

Hawaiian Electric: Revised Model Shows \$4.9B in Potential Liabilities from Settlement; Maui County Increasingly Likely to Share Burden

August 30, 2023

EXECUTIVE SUMMARY

- Capstone’s updated liability estimate for Hawaiian Electric Industries Inc. (HE) for a potential settlement for the Maui wildfires has risen to \$4.9 billion, up from \$3.9 billion, after accounting for revised implied loss per structure from prior wildfire settlements and new information regarding fatalities and missing people (see Exhibit 1). We believe the scope of these liabilities—coupled with Hawaiian Electric Co.’s (HECO) recent drawdown from its revolving credit facility—increases the risk of a bankruptcy filing.
- We believe Maui County will likely share some of the costs associated with the fires, particularly related to wrongful deaths, based on recent reports highlighting inadequacies in the emergency response. That said, the magnitude of liabilities for destroyed structures alone—and HE’s confirmation that its infrastructure started the fires early in the morning on August 8th—likely suggests that Maui County’s culpability would be insufficient to insulate HE entirely from liabilities. While HE claims there was a second fire that ignited at the same location while its power lines were de-energized, we believe a jury would find it unconvincing that the second fire was unrelated to the initial brush fire—ignited by HE’s equipment—if ongoing litigation goes to trial.
- Capstone increasingly believes intervention by state policymakers—and potentially federal policymakers—will likely be necessary to ensure the financial health and function of HECO given the scope of liabilities. Regulators at the Hawaii Public Utilities Commission (PUC) could leverage part of the company’s performance-based ratemaking formula to socialize costs from the 2023 fires with California’s wildfire fund, providing a framework for future legislative action (see Exhibit 2). As we saw with PG&E, de-risking the utility from future wildfires will be key to the path forward for HECO.

Exhibit 1: Capstone’s Updated Liability Estimate for Hawaiian Electric (\$M)

	Total Number	Estimated Settlement Cost	Total Cost
Fatalities	115	\$5.00*	\$575
Missing Persons	~850	\$0.50	\$425
Structures (Destroyed)	2,744	\$1.39**	\$3814
Structures (Damaged)	~500	\$0.139	\$70
		Total	\$4,884

*Our estimated cost per fatality used the Federal Emergency Management Agency’s (FEMA) 2023 Value of Statistical Life (VSL) of \$12.5 million, discounted by 60% to account for settlement value.

**Our estimated cost per structure destroyed is informed by the average residential house price of \$1.18M in the impacted zip codes, increased by ~18% to account for the implied cost per structure in prior wildfire settlements.

A DEEPER LOOK

Updated Capstone Hawaiian Electric Liability Model

We have updated our model to more accurately incorporate comparable wildfires, including settlement values that encompass payments both to insurance companies and individual plaintiffs. These settlement values capture losses including, but not limited to, injury, non-economic losses, emotional damages, loss of output on land, and structural damages/insurance payouts. This has resulted in our estimated potential liability for HE stemming from a settlement to \$4.9 billion from \$3.9 billion (see “[Hawaiian Electric Likely Faces \\$3.9 Billion in Wildfire Liabilities, Limited Liquidity Raises Questions Over Solvency; Cost Recovery Unlikely](#),” August 18, 2023).

Exhibit 2: Updated Wildfire Comparison Table (\$M)

Year	Name	Destroyed Structures	Fatalities	Settlement Payments	Fatality Discount	Implied Loss per Structure
2007	Rice, Witch, and Guejito Fires (CA)	1872	2	\$ 2,400	\$10	\$1.277
2017-2018	Camp & Tubbs Fires (CA)	19,245	107	\$ 25,500	\$535	\$1.021
2020	Zogg Fire (CA)	204	4	\$ 400	\$20	\$1.863
Average						\$1.387

Sources: Cal Fire, PG&E, SDG&E

This also has informed our internal liability model for the Hawaiian wildfires. We have increased our estimated settlement cost per structure to \$1.39 million per structure, which falls more in line with the previous wildfires we identified above. This represents an approximate 18% premium on the average residential property for the impacted ZIP codes. We also have updated the model to reflect the most recent data regarding fatalities and missing people from the fires. Overall, we believe this new model is more representative of the potential quantum of liabilities that HE could face if deemed negligent for these fires.

