss later in my testimony, SDG&E also proposes to further reduce the WEMA Costs by crediting certain collections related to miscellaneous revenue to the WEMA each year.

1 ~~recovery, using three amortization scenarios (six, eight, and ten years) that I asked her to present,~~
2 ~~which result in monthly rate impacts for a typical non-California Alternate Rates for Energy~~
3 ~~("CARE") residential customer of \$1.67 (six years), \$1.25 (eight years), and \$1.00 (ten years).~~

4 Q: Is SDG&E submitting any other testimony?

5 A: Yes. Based on prior Commission and FERC proceedings related to these fires, SDG&E
6 expects opposition to this application. Accordingly, while we believe it is not necessary for the
7 Commission to make any findings in connection with this application regarding the
8 reasonableness and prudence of SDG&E's operations leading up to the 2007 wildfires because
9 California law holds SDG&E strictly liable for the claims, SDG&E is nevertheless submitting
10 extensive testimony regarding its operational and engineering practices and procedures in order
11 to demonstrate that SDG&E acted prudently in its operations with respect to safety, reliability
12 and cost-effectiveness under the pre-fire circumstances. Mr. Dave Geier, SDG&E's Vice
13 President for Electric Transmission and System Engineering, is the overview witness for those
14 operational and engineering issues. His testimony is supported and supplemented by the
15 testimony of SDG&E witnesses Darren Weim, Greg Walters and Don Akau. Additionally, Mr.
16 Steve Vanderburg and Dr. Jon Peterka present testimony about the extreme winds and other
17 conditions that existed in October 2007, which were major factors in the ignition and spread of
18 the 2007 wildfires.

19 **IV.II. BACKGROUND**

20 **A. The 2007 Wildfires**

21 Q. Please describe the 2007 wildfires.

1 A. In late October 2007, more than a dozen major wildfires⁵ spread across Southern
2 California. According to the *California Fire Siege 2007* report released by Cal Fire and other
3 agencies, these fires were spawned by “an unusually severe fire weather event characterized by
4 intense, dry, gusty Santa Ana winds.”⁶ Thousands of homes and other buildings were destroyed,
5 and hundreds more were damaged. Hundreds of thousands of people were evacuated from their
6 homes in Southern California. The wildfires burned more than 500,000 acres. Cal Fire deemed
7 the 2007 wildfires as “unquestionably one of the most devastating wildfire events in the history
8 of California.”⁷ I was living in San Diego County at the time of these wildfires and witnessed
9 that devastation first-hand. My family evacuated our home, as did the families of many SDG&E
10 employees.

11 Q. Which of these wildfires were linked to SDG&E facilities?

12 A. Reports issued by Cal Fire concluded that two of these fires (the Witch and Rice Fires)
13 were caused by SDG&E power lines and that a third fire (the Guejito Fire) occurred when a wire
14 securing a Cox Communications’ fiber optic cable came into contact with an SDG&E power line
15 “causing an arc and starting the fire.” The CPSD also issued its own report, the “Report of the
16 Consumer Protection and Safety Division Regarding the Guejito, Witch and Rice Fires” (“CPSD
17 Report”). With respect to the Witch fire, the CPSD Report found that: “SDG&E’s 69 kV
18 overhead conductors contacted each other during Santa Ana wind conditions, starting a fire.”
19 With respect to the Guejito Fire, the CPSD Report found that “a Cox Communications (Cox)

⁵ The number of wildfires that occurred in late 2007 has been counted differently by various federal and state agencies (*e.g.*, one agency counted 17 major wildfires, while another reported 24 total fire incidents).

⁶ See Appendix 2 at 6. The Commission has previously taken official notice of this report. See D.12-01-032 at 5, n.1.

⁷ *Id.*

1 lashing wire contacted an SDG&E 12 kV conductor during Santa Ana wind conditions, starting a
2 fire.” With respect to the Rice Fire, the CPSD Report found that “[a] sycamore tree limb broke
3 and fell onto SDG&E’s 12 kV conductors during Santa Ana wind conditions, starting a fire.”

4 Q. Does SDG&E dispute that its facilities were involved in the ignitions of these three
5 wildfires?

6 ~~A. While it is impossible to say exactly how each fire started, given that there were no
7 eyewitnesses to the ignitions, SDG&E does not dispute that its facilities were involved in those
8 ignitions.~~

9 ~~Q. You mentioned that the CPSD issued a report into the fires. What happened as a result of
10 that report?~~

11 ~~A. The Commission initiated Orders Instituting Investigation into each of the three fires.
12 Mr. Geier describes those proceedings in greater detail. Ultimately, SDG&E and Cox
13 Communications each entered into settlement agreements with the CPSD, which the
14 Commission approved, resolving those investigations.⁸ Among other terms of the settlement,
15 SDG&E agreed to pay \$14.75 million, and it did not admit to any violations of safety General
16 Order provisions or other statutory requirements.~~

17 Q. How has SDG&E reacted to the 2007 wildfires?

18 ~~A. That is a very important subject and is treated in detail in the testimony of Messrs. Geier,
19 Weim, Walters, Akau and Vanderburg. Those witnesses discuss a host of measures SDG&E has
20 undertaken in order to lessen the risk that SDG&E facilities will be involved in the ignition of
21 future wildfires. As a member of SDG&E’s management team, I can say that minimizing fire
22 risk is a key priority of our business.~~

⁸ D.10-04-047.

