All of the major electric utilities located in the western region of the United States are reviewed in this Issue; eastern electrics, in Issue 1; and the remaining utilities, in Issue 5.

Costs and potential liability stemming from wildfires in California have been a cause for concern for utilities in the Golden State. We discuss developments about this matter.

Several utilities covered in Issue 11 are active in the regulatory arena.

Electric utility stocks have turned in mixed results in 2018, following a stellar showing for most issues in 2017. Most utility equities are still expensively priced, in our view.

Wildfires In California

In 2017, wildfires caused extensive damage in the service areas of Pacific Gas and Electric (a subsidiary of *PG&E Corporation*) and Southern California Edison (a subsidiary of *Edison International*). Investigations about the causes of some of the fires are ongoing, but the state agency conducting the investigations has already blamed Pacific G&E for some of them. Lawsuits have been filed against the utilities, as well. At this point, neither company knows what its liability will be. What makes the liability potentially huge is California's inverse condemnation law. Under this law, if a utility's equipment contributed to the fire, the utility is liable even if established inspection and safety rules were followed. *PG&E*, whose board suspended the dividend last December, has already taken a $2.5 billion charge for potential liability. There will undoubtedly be additional charges, but the amount and timing of these are impossible to predict. The utilities have insurance coverage, but this probably won't be enough to cover the entire liability.

Utilities in California are trying to address this problem through a regulatory, legal, and legislative strategy. The state legislative session ended with a new law that will be helpful to utilities. The regulatory commission will have to consider a utility's financial health when determining who ultimately pays for the costs. Companies will be able to issue bonds that will be securitized by payments from customers over time. And the commission may split the costs between the utility and its customers, instead of disallowing recovery of the entire cost even if a utility was only partially responsible. (This is what happened to San Diego Gas & Electric, a subsidiary of *Sempra Energy*, which had to write off the entire cost related to wildfires that occurred in 2007.) Although the new law was welcome (and was even derided in some circles as a bailout for utilities), this fell far short of fixing the inverse condemnation problem. Accordingly, Pacific G&E and Southern California Edison are trying to get some relief from the courts.

It should come as no surprise that the cost of wildfire insurance has risen materially. Current expenses are well above the levels that the utilities are recovering in rates. Thus, companies must either swallow these costs or defer them for future recovery. *Edison International* absorbed $0.08 a share of these expenses in the first quarter of 2018, and is deferring an additional $0.30 a share based on the expectation that the regulators will eventually grant recovery of these costs.

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Regulatory Matters

From time to time, utilities need to file rate cases in order to place capital expenditures in the rate base and recover higher expenses. Adjusting the cost of capital or changing rate structures among customer classes sometimes justify regulatory filings, as well. And the new federal tax law led companies to work with regulators to determine the best way to pass the benefits through to ratepayers.

Some utilities have been underearning their allowed returns on equity, and have been trying to address this gap by filing rate applications. *Xcel Energy* has accomplished this in recent years. The utilities owned by *Hawaiian Electric Industries* have received rate relief, but still have some ground to make up in order to start earning an adequate return on equity. Elsewhere, *Black Hills* avoided rate cases as long as possible, but has begun a process that will see several filings in the next few years. And *NorthWestern* put forth its first electric petition in Montana since 2009.

Conclusion

Electric utility stocks have had a mixed performance in 2018, after a stellar showing (for most issues, with *PG&E* and *Edison International* two exceptions) the year before. Interest rates have risen, and further increases from the Federal Reserve are expected. Because rates are still relatively low, valuations of utility equities are still high. Takeover speculation is probably a factor for some stocks, as well. The average dividend yield for the Electric Utility Industry is just 3.4%, which is low, by historical standards. In addition, many utility stocks have a relative price-earnings ratio above 1.00. Most of these equities are trading within their 2021-2023 Target Price Range, and some (including *IDACORP*) are trading above this range. Due to these lofty valuations, the average total return potential for this industry over the 3- to 5-year period is just 4%.

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