Likelihood of Bankruptcy Growing

In the weeks since the fires started, we have seen multiple downgrades of HE’s credit rating from [Fitch](#), [Moody’s](#), and [S&P](#). Additionally, HE filed an [8K](#) on August 24th announcing the indefinite suspension of its quarterly dividend as of Q3 2023. It also said HE drew \$170 million, and HECO drew \$200 million from their existing revolver of unsecured credit. In addition, HE [hired](#) as an adviser Guggenheim, which assisted PG&E with its bankruptcy filing in 2020. We believe its actions in the wake of the rating downgrades points to an increased likelihood of HE filing for bankruptcy soon.

Maui County Lawsuit and Potential Culpability

The County of Maui filed a lawsuit (Case ID 2CCV-23-0000238) on August 24th against Hawaiian Electric in the Second Circuit Court of Maui, alleging negligence, gross negligence, nuisance, ultrahazardous activity, injunctive relief, and trespass. The county is seeking damages for all property destroyed/damaged, loss of revenues and work productivity, damage to public infrastructure, loss of public lands and natural resources, debris removal, cost of rebuilding and community efforts, fire suppression and law enforcement costs, all other damages and restoration costs, and punitive and exemplary damages.

This case joins a growing number of lawsuits against the companies (see Exhibit 3). However, while the other cases could be consolidated into a broader class for property owners, the County of Maui case will proceed separately.

Exhibit 3: Ongoing Litigation against Hawaiian Electric

Case ID	Plaintiffs	Defendants	Details	Court and Judge Assignment
1CCV-23-0001045	Property owners	HECO, HELCO*, MECO**, HE	<ul style="list-style-type: none"> - Class action complaint, jury trial - Counts of negligence, gross negligence, private nuisance, inverse condemnation, ultrahazardous activity, injunctive relief 	First Circuit of Oahu, Sixth Division, Judge Jeffrey Crabtree
2CCV-23-0000224	Property owners	HECO, MECO, County of Maui, County of Hawaii	<ul style="list-style-type: none"> - Class action complaint, jury trial - Counts of negligence, strict liability (HE and MECO only), trespass (HE and MECO only), nuisance (HE and MECO only), premise liability; jury trial 	Second Circuit of Maui, Second Division, Judge Peter Cahill
2CCV-23-0000225	Property owners	HECO, HELCO, MECO, HE	<ul style="list-style-type: none"> - Complaint, jury trial - Counts of negligence, trespass, and nuisance 	Second Circuit of Maui, Second Division, Judge Peter Cahill
2CCV-23-0000227	Property owners	HECO, HELCO, MECO, HE	<ul style="list-style-type: none"> - Complaint, jury trial - Counts of inverse condemnation, negligence, gross negligence, public nuisance, trespass 	Second Circuit of Maui, Second Division, Judge Peter Cahill
2CCV-23-0000238	County of Maui	HECO, HELCO, MECO, HE	<ul style="list-style-type: none"> - Complaint, jury trial - Counts of negligence, gross negligence, nuisance, ultrahazardous activity, injunctive relief 	Second Circuit of Maui, Second Division, Judge Peter Cahill

Source: Capstone analysis, Hawaii eCourt Kōkua

*Hawaiian Electric Light Co. Inc. **Maui Electric Co. Ltd.

Similar to other lawsuits, the county brought charges against HE and the three subsidiary utilities. The lawsuit states that HECO, MECO, and HELCO operate as a single business enterprise sharing a common business purpose, and they are not separate entities. In addition, it states that HE has unified control over the utilities and appoints board members and leadership of these subsidiaries. The lawsuits contend that the utilities (HECO, MECO, and HELCO), as well as the parent company HEI are jointly and severally liable.

Notably, all the cases have now been moved to the Second Division of the Second Circuit Court in Maui. The Second Division judge is Peter Cahill, who began serving on the Circuit Court in 2012. Before his appointment, he was a trial lawyer and specialized in injury and wrongful death cases.

Maui County Culpability

Mounting evidence suggests that Maui County also could be held at fault for the spread of fires and resulting injuries and deaths. Media reports [suggest](#) that the Maui Emergency Management Agency previously warned county officials that the emergency infrastructure was inadequate. On the day of the fires, Hawaii [confirmed](#) that no evacuation sirens were activated, and many residents did not receive phone alerts. In addition, there are [allegations](#) that fire crews did not extinguish the initial fire, causing it to reignite and spread out of control later in the day, and water resources were not appropriately distributed.

In an [8-K filing](#) on August 28th, Hawaiian Electric stated that the Maui County Fire Department concluded that the initial fire caused by its infrastructure was “100% contained” by 9:00 a.m. and “extinguished” by 2:00 p.m. Hawaiian Electric argues that the real damage was caused by a separate, distinct Afternoon Fire that began before 3:00 p.m., by which point its power lines had been de-energized for more than six hours. We anticipate the county will argue that the Afternoon Fire was simply a reignition of the initial fire, which evidence indicates was started by Hawaiian Electric. Based on the evidence to date, we believe it is unlikely that there was a separate and distinct ignition unrelated to HE’s infrastructure that caused the Afternoon Fire.

In addition, residents have [stated](#) that Maui County was aware of the wildfire risks and the importance of having emergency infrastructure and evacuation plans from prior wildfires. Maui experienced a bad wildfire season in the summer of 2018, which resulted in greater lawmaker attention to wildfire mitigation and the PUC requiring MECO to produce initial wildfire mitigation plans. Prior public backlash after these fires criticized Maui for lacking appropriate emergency response infrastructure and not sending emergency evacuation signals to residents. Despite this backlash and promises from lawmakers to prioritize emergency planning, evidence suggests that the county made few improvements since 2018.

Hawaii Comparative Negligence Standard

Capstone believes Maui County could face liabilities under the state’s comparative negligence standard if found at fault. If the county also is found to be at fault for the fires, Hawaii’s comparative negligence standard would come into play in the county’s lawsuit (HRS §663-31). The state’s comparative negligence standard will not allow the county to recover damages from HE if the county is assigned at fault beyond 51%. Below that threshold, damages would be awarded proportionally based on the degrees of determined negligence.

In the lawsuits from property owners, Hawaii’s joint and several liability standard will factor in if the county is found to be at fault. Hawaii’s law generally applies several liability, which holds only a defendant liable for a share of damages that is proportional to their degree of fault. However, Hawaii has certain exceptions and can apply joint and several liability, which holds defendants jointly liable up to the total amount of damages.

Therefore, if Hawaiian Electric was unable to pay its share of the damages, then plaintiffs could attempt to collect the total amount of damages from the county. These exceptions include 1) economic damages in an injury or death case; and 2) non-economic damages in an injury or death case if the defendant is found to be at least 25% at fault (HRS §663-10.9). As a result, a jury verdict on the personal injury and wrongful death components potentially could hold multiple defendants jointly and severally liable for the total damages.

Likelihood of State Intervention Growing

PUC Action

While it is unlikely the PUC will approve cost recovery if HE is found negligent, it is possible the PUC could issue a contingent approval for cost recovery (i.e., conditional on the company not being found negligent) or attempt to pass a portion of the rebuilding costs through to ratepayers. We believe the PUC will be favorable toward cost recovery associated with rebuilding electric infrastructure, given the urgent need for power restoration.

MECO filed a request for deferred accounting on August 21st for costs associated with rebuilding the electric system (Docket No. [2023-0349](#)). It asked the PUC to approve this request by December 31, 2023, to allow deferred accounting treatment for costs through December 31, 2024. MECO cites that substantial damages were sustained, including damages to 400 poles out of 750 and 300 out of 575 transformers. The PUC has approved deferred accounting treatment for expenses related to prior unforeseeable events, including Hurricane Iniki and the COVID-19 pandemic.

The PUC has other regulatory mechanisms that could be leveraged for electric infrastructure rebuilding costs. The commission's performance-based ratemaking framework uses a formula called attrition relief mechanism (ARM) to set the annual revenue requirement for utilities. This [formula](#) contains a "Z-factor," which is designed specifically for catastrophic events that are out of a utility's control. The PUC could open a new proceeding to adjust the revenue requirement that includes the rebuilding of all-electric infrastructure.

State Intervention and Municipalization

We believe the state is likely to provide support to the utility, although it is unclear at this point what avenue the state would take. Legislators could allow securitization or create a state fund to help cover damage costs, similar to California's. Hawaii's legislative calendar runs from January to May for regular sessions. The legislature can vote to hold a special session outside of the typical time frame when a two-thirds majority of the state House and Senate petition the speaker of the House and the president of the Senate. Hawaii has held several special sessions for various reasons (e.g., judicial confirmation hearings and funding for the Honolulu rail project) in 2014, 2015, 2016, 2017, and 2018.