1 **B. WEBA, Z-Factor and WEMA Proceedings**

2 ~~Q. Please describe the Commission proceedings that preceded and led to the filing of this~~
3 ~~application.~~

4 ~~A. In August and September 2009, SDG&E made three related filings at the Commission.~~
5 ~~First, jointly with Southern California Gas Company, Southern California Edison Company, and~~
6 ~~Pacific Gas & Electric Company (“Utilities”), SDG&E filed a Wildfire Expense Balancing~~
7 ~~Account (“WEBA”) application, proposing a new framework and mechanism for future recovery~~
8 ~~of all wildfire-related expenses for claims, litigation expenses and insurance premiums in excess~~
9 ~~of amounts authorized by the Commission for recovery in distribution rates (A.09-08-020).~~

10 ~~Second, SDG&E filed an application for authorization to recover unforeseen liability~~
11 ~~insurance premiums and deductible expense increases as a Z-Factor event (A.09-08-019). Z-~~
12 ~~Factor mechanisms allow utilities to adjust their rates for unexpected and uncontrollable events.~~
13 ~~In December 2010, the Commission granted (with modifications) SDG&E’s Z-Factor~~
14 ~~application.⁹~~

15 ~~Third, SDG&E filed an advice letter requesting approval to establish a WEMA (Advice~~
16 ~~Letter 2109 E), as did the other Utilities, by separate letters. As explained in those advice letters,~~
17 ~~the establishment of a WEMA was necessary so that the Utilities could record the wildfire costs~~
18 ~~prior to any decision on the WEBA. In July 2010, in Resolution E-4311, the Commission~~
19 ~~approved the establishment of a WEMA for each of the Utilities, but required several~~
20 ~~modifications.¹⁰~~

⁹ D.10-12-053 (as modified by D.11-12-023).

¹⁰ Specifically, the Commission directed the Utilities to: (1) record the same wildfire costs in the WEMA as they proposed to record in the WEBA, except for financing costs; (2) treat the recovery of costs as dependent on a Commission decision in the WEBA proceeding; (3) use a separate tariff section to address disposition of costs recorded in the WEMA; (4) include in the WEMA tariffs a credit for any

1 ~~In December 2012, the Commission denied the WEBA application, finding that the~~
2 ~~application did not present financial or operational incentives for management to reduce the risk~~
3 ~~of wildfires, such that ratepayers remain subject to limitless potential liability for uninsured~~
4 ~~damages to third parties.¹¹ This rationale does not apply to this Application since the amount of~~
5 ~~the liability related to the 2007 wildfires is now known, and since SDG&E has taken extensive~~
6 ~~measures to reduce the risk of wildfires, as discussed by Mr. Geier and recognized by the~~
7 ~~Commission.¹² Moreover, in denying the WEBA application, the Commission specifically~~
8 ~~allowed SDG&E to maintain the WEMA and to later seek recovery of amounts recorded to the~~
9 ~~WEMA, “subject to [a] reasonableness review.”¹³~~

10 ~~V. JUSTIFICATIONS FOR WEMA COST RECOVERY~~

11 ~~Q. Why should SDG&E be permitted to recover the WEMA Costs in this proceeding?~~

12 ~~A. The Commission should permit SDG&E to recover the WEMA Costs for several~~
13 ~~important reasons.~~

14 ~~First, under basic principles of utility regulation, the WEMA Costs are costs of the utility~~
15 ~~business and, as such, are appropriate for recovery in rates. The Commission generally permits~~

~~wildfire costs recovered through revenues authorized by FERC; (5) use the three month commercial paper rate for interest on WEMA balances, and not include incremental debt/equity costs; and (6) include credit entries on their WEMAs for any wildfire costs recovered through the Z Factor mechanisms. SDG&E filed Advice Letter 2109 E A in response to Resolution E 4311, which the Commission found to be in compliance with that resolution.~~

¹¹ ~~_____ D.12-012-029.~~

¹² ~~_____ In the Z Factor proceedings I discussed above, the Commission has repeatedly recognized that “SDG&E actively took steps to improve its risk profile, including expanding its existing ‘Community Fire Safety Program’ to further reduce the likelihood of strong winds causing power line fires.” Resolution E-4484 at 18; see also D.10-12-053 at 36-37; and Resolution E-4450 at 16. Those steps have only increased since that time.~~

¹³ ~~_____ D.12-012-029 at 19, OP 3.~~

1 recovery of the costs of claims and suits for injuries and property damages, and it also permits
2 recovery of costs related to natural disasters.

3 ~~Second, in light of the application of inverse condemnation and the accompanying strict~~
4 ~~liability standard to SDG&E in the 2007 Wildfire Litigation, SDG&E's decision to pursue~~
5 ~~settlement of the claims was reasonable and prudent, as was the settlement process itself and the~~
6 ~~final cost. Thus the WEMA Costs were reasonably and prudently incurred.~~

7 ~~Third, SDG&E has taken reasonable and prudent steps to reduce or mitigate the amount~~
8 ~~of costs to be recovered in this proceeding—through insurance, recoveries from other third~~
9 ~~parties, and voluntary shareholder contributions. These steps, and recovery of amounts allocated~~
10 ~~to FERC, have reduced the costs SDG&E now seeks to recover significantly (from~~
11 ~~approximately \$2.4 billion to approximately \$379 million), further demonstrating the~~
12 ~~reasonableness and prudence of the WEMA Costs.~~

13 ~~I discuss each of these justifications in greater detail in the following subsections. Other~~
14 ~~SDG&E witnesses for whom Mr. Geier presents overview testimony provide additional input~~
15 ~~from an operational and engineering perspective.~~

16 ~~**A.—The WEMA Costs Are Costs of Providing Utility Service and As Such, Are**~~
17 ~~**Appropriate for Recovery**~~

18 ~~Q.—Why are the WEMA Costs appropriate for recovery in rates?~~

19 ~~A.—The WEMA Costs are costs that SDG&E incurred as part of its utility business. Under~~
20 ~~the regulatory compact, there is an exchange of costs and benefits involving regulated utilities,~~
21 ~~ratepayers and the Commission. The utility is granted a franchised service territory and is in turn~~
22 ~~obligated to serve each and every customer in that service territory, no matter how risky~~
23 ~~providing such service may be. In exchange, the utility is permitted to recover its just and~~
24 ~~reasonable costs and has an opportunity to earn a reasonable return on its investment. While cost~~

1 ~~recovery reduces the utility's financial risk, rate regulation also means that the utility is giving up~~
2 ~~financial upside in that its profits are limited, unlike an unregulated business that can charge~~
3 ~~whatever the market will bear.~~

4 ~~Q.— But don't the WEMA Costs arise from settlement of third-party damage claims (and~~
5 ~~related legal costs), rather than providing transmission or distribution service?~~

6 ~~A.— The WEMA Costs do arise from those settlements, and more specifically, from the~~
7 ~~amount of damage claims SDG&E paid above and beyond what was covered by insurance, third~~
8 ~~party recoveries, and amounts allocated to FERC jurisdictional rates. But it is well established~~
9 ~~that third-party liabilities are an inherent cost of the utility business. Thus, in their General Rate~~
10 ~~Cases, utilities forecast the costs of such third-party liabilities through Account 925 (Injuries &~~
11 ~~Damages), including amounts for liability insurance premiums, self-insurance costs, uninsured~~
12 ~~losses, the costs of property damages, and settlement costs.¹⁴ The WEMA Costs are certainly~~
13 ~~losses not covered by insurance and are also expenses incurred in the settlement of injuries and~~
14 ~~damages claims. While that fact alone means that the WEMA Costs fall squarely within the~~
15 ~~types of costs that are appropriate for recovery in rates, I think it is also important to recognize~~
16 ~~that these costs implicate the regulatory compact in another way.¹⁵~~

17 ~~Q.— Please elaborate.~~

18 ~~A.— SDG&E cannot simply withdraw from fire-prone areas in its service territory. As a~~
19 ~~public utility, it has the obligation and responsibility to serve all customers who request service,~~

¹⁴— The instructions to FERC Account 925, in which such costs are recorded state: “This account shall include the cost of insurance or reserve accruals to protect the utility against injuries and damages claims of employees or others, losses of such character not covered by insurance, and expenses incurred in settlement of injuries and damages claims.” 18 C.F.R. Part 101.

¹⁵— While, as noted, such costs are typically authorized in General Rate Cases on a forecast basis, the Commission also permits utilities to record such costs to expense memorandum accounts when projected costs or ratepayer benefits are uncertain.

1 even if the climatic and geographic conditions associated with that service carry with them a
2 heightened risk of fires or other disasters. Whereas an insurance company could decide it no
3 longer wanted to provide property insurance coverage to homeowners in particular regions due
4 to the risk of natural disasters, SDG&E does not have that option.

5 — Nor does SDG&E have the option to impose rate increases on selected customers living
6 in particularly fire-prone or risky areas. That is an option an unregulated business could use as a
7 means of protecting itself from the risk of serving customers in fire-prone areas, and indeed
8 SDG&E's liability insurers took that very step in the aftermath of the 2007 wildfires, raising
9 SDG&E's premiums considerably because of the heightened risk profile they perceived as a
10 result of the fire-prone conditions in SDG&E's service territory, coupled with the applicability of
11 inverse condemnation.¹⁶

12 In sum, since the risk of operating in a fire-prone service territory is imposed on SDG&E
13 as part of the regulatory compact, it should be permitted to recover the costs associated with
14 those operations as part of the exchange of costs and benefits I described earlier.

15 Q. — Does the Commission permit utilities to recover costs from natural disasters?

16 A. — Yes. For example, the Commission has permitted utilities to record and recover costs
17 related to restore utility service after natural disasters through Catastrophic Event Memorandum

¹⁶ — In the Z-Factor decision I mentioned earlier, the Commission specifically agreed with the insurers' assessment of SDG&E's risk profile:

We agree that SDG&E has a heightened risk profile due to its excessive wildfire risk exposure and San Diego County's inadequate firefighting resources, its legal liability under inverse condemnation, and the imposition on California investor-owned utilities of strict liability for wildfires, thus exposing it to insurance liability costs far exceeding the normal cost of doing business.

D.10-12-053 at 33-34.

1 ~~Accounts (“CEMA”).¹⁷—The Commission authorized the establishment of CEMAs by all utilities~~
2 ~~in 1991. These accounts were a response to regulatory and ratemaking issues that arose after the~~
3 ~~Loma Prieta earthquake.¹⁸—The Legislature codified disaster cost recovery through CEMA in~~
4 ~~Section 454.9 of the Public Utilities Code in 1994. As explained by the Commission, the~~
5 ~~resolution authorizing utilities to establish CEMA was intended “to preserve the opportunity for~~
6 ~~utilities incurring unusual and extraordinary costs to seek their recovery subsequently.”¹⁹~~

7 ~~Under a Commission-approved settlement, SDG&E recovered a portion of the amounts~~
8 ~~recorded to its CEMA for the 2007 wildfires.²⁰—The costs SDG&E recorded to CEMA were~~
9 ~~incremental costs incurred for restoring utility service to customers; repairing, replacing, or~~
10 ~~restoring utility facilities that were damaged in the 2007 wildfires; and complying with~~
11 ~~governmental agency orders in connection with the events.~~

12 ~~——— I recognize that CEMAs address the costs of restoring service, repairing damaged utility~~
13 ~~facilities, and complying with government orders, which are of a different character than the~~
14 ~~WEMA Costs sought here. But the principles embodied in CEMA are applicable to wildfire~~
15 ~~claims: natural disasters cannot be predicted or controlled, and it is appropriate to include costs~~
16 ~~resulting from these events in rates because they are part of the utility’s cost of doing business.~~

¹⁷ ~~——— Similarly, through its Z-factor mechanism, the Commission permits utilities to recover costs for unforeseen, exogenous events.~~

¹⁸ ~~——— Res., *Order Authorizing All Utilities to Establish Catastrophic Event Memorandum Accounts* (July 24, 1991), codified as Cal. Pub. Util Code § 454.9.~~

¹⁹ ~~——— D.93-11-071, p. 4.~~

²⁰ ~~——— SDG&E and the Division of Ratepayer Advocates entered into a settlement agreement in connection with SDG&E’s CEMA application, by which SDG&E’s authorized CEMA revenue requirement was \$25.44 million (or 79% of SDG&E’s originally requested recovery). The Commission approved this settlement agreement in October 2010. See D.10-10-004.~~

1 Q.—— Does the regulatory compact mean that SDG&E automatically gets to recover the
2 WEMA Costs?

3 A.—— No. In the case of extraordinary or “one-time” costs, the Commission typically engages
4 in a reasonableness review of the costs to ensure that the costs are reasonable and prudent. In
5 this instance, the Commission has specifically told SDG&E that the WEMA costs would be
6 “subject to [a] reasonableness review.”²⁴ Below, I explain why the WEMA Costs are reasonable
7 and prudent.

8 **B.—— SDG&E’s Settlement of the 2007 Wildfire Litigation Claims Was Reasonable**
9 **and Prudent**

10 Q.—— Earlier, you mentioned that the Commission has indicated that it would subject SDG&E’s
11 application for recovery of the WEMA Costs to a reasonableness review. What criteria does the
12 Commission use in such a review?

13 A.—— My understanding is that in a “reasonableness review,” the Commission assesses whether
14 a utility management’s voluntary decisions to incur a particular cost was “reasonable” or
15 “prudent” under the *then-existing* circumstances. Such decisions are viewed in light of what the
16 utility knew or should have known *at the time the decision was made*. I also understand that a
17 prudent and reasonable decision can include a spectrum of possible decisions and is not limited
18 to the best possible decision, nor is the evaluation of that decision based on a hindsight analysis.
19 Thus, it is inappropriate for the Commission to assess whether the decision was “reasonable” or
20 “prudent” based on information learned *after* the decision (or decisions) at issue were made.

21 Q.—— What SDG&E decisions or actions are appropriate for such a reasonableness review?

²⁴—— D.12-12-029.

1 A.—— Since SDG&E did not voluntarily incur any Wildfire Costs, I believe that the relevant
2 decisions from a reasonableness review perspective are the decisions SDG&E voluntarily made
3 in light of the imposition of those costs on SDG&E—*i.e.*, those decisions that led to the specific
4 amount of WEMA Costs. Such decisions and actions include: SDG&E’s decision to settle
5 claims raised in the 2007 Wildfire Litigation in light of the applicability of inverse
6 condemnation; its settlements for reasonable amounts; and the steps SDG&E took to reduce the
7 Wildfire Costs by approximately \$2 billion, to the amount for which SDG&E is seeking recovery
8 (approximately \$379 million).

9 Q.—— Why was SDG&E’s settlement of the 2007 Wildfire Litigation claims reasonable and
10 prudent?

11 A.—— SDG&E’s decision to settle the claims was reasonable, in light of the application by
12 California courts of the doctrine of inverse condemnation to investor-owned utilities. SDG&E
13 engaged in a well-conceived and careful settlement process intended to ensure that the settlement
14 payments were also reasonable.

15 Q.—— What is your understanding of inverse condemnation?

16 A.—— Inverse condemnation is a type of claim under the California Constitution by which a
17 plaintiff may assert that the government has taken or damaged private property for public use
18 without just compensation. In such cases, a strict liability standard applies, meaning that a
19 government entity or public utility must provide just compensation to the property owner,
20 whenever its facilities are involved in the taking, regardless of fault or the foreseeability of the
21 resulting damage.

22 Q.—— In your previous answer, you referred to “government” takings or damages. Does inverse
23 condemnation only apply where the government has taken or damaged private property?

