UTILITY DIVE

Insurance — public or private — likely won't stop utility wildfire risks, experts say

California's state-run wildfire insurance fund was an industry-leading model. Now investors and experts are voicing concerns about its potential collapse.

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"The wildfire situation in California appears to be getting worse due to climate change," said Michael Wara, a senior research scholar at the Stanford Woods Institute for the Environment. "You can run faster, but the treadmill is speeding up so that you may still fall off the back." David McNew via Getty Images

When Michael Wara, a senior research scholar at the Stanford Woods Institute for the Environment, helped set up the California Wildfire Fund in 2019, he suggested the fund aim to save $40 billion in order to have enough to pay off claims against Southern California utilities that triggered catastrophic wildfires. He also believed, at the time, that $40 billion might be too high.

"I was being conservative about how fast utilities could improve" their wildfire mitigation, Wara said in an interview this month.

While utilities have ramped up their wildfire mitigation and grid

hardening spending to tens of billions per year, significantly reducing the risk of ignition, the overall risk of wildfire has outstripped their efforts, Wara said. Fires across the nation and in Southern California in particular continue to grow in size and intensity as a result of rising temperatures and increasingly severe drought conditions. And with the latest round of fires in the Los Angeles area, investors in the state's largest utilities have begun to worry that the growing scale of utilities' wildfire liabilities may have already outstripped the fund's $21 billion target capacity.

Those investors are not wrong to be worried, Wara said. The Eaton Fire, if it was in fact connected to Southern California Edison's equipment, could deplete the fund's current reserves, leaving little in the bank for the next catastrophic fire. California utilities and their investors have already called on the state legislature to expand the fund, but Wara and other experts believe that at this point, any such expansion would just be a stop-gap in the absence of a broader societal solution.

"Competing against [the fund's growth] is the fact that the wildfire situation in California appears to be getting worse due to climate change. You can run faster, but the treadmill is speeding up so that you may still fall off the back," Wara said, later adding that he recently told the state wildfire commission that "we cannot insure our way out of this problem."

The 'go-forward' problem

The cause and cost of the Eaton Fire remain under investigation,

and so it remains to be seen whether Southern California Edison will need to tap the California Wildfire Fund to cover lost property claims — or how much they will need. But some back-of-the envelope math illustrates why investors have raised the issue during recent conference calls with all three of southern California's largest investor-owned utilities.

The fund currently has more than $12 billion in liquid assets, and has so far reimbursed one utility, Pacific Gas and Electric Company, $168 million for the 2021 Dixie Fire, according to a spokesperson for the California Earthquake authority, which manages the fund. Based on the most recent 10-Q report by PG&E, the fund expects to pay a potential $925 million for that fire.

Officials are still working on loss estimates related to the Eaton Fire, and wherever the figure lands, the wildfire fund wouldn't expect to pay for the entire sum, Wara said. According to a spokesperson for the California Wildfire Fund, utilities must pay the first $1 billion of claims by themselves, before they can seek reimbursement from the fund. Property owners must first seek reimbursement from their own insurance coverage, and utilities are expected to try to reach settlements with insurance companies that file wildfire claims.

California's AB 1054, the law that created the fund, dictates that the fund will only reimburse claims settlements deemed reasonable by the fund administrator. Settlements with insurance companies are considered reasonable if the claim is settled for 40% or less of what the insurance company paid. But those that exceed

40% are subject to additional scrutiny under the law, according to the fund spokesperson.

Even if private insurance picks up, say, half the bill, a $10 billion to $15 billion loss on the Eaton Fire would eat a sizable chunk of the fund's available assets and leave it with limited resources to cover the next large California Wildfire, Wara said. Thus the concern by investors: not whether the fund will cover SCE's Eaton-related liabilities, but whether there will be enough left in the bank for the next utility hit by wildfire lawsuits.

The fund's relatively slow rate of replenishment relative to what it may need to pay out represents the other part of investors' concerns. According to the wildfire fund's 2024 annual report, the fund has received $9 billion in annual contributions since 2019 from the three participating utilities — SCE, PG&E, and San Diego Gas & Electric. One-time initial contributions paid to join the fund represent $7.5 billion of this total.