There have been some prior attempts to municipalize utilities, but the lack of precedent cases poses hurdles toward implementation and timeline (see "[Hawaiian Electric Likely Faces \\$3.9 Billion in Wildfire Liabilities, Limited Liquidity Raises Questions Over Solvency; Cost Recovery Unlikely](#)," August 18, 2023). In Kauai, private owners formed an electric cooperative (co-op) in

1999, switching from an investor-owned utility model. The Big Island has been considering a co-op model for HECO for more than a decade. Based on the existing co-op model and the uncertainty about a municipalization process in Hawaii, we believe the state legislature will be more open to co-op models or other private owners.

Outlook for Federal Intervention

Congressional Inquiry and Emergency Funding

Capstone expects federal attention will increase on the Maui fires, with House Speaker Kevin McCarthy [indicating](#) a congressional inquiry is on the horizon. In turn, we expect emergency funding for Hawaii to emerge in the context of federal appropriation negotiations this fall. We expect Hawaii Senators Brian Schatz (D) and Mazie Hirono (D) will push for federal disaster relief, while Republican senators from Alabama, Georgia, and Louisiana will seek emergency funding for flooding over this past year. We believe this will lay the groundwork for a bipartisan deal as part of appropriations. However, it is unlikely any federal funding will offset potential liabilities for Hawaiian Electric. Instead, this funding will likely be used to support local governments.

FEMA and HUD Funding

Based on prior federal assistance for natural disasters, we anticipate that the Federal Emergency Management Agency (FEMA) funding will largely not assist Hawaiian Electric outside of electric infrastructure rebuilding. FEMA has previously supported municipally-owned utilities, including the Puerto Rico Electric Power Authority (PREPA). However, investor-owned utilities historically have not received direct FEMA assistance and are expected to have adequate insurance for natural disasters.

FEMA's Disaster Relief Fund is allocated to federal resources and state resources, with the majority of funding being allocated federally for more extreme natural disasters. We anticipate the early share of expenses to be used to manage the federal response, including restoration of public lands and infrastructure, emergency housing and assistance to residents, and payments for first responders and cleanup efforts. However, we anticipate later funds could be distributed to the state of Hawaii for "hazard mitigation initiatives." California has leveraged funding to underground power lines and enacted other natural disaster prevention measures.

Following a disaster declaration, the US Department of Housing and Urban Development (HUD) also often receives funding through congressional appropriations for its Community Development Block Grant Disaster Recovery (CDBG-DR) program. Once funding is granted, HUD sets parameters for the funding that states can access, which often includes hazard mitigation. FEMA and HUD funding could help support Hawaii's hazard mitigation efforts, including critical electric infrastructure restoration and grid hardening. However, we believe this funding will largely not support Hawaiian Electric since it is privately owned. If Hawaii considers municipalization of the utility, it could apply for funding from federal resources. However, there is no precedent for disaster relief funding to apply to municipalization.

Hawaiian Electric Conference Call

Thursday, August 31, 2023, at 12:00 p.m. EDT

On August 31st, Capstone Managing Director Eric Scheriff and Energy Analyst Alyssa Lu will host a conference call with Alison Plessman, Partner at Hueston Hennigan, to discuss the Maui wildfires and potential liabilities that Hawaiian Electric (HE) faces. Alison defended PacifiCorp in dozens of lawsuits filed in multiple jurisdictions across Oregon and California arising out of the 2020 Labor Day Fires. During the call, we will discuss the outlook for a potential negligence finding, key issues about HE's potential defense, and the broader political backdrop presently surrounding Hawaiian Electric in the state.

If you are interested in attending, please contact your Capstone sales representative or RSVP@capstonedc.com.

In Case You Missed It: A roundup of Capstone's recent notes and events on Hawaiian Electric:

[Conference call](#) with energy policy expert Jennifer Potter, former Hawaii PUC commissioner, August 25, 2023

[Hawaiian Electric Likely Faces \\$3.9B in Wildfire Liabilities, Limited Liquidity Raises Questions Over Solvency; Cost Recovery Unlikely](#), August 18, 2023

[Conference call](#) with wildfire expert Michael Wara, Director of the Climate and Energy Policy Program at the Stanford Woods Institute for the Environment, August 18, 2023

[Conference call](#) with mass tort trial attorney Mikal Watts, Partner at Watts Guerra, August 15, 2023