1 ~~A.—— No. Inverse condemnation was originally applied to governmental or public entities, but~~
2 ~~that application was extended by California courts to privately owned public utilities.²²~~

3 ~~Q.—— Why has inverse condemnation been applied to privately owned public utilities?~~

4 ~~A.—— California courts treat power lines as dedicated to the public use—and so damage~~
5 ~~resulting from power lines is considered a “taking” for public use that should be paid for by the~~
6 ~~public. The rationale is that a privately owned public utility (through rates), like a governmental~~
7 ~~entity (through taxes), is able to spread costs, so that the property owner who suffers damage is~~
8 ~~not disproportionately burdened by the public use.~~

9 ~~Q.—— Was inverse condemnation asserted by plaintiffs against SDG&E in the 2007 Wildfire~~
10 ~~Litigation?~~

11 ~~A.—— Yes. In the 2007 Wildfire Litigation, all plaintiffs asserted an inverse condemnation~~
12 ~~claim against SDG&E. SDG&E objected to this claim by filing a demurrer challenging the~~
13 ~~notion that inverse condemnation may properly be asserted against a privately owned public~~
14 ~~utility. The trial court overruled that demurrer. SDG&E then filed a petition for a writ of~~
15 ~~mandate in the Court of Appeals, asking it to review the trial court decision. That petition was~~
16 ~~summarily denied. Lastly, SDG&E filed a petition for review with the California Supreme~~
17 ~~Court, which was also summarily denied without an opinion. So even though SDG&E sought to~~
18 ~~avoid the application of inverse condemnation to it in the context of the wildfire claims,~~
19 ~~California courts rejected SDG&E’s position, giving plaintiffs a strict liability claim against~~
20 ~~SDG&E.~~

²²—— See, e.g., *Barham v. Southern Cal. Edison Co.*, (1999) 74 Cal. App. 4th 744.

1 ~~Q.— Was the applicability of inverse condemnation to SDG&E a factor in management’s~~
2 ~~decision to pursue settlement of the damage claims asserted by plaintiffs in the 2007 Wildfire~~
3 ~~Litigation?~~

4 ~~A.— Yes, it was the major factor. As noted in my previous answer, SDG&E took all the legal~~
5 ~~steps it could to shield itself from the application of inverse condemnation. Once those efforts~~
6 ~~failed, SDG&E made the reasonable and prudent decision to settle the damage claims.~~

7 ~~Q.— Why was it reasonable and prudent to settle the damage claims under these~~
8 ~~circumstances?~~

9 ~~A.— First, SDG&E faced a difficult litigation position as a result of strict liability. The~~
10 ~~involvement of SDG&E facilities meant that SDG&E would owe damages. Given that we~~
11 ~~would be held strictly liable for damages, it made sense to settle cases brought against SDG&E.~~

12 ~~Second, litigation poses many risks and costs that can be minimized through reasonable~~
13 ~~settlements. For example, a jury might award a plaintiff far more than SDG&E believes the~~
14 ~~plaintiffs’ claims are worth, and, thus, far more than it would pay to settle the case. This risk is~~
15 ~~particularly present, for example, in emotional cases such as this in which a plaintiff’s home and~~
16 ~~personal possessions have been destroyed. Furthermore, continued litigation—particularly~~
17 ~~where, as here, there are thousands of claims—would have led to increased legal fees and costs~~
18 ~~for both sides, which inverse condemnation law would require SDG&E to solely bear.~~

19 ~~Ultimately, settling a case for a known amount results in final resolution of a dispute reduces the~~
20 ~~risk and costs of litigation.~~

21 ~~Q.— How did SDG&E ensure that the settlement payments it agreed to make were reasonable~~
22 ~~and prudent?~~

1 A. ~~As discussed in more detail in Ms. Sedgwick's direct testimony, plaintiffs in the Wildfire~~
2 ~~Litigation asserted claims of approximately \$4 billion. SDG&E analyzed the plaintiffs' claims in~~
3 ~~detail. Based on that analysis, and in light of applicable law, SDG&E, its counsel and experts~~
4 ~~determined the amount at which they believed it would be reasonable to settle the damage claim.~~
5 ~~SDG&E used this process to settle approximately 2,500 claims brought by residential,~~
6 ~~commercial, and governmental plaintiffs, for a total of approximately \$2.4 billion.~~

7 Q. ~~Why is it important for the Commission to take account of the applicability of inverse~~
8 ~~condemnation here?~~

9 A. ~~This may be the first Commission proceeding (and certainly the first where the costs were~~
10 ~~of this magnitude) where the interplay of inverse condemnation and a Commission~~
11 ~~reasonableness review has arisen, and I think that is an important consideration. Because~~
12 ~~California courts apply inverse condemnation and strict liability to SDG&E and other utilities,~~
13 ~~the Commission should recognize how it influences the decisions SDG&E must make under the~~
14 ~~circumstances. Inverse condemnation (and strict liability for damages) applies to utilities~~
15 ~~irrespective of considerations of prudence and reasonableness.~~
16 ~~Moreover, as I noted above, the key rationale California courts have articulated for applying~~
17 ~~inverse condemnation to privately owned public utilities is cost spreading, the idea that a utility,~~
18 ~~through rates, can spread costs associated damage caused by a public good (electricity) broadly~~
19 ~~throughout the community that benefits from that public good. If a municipally owned utility~~
20 ~~had been involved in the 2007 wildfires, it would have recovered damages or settlement~~
21 ~~payments through taxes. The situation should be no different here. Through this Application,~~
22 ~~SDG&E is seeking only to spread costs in the very fashion assumed by the California courts~~
23 ~~when they apply inverse condemnation to privately owned public utilities.~~

1 Q.— In the FERC proceedings regarding SDG&E’s proposal to recover the portion of the
2 Wildfire Costs allocated to FERC rates, was there any consideration of the importance of inverse
3 condemnation in relation to the prudence of SDG&E’s decision-making?

4 A.— Yes, FERC explicitly considered that issue. In a proceeding on one of SDG&E’s formula
5 rate filings to recover a portion of the Wildfire Costs allocated to FERC jurisdictional rates, the
6 Administrative Law Judge (“ALJ”) specifically directed the parties to brief the issue of how
7 inverse condemnation affects the determination of the reasonableness and prudence of its
8 decisions that led to the Wildfire Costs. The FERC decision then found as follows:

9 As pointed out by the Staff, under California law an inverse
10 condemnation action can be initiated by one whose property was
11 ‘taken’ for public use. California Courts have interpreted this to
12 mean that ‘any actual physical injury to real property proximately
13 caused by a public improvement as deliberately designed and
14 constructed is compensable . . . whether foreseeable or not.’ I find
15 it telling that California jurisprudence holds the ‘presence or
16 absence of fault by the public entity ordinarily is irrelevant.’ It
17 applies to utilities whose facilities were involved in fires that
18 damaged private property. Under the present circumstances,
19 therefore, it is highly probable that California’s inverse
20 condemnation policy would result in SDG&E’s strict liability for
21 the damages resulting from the 2007 wildfires. In fact, a 2009
22 Minute Order issued by the Superior Court of California, County
23 of San Diego found that plaintiffs seeking damages for the 2007
24 wildfires had ‘adequately alleged a cause of action for inverse
25 condemnation against SDG&E.’

26 Under these circumstances it is clear that SDG&E’s proactive steps
27 in settling the related third party claims were justified since they
28 would have been exposed to strict liability for third party claims in
29 any event. By settling, SDG&E avoided facing considerable
30 litigation risk and disposed of the claims for significantly less than
31 the amount demanded by the claimants. Therefore, I find
32 SDG&E’s conduct was rational and prudent.²³

²³——— 146 FERC ¶ 63,017 at PP 61–62 (internal citations omitted). While this decision was an Initial Decision issued by the ALJ, FERC’s regulations specify that ‘if no party takes exception to the Initial

1 ~~I believe that the Commission should reach the same conclusion here.~~

2 ~~C. **SDG&E Took Reasonable and Prudent Steps to Substantially Reduce the**~~
3 ~~**Costs**~~

4 ~~Q. What is the total amount that SDG&E has paid to settle claims raised in the 2007~~
5 ~~Wildfire Litigation?~~

6 ~~A. The total amount of Wildfire Costs (including settlements and associated legal fees) is~~
7 ~~approximately \$2.4 billion.~~

8 ~~Q. Earlier you mentioned that the WEMA Costs SDG&E seeks to recover in this proceeding~~
9 ~~is approximately \$379 million. Why are the WEMA Costs so much lower than the total Wildfire~~
10 ~~Costs?~~

11 ~~A. Again, Mr. Gentes describes the elements of the WEMA in more detail, but in brief,~~
12 ~~SDG&E reduced the amount through substantial liability insurance coverage, recoveries from~~
13 ~~third parties, FERC recovery, as well as through voluntary shareholder contributions.~~

14 ~~Q. Were the actions that SDG&E took to reduce the amount of the Wildfire Costs reasonable~~
15 ~~and prudent?~~

16 ~~A. Yes, I believe that those decisions were reasonable and prudent. First, as discussed by~~
17 ~~Ms. Sedgwick, at the time of the 2007 wildfires, SDG&E had \$1.1 billion in insurance, more~~
18 ~~than a reasonable amount of liability insurance coverage, particularly since we had as much or~~
19 ~~more liability insurance as any utility in California, even though SDG&E serves a relatively~~
20 ~~smaller service territory. Second, as Ms. Sedgwick also discusses, SDG&E obtained \$824~~
21 ~~million from third parties. Through those settlements, SDG&E recovered more than the amount~~
22 ~~for which it seeks recovery in this Application, to the benefit of ratepayers. Third, even though~~

~~Decision (and none did), and there is no further action by the FERC, the Initial Decision becomes the final decision of the Commission.~~

1 ~~the reasonableness and prudence of SDG&E's recoveries through FERC proceedings is not~~
2 ~~within the scope of what this Commission considers, those recoveries further reduced the costs~~
3 ~~for which SDG&E seeks recovery. Lastly, SDG&E is proposing a voluntary deduction of 10%~~
4 ~~of the remaining costs (after these deductions, and the amounts allocated to FERC ratepayers),~~
5 ~~and it is also proposing to credit revenues it collects above the amount of Commission authorized~~
6 ~~miscellaneous revenue to the WEMA balance each year.~~