Utilities' annual contributions to the fund have brought in $1.5 billion, and proceeds from surcharges on ratepayers' electric bills have generated about $3.3 billion, according to the annual report. Figures from 2023, the last full year of contributions detailed in the report, suggest the fund has a little under $1.2 billion coming in annually.

"That is the real source of uncertainty for utilities right now," Wara said. "It's what we call … the 'go forward' problem."

Insurance Costs

For utilities, the immediate impact is not such much the threat of another bankruptcy on the near horizon, but the question of whether shareholders will be willing to accept current rates of returns in exchange for what appears to be much greater financial risk. And utilities have already begun to see some investors' answers. PG&E stock dropped 19% following the outbreak of the L.A. fires, while stock in Sempra, SDG&E's parent company, fell 9%. Edison International, SCE's parent company, dropped 26% following the fires — even before speculation about the cause began. Edison's stock price is now down by nearly 30%.

Declining stock prices, coupled with other increases in borrowing costs, impact utilities' ability to raise and deploy capital — hindering their ability to invest in wildfire mitigation and in new generation to meet growing demand, Emily Fisher, chief strategy officer for the Smart Electric Power Alliance, said during a February 19 webinar discussion on wildfires.

Utilities in California and throughout the west have also seen their credit scores downgraded as a result of growing wildfire risk, Fisher said, and PG&E CEO Patti Poppe said during the company's fourth quarter earnings call on Feb. 13 that it was unlikely the company would see substantial improvements in its credit score this year as a result of the fires.

Utility companies have also seen dramatic increases in their insurance premiums in recent years — assuming such insurance is

even available, according to Alp Can, an actuary for USI Insurance Services and chair of the Actuaries Climate Index. Many utility companies have dropped their wildfire insurance policies and moved toward a self-insurance model, either to cut costs or because they cannot find a suitable policy, Can said.

“There are positives and negatives involved in that. Obviously you have to have the wherewithal, you have to reserve the funds in anticipation of catastrophic events,” Can said, adding that decreased costs typically come with a higher risk of insolvency.

Joe Wilson, a regional vice president for PG&E, noted during the Feb. 19 webinar that moving to a self-insurance model will save the company’s customers $1.8 billion over the next four years — though, as a participant in the California Wildfire Fund, this move is potentially less risky for PG&E than for utilities in other states. Poppe told investors during the company’s earnings call that PG&E was working with lawmakers to find ways to shore up the wildfire fund — as did leaders at Edison International and Sempra during their own earnings calls

This is the real challenge the wildfire fund seeks to address, Wara said: utility shareholders typically accept lower returns in exchange for reliable financial performance. Investors willing to accept the scale of risk associated with catastrophic wildfire do exist, but they generally expect much greater returns when their investments pan out.

“We can’t afford to buy utility infrastructure from investors who

expect a 20% return on their money," he said. "It doesn't work."

Reducing the consequences

Climate experts, including Wara, have historically called for a federal solution similar to the California Wildfire Fund in order to address the growing threat of wildfire litigation against utilities. But given the current policy climate, that seems unlikely. Even within the state of California, finding the will to increase the wildfire fund surcharges on residents' electric bills could prove challenging given the current political and economic environment, Wara said. And utilities oppose paying more into the fund without a commensurate increase in electric rates, as this would eat into shareholder's returns, he said.

As a result, Wara and other experts are contemplating solutions outside the insurance paradigm. Eric Gray, vice president for government relationship at the Edison Electric Institute, argued that simple reforms like expedited permitting could help utilities implement mitigation strategies like undergrounding and vegetation management in a more timely manner.

Another option, Gray said, is liability reform — eliminating the strict liability paradigm that has emerged to hold utilities responsible for all damages related to fires started by their equipment, regardless of whether their actions are deemed negligent or not. He noted that some states, such as Utah, have already taken measures to limit utility liability, and that conversations surrounding this option are taking place in other