BEFORE THE PUBLIC UTILITIES COMMISSION OF THE F I L E D

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STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U 902-M) for Authority, Among Other Things, to Increase Rates and Charges for Electric and Gas Service Effective on January 1, 2012	Application No. 10-12-005 (Filed December 15, 2010)
Application of Southern California Gas Company (U 904-G) for authority to update its gas revenue requirement and base rates effective January 1, 2012	Application No. 10-12-006 (Filed December 15, 2010)

<u>REPLY BRIEF OF SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E)</u>

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Reply Brief of Southern California Edison Company (U 338-E)

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REPLY BRIEF OF SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E)

Pursuant to Rule 13.11 of the Rules of Practice and Procedure of the California Public Utilities Commission (Commission) and Administrative Law Judge John Wong's email ruling of May 1, 2012, Southern California Edison Company (SCE) submits its reply brief in the 2012 General Rate Case (GRC) of San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SCG).[1] This brief follows the common briefing outline circulated by the Sempra Utilities on January 31, 2012.

3.1 The Burden of Proof for a General Rate Case is a Preponderance of the Evidence

The Division of Ratepayer Advocates (DRA) claims that the standard of proof for a GRC should be clear and convincing evidence.[2] However, in its decision on SCE's 2009 GRC, the

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1 SDG&E and SCG are referred to collectively as the Sempra Utilities.

2 Opening Brief of DRA, pp. 5-7. The Black Economic Council, the National Asian American Coalition, and the Latino Business Chamber of Greater Los Angeles (Joint Parties) join DRA in this argument. *See* Opening Brief

(Continued on the next page)

Commission clarified that "the standard of proof the applicant must meet is that of a preponderance of evidence, which the Commission has, at times, incorrectly referred to as 'clear and convincing' evidence."[3] This clarification conforms Commission practice to California law, which states that "[e]xcept as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence."[4]

DRA alleges that the Commission "offered no explanation of why 'clear and convincing evidence' is the 'incorrect' standard to apply."[5] As SCE noted in its pending test-year 2012 GRC, the Commission has thoroughly explained why the "preponderance" standard is correct.[6] In a 2008 decision, the Commission discussed the origin of the mistaken citations to a "clear and convincing" standard:

> Our own research indicates that the Commission first appeared to require clear and convincing evidence in D.44923, where in the course of its review of a motion to dismiss a telephone utility's application for a rate increase, the Commission stated:
>
> "We must keep in mind that this is not an adversary proceeding in the sense that, as in an ordinary civil case, only a *prima facie* case must be shown. This is a legislative proceed[ing] in which the burden of proof rests most heavily upon applicant to prove by clear and convincing evidence that the present rates of which it complains work a confiscation of its property."
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> However, it is unclear from the discussion in D.44923 whether the Commission used the words "clear and convincing" in a lay sense only, or whether it was adopting a specific legal standard.[7]

The Commission affirmed the "preponderance" standard in its decision on Pacific Gas and Electric Company's (PG&E) 2011 GRC.[8] There, DRA and The Utility Reform Network

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of the Joint Parties, p. 7. This section of SCE's reply brief should be construed as also rebutting the Joint Parties' argument.

3 *Re Southern California Edison Co.*, Decision (D.) 09-03-025, p. 8.

4 CAL. EVID. CODE § 115. The Commission has noted that "[t]he preponderance of the evidence is generally the default standard in civil and administrative law cases." *Re San Diego Gas & Electric Co*., D.08-12-058, p. 19, citing California Administrative Hearing Practice, 2d ed. (2005) at 365.

5 Opening Brief of DRA, p. 6.

6 Application (A.) 10-11-15, Opening Brief of SCE, pp. 9-10.

7 *Re San Diego Gas & Electric Co*., D.08-12-058, pp. 18-19, n. 28 (quoting *Pacific Telephone & Telegraph Co. Rate Application*, D.44923, 50 CPUC 247, 248 (1950)).

(TURN) argued for the "clear and convincing" standard, basing their arguments on cases predating D.09-03-025.[9] The Commission reiterated that those "clear and convincing" cases were incorrect and upheld the "preponderance rule."[10] As in the PG&E GRC, DRA again relies on outdated cases.[11] The Commission has overruled those decisions regarding the burden of proof,[12] it has explained why the "preponderance" standard is correct,[13] and it has reaffirmed the "preponderance" standard.[14] Notably, TURN has abandoned its previous argument and now agrees that the burden of proof is a preponderance of the evidence.[15] The Sempra Utilities should only be required to establish the reasonableness of their applications by a preponderance of the evidence.