7 Q. ~~Why has SDG&E proposed the 10% voluntary deduction?~~

8 A. ~~This 90/10 allocation was based on a Commission decision approving a settlement~~
9 ~~mechanism for the recovery of hazardous waste cleanup costs.²⁴ This mechanism was created~~
10 ~~primarily because California investor-owned utilities were subject to environmental claims under~~
11 ~~state and federal laws. Under the settlement mechanism, 90% of the costs—including cleanup~~
12 ~~costs, settlement costs paid to third parties for losses and damages, and related litigation costs—~~
13 ~~were to be recovered from ratepayers, while the remaining 10% were to be recovered from utility~~
14 ~~shareholders. SDG&E believes that the 90/10 cost sharing represents a reasonable approach in~~
15 ~~this context as well.~~

16 Q. ~~Please describe SDG&E's proposal to further reduce the costs for which it seeks~~
17 ~~recovery using miscellaneous revenues.~~

18 A. ~~Miscellaneous revenues consist of fees and revenues that SDG&E collects for the~~
19 ~~provision of specific products or services. These include revenues from items such as service~~
20 ~~establishment charges, collection charges and rents. The Commission authorizes a specific~~
21 ~~amount of miscellaneous revenues in SDG&E's General Rate Case, and miscellaneous revenues~~

²⁴ ~~D.94-05-020.~~

1 are incorporated into rates as a reduction to the electric distribution and gas base margin revenue
2 requirements charged to customers for utility services, thereby lowering rates.²⁵

3 Each year, SDG&E collects an amount of miscellaneous revenues that is either greater or less
4 than the amount authorized by the Commission. If the actual collections exceed the authorized
5 amount, SDG&E retains those funds, and if the opposite occurs, SDG&E must fund the
6 difference. SDG&E's proposal is to take any actual collections of electric distribution
7 miscellaneous revenues that exceed the authorized amount and to credit those funds to the
8 WEMA each year, thereby reducing the balance in the WEMA to be collected by customers
9 using funds that would otherwise be retained by shareholders.²⁶

10 Q.—When would such credits be implemented?

11 A.—From a timing perspective, the actual collections of miscellaneous revenues are known by
12 April of the year following the year in which they were collected. SDG&E would apply the
13 credit, and it would file an annual advice letter to recompute the balance of WEMA Costs and
14 reduce rates accordingly.

15 Q.—Do you know what the magnitude of these credits would be?

16 A.—Not with certainty. It really depends on what miscellaneous income we receive in a given
17 year, as well as the amount of miscellaneous revenues that the Commission authorizes us to
18 collect, which is currently an issue in SDG&E's pending General Rate Case before the
19 Commission.

20 Q.—How does SDG&E propose to recover the WEMA Costs in rates?

²⁵—Miscellaneous revenues authorized by the Commission in SDG&E's General Rate Cases exclude such revenues associated with electric transmission properties and facilities, wheeling charges, and other non-distribution sources recovered through FERC jurisdictional ratemaking mechanisms.

²⁶—SDG&E would not, however, deduct undercollections of miscellaneous revenues from the WEMA Costs.

1 A.——That recovery is presented in the testimony of Cynthia Fang. I have instructed Ms. Fang
2 to present three scenarios for rate recovery—amortization periods of six, eight and ten years.

3 Q.——Why did you instruct Ms. Fang to present these three amortization scenarios?

4 A.——I did that to enable the Commission to select the recovery approach that it views in its
5 judgment as the most sensible for ratepayers.

6 Q.——Do you have a recommendation as to amortization schedule the Commission should
7 adopt?

8 A.——Yes. I recommend the six year amortization period since the recovery takes place more
9 quickly.

10 Q.——Please summarize what the rate impacts would be under the six, eight and ten year
11 amortization proposals.

12 A.——A typical non-CARE residential customer living in the Inland climate zone and using
13 500 kilowatt hours (“kWh”) per month under the current residential rate structure could see the
14 following monthly summer bill increases:

15 (1)——Six Year Amortization: \$1.67

16 (2)——Eight Year Amortization: \$1.25

17 (3)——Ten Year Amortization: \$1.00

18 These rate impacts could be further reduced each year if SDG&E receives miscellaneous
19 revenues above the amount authorized by the Commission since we propose to credit such
20 revenues to the WEMA, as I described above.

21 **O.B. Opposition to This Application**

22 Q. Earlier you said that SDG&E expects opposition to this Application. How do you
23 respond to the argument that SDG&E should not be permitted to recover the WEMA Costs
24 because it caused the Witch, Guejito and Rice Fires?

1 A. I think that is an overly simplistic and unpersuasive argument for several reasons. As an
2 initial matter, we expect that any such opposition will be driven by the amount (approximately
3 \$379 million) that SDG&E seeks in this Application. ~~If the WEMA Costs had been covered by~~
4 ~~SDG&E's liability insurance, or if the amount of costs not covered by insurance had been~~
5 ~~minimal, SDG&E would not have needed to establish a WEMA or file this Application.~~ But it is
6 important to recognize that the ultimate cost of a wildfire is completely out of SDG&E's control,
7 and so the amount of the WEMA Costs should not determine whether they can be recovered.

8 Once a wildfire begins, the factors that determine whether it will cause \$2 or \$2 billion in
9 damages include the strength of the winds, the local geography and terrain, the dryness and
10 density of fuel, the density (and value) of the real estate or other property in the fire's path, the
11 number of other fires that may be simultaneously in progress, and the availability of local
12 firefighting resources. These factors have been repeatedly recognized in post-fire reports issued
13 by federal and state agencies regarding the 2007 wildfires.

14 For instance, the *After Action Report* issued by the City of San Diego following the 2007
15 wildfires highlighted the role of the winds in the spread of the Witch Fire:

16 Due to the significant winds, fire behavior was extreme, with rates
17 of spread on occasion in excess of 5 miles per hour, long range
18 spotting over half a mile, and flame lengths often in excess of 80'
19 to 100' high. Locals in the San Pasqual Valley area reported *wind*
20 *gusts of over 100 mph*. Strong Santa Ana winds pushed the fire
21 west towards the coast. Ember production and transport was a
22 significant contributor to fire spread and structure losses.²⁷

23 And, as noted by Cal Fire and other agencies, winds and other conditions that contribute to the
24 rapid spread of wildfires can also render fire suppression resources ineffective:

²⁷ See Appendix 3 at 5 (emphasis added).

1 Just 40 miles north of the Harris Fire, the Witch Fire is reported at
2 12:35 p.m. in the rural area of Witch Creek, east of Ramona in San
3 Diego County. Aircraft diverted from the Harris Fire take
4 immediate action due to imminent structure threat and rapid rate of
5 spread toward Ramona. Air tanker drops are ineffective due to the
6 winds, and the air attack is cancelled.²⁸

7 Obviously, if that air attack had been successful, the Witch Fire would have been quickly
8 contained. Indeed, according to the California Office of Emergency Services, 251 wildfire starts
9 (or more than 10 times the number of wildfires that ultimately spread throughout Southern
10 California) were caught on initial contact between October 20 and 25, 2007, including 45 in San
11 Diego County alone.²⁹ Unfortunately, the Witch, Guejito and Rice Fires were not among those
12 fires that were immediately contained.

13 Additionally, the firefighting resources available in parts of Southern California are
14 limited, and in recent years, California has faced multiple fires at once, stretching firefighting
15 resources to the limit. This resource limitation is repeatedly emphasized in the *California Fire*
16 *Siege 2007* report. For example, in describing the events of October 22, 2007, the report states:
17 “Competition for firefighting resources continues to pose major problems ... The Witch Fire is
18 reported at over 145,000 acres. No containment progress has been made to due to rapid fire
19 spread and limited on-scene resources.”³⁰

20 A Grand Jury Report issued in San Diego County, *The Fire Next Time – Will We Be*
21 *Ready?*, likewise concluded that both San Diego County and the City of San Diego had not
22 developed or funded sufficient fire-fighting resources.³¹ With respect to the City of San Diego,

28 See Appendix 2 at 20.

29 See Appendix 4 at 33.

30 See Appendix 2 at 28.

31 See Appendix 5.

1 for instance, the Grand Jury Report found that its fire department did not meet national
2 standards, that many of its engine districts exceed the standard nine square mile service area, and
3 that 46% of the time the department cannot meet the national five-minute response time. With
4 respect to San Diego County, the report noted that (at the time) it spent only \$8.5 million
5 annually on fire protection, far less than was spent by Orange County (\$260 million) or Los
6 Angeles County (\$860 million). The report further noted: “In spite of Santa Ana conditions,
7 insufficient rainfall, longer fire seasons and urban sprawl, the County remains without a unified
8 fire protection agency and no central command.”³²

9 As a result of these deficiencies, the City of San Diego, in its *After Action Report*, made a
10 host of recommendations regarding beefing up its firefighting resources, including procuring
11 additional fire engines, helicopters and other firefighting equipment.³³ However, the *After*
12 *Action Report* also highlighted important accomplishments and successes in firefighting efforts.
13 For instance, it noted that while hundreds of structures and homes were destroyed in Rancho
14 Bernardo and the City of San Diego by the Guejito Fire, “it is estimated that approximately 6,000
15 homes in the path of the fire were saved as a result of aggressive firefighting action taken by
16 SDFD firefighters.”³⁴ Without such firefighting, the damages from that fire would undoubtedly
17 have been far worse.

18 Ultimately, the Witch, Guejito and Rice Fires were devastating *not* because the ignition
19 source may have been power lines but rather because of these factors beyond SDG&E’s control.

³² *Id.* at 8.

³³ Indeed, SDG&E’s settlement with the County funded many similar upgrades, including \$9.5 million dollars spent to replace a fire station and the county’s outdated radio system.

³⁴ *See* Appendix 2 at 6.

1 Because the 2007 wildfires were essentially natural disasters, akin to hurricanes and tornadoes in
2 other jurisdictions, SDG&E should be allowed to recover the associated costs.

3 Moreover, although SDG&E's facilities may have been involved, SDG&E acted
4 reasonably in light of the risks known prior to the 2007 wildfires. All of the facilities linked to
5 each of the three wildfires had been safely in place for many years and had been appropriately
6 inspected and maintained, as discussed by Mr. Weim, Mr. Walters, and Mr. Akau. In addition, a
7 number of factors contributed to the ignitions of the Witch, Guejito and Rice Fires, including the
8 extreme wind and weather conditions discussed by Mr. Vanderburg and Dr. Peterka; Cox
9 Communications' facilities (in the case of the Guejito Fire), as discussed by Mr. Walters; and a
10 sycamore tree limb (in the case of the Rice Fire) as discussed by Mr. Akau. The confluence of
11 these factors was extraordinary, and SDG&E had no reason prior to the 2007 wildfires to predict
12 the level of damages that resulted from those wildfires.

13 **VI.III. CONCLUSION**

14 Q. Does this conclude your prepared direct testimony?

15 A. Yes it does.