17.2.1 A Ratepayer Vote on Compensation Would Be Inappropriate and Unprecedented

The Joint Parties recommend a ratepayer advisory vote regarding executive compensation.[16] The Commission should reject this recommendation for several reasons. First, the California Constitution limits the Commission's authority by stating that it may "fix rates, establish rules, examine records, issue subpoenas, administer oaths, take testimony, punish for contempt, and prescribe a uniform system of accounts for all public utilities subject to its jurisdiction."[17] Similarly, Public Utilities Code section 701 states that "[t]he Commission may supervise and regulate every public utility in the State and may do all things, whether specifically

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8 *Re Pacific Gas & Electric Co.,* D.11-05-018, pp. 68-70 & n. 68.

9 *Id.* at 68-69.

10 *Id.*

11 *See* Opening Brief of DRA, pp. 5-7.

12 *See Re Southern California Edison Co.*, D.09-03-025, p. 8

13 *See Re San Diego Gas & Electric Co*., D.08-12-058, pp. 18-19, n. 28.

14 *See Re Pacific Gas & Electric Co.*, D.11-05-018, pp. 68-69.

15 *See* Amended Brief of TURN on Issues Specific to SCG and the Legacy Meter Issue for SDG&E (Opening Brief of TURN), p. 11.

16 Opening Brief of the Joint Parties, pp. 29-30.

17 CAL. CONST. art. XXII, § 6.

designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction."[18]

In exercising its jurisdiction, the Commission has directed DRA, which represents the ratepayers,[19] and the utilities to jointly conduct compensation studies to determine the reasonableness of utility employees' compensation, including executive compensation.[20] These studies, and the related requirement that compensation not exceed five percent of the market average,[21] give ratepayers a unique power to control compensation that is not available to customers of private companies. But there is nothing in the California Constitution or statutes that allows the ratepayers to directly vote on utility executives' compensation, nor did the Commission approve such a procedure in any utility rate case.

Additionally, if the Commission were to approve a ratepayer advisory vote in this proceeding, it would be a major policy shift in the way utility rate cases are handled and would impact not just the Sempra Utilities, but also other utilities in the future. Such a broad legal and policy issue should be decided, if at all, by the full Commission in a generic proceeding such as a rulemaking, and not through an individual, utility-specific GRC proceeding.[22]

17.2.2 Total Compensation Studies Provide the Best Evidence of Reasonable Compensation

The Joint Parties argue that total compensation studies are no longer useful.[23] Their argument, however, is based on gamesmanship, not reasoned analysis. The Joint Parties rely on DRA's statements from SCE's pending test-year 2012 GRC.[24] There, the total compensation

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[18] PUB. UTIL. CODE § 701.

[19] PUB. UTIL. CODE § 309.5(a).

[20] *See Re Southern California Edison Co.*, D.04-07-022, p. 202 ("The submission of the total compensation study comports with prior Commission directives.").

[21] *Re Pacific Gas & Electric Co.*, D.95-12-055, 63 CPUC 2d 570, 591.

[22] *See* PUB. UTIL. CODE § 1701.1(c)(1) (defining quasi-legislative cases, including rulemakings, as the proper type of proceeding to establish policies and rules affecting an entire industry).

[23] Opening Brief of the Joint Parties, pp. 32-33.

[24] *See id.*

study determined that SCE's compensation was below the market average, leading DRA to question the study's accuracy.[25] In this proceeding, the total compensation studies determined that the Sempra Utilities' compensation was above the market average.[26] DRA not only accepts the study in this GRC, but it relies upon it to prove that compensation is "within the range of competitiveness."[27]

In SCE's GRC, DRA attacked the concept of total compensation studies.[28] In this case, it relies upon the studies without even hinting that it recently claimed to be "currently reassessing the utility of total compensation studies in GRCs and whether to continue to participate in them."[29] The only difference between the two cases is that SCE's study shows that compensation falls short of the market average, thus implicitly finding that an increase could be reasonable, while a decrease could drop total compensation below the range of competitiveness. In comparison, the Sempra Utilities' studies show that compensation is already in the upper half of the range of competitiveness. DRA's opinion of total compensation studies appears to shift with the results. By embracing the results of the Sempra Utilities' total compensation study, DRA has undermined its argument in the SCE GRC and, by extension, the Joint Parties' argument in this proceeding.

17.2.3 The Commission Should Reject Attempts to Micromanage Utility Compensation

TURN and the Utility Consumers Action Network (UCAN) propose excluding from rates all incentive compensation. Alternatively, they recommend funding no more than half of short-term incentive compensation for executives.[30] DRA also proposes less than full funding for

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25 *See* A.10-11-015, Opening Brief of DRA, pp. 286-88 (cited by Opening Brief of the Joint Parties, pp. 32-33). *Cf.* A.10-12-005 and A.10-12-006, Assigned Commissioner and Administrative Law Judge's Scoping Memo and Ruling, p. 13 (coordinating the Sempra Utilities' and SCE's GRCs).

26 Ex. 372, app. 1, p. 4; Ex. 375, app. 1, p. 4.

27 Ex. 520, pp. 7, 19. *See also* Opening Brief of DRA, pp. 337, 341.

28 *See* A.10-11-015, Opening Brief of DRA, pp. 286-88.

29 *Id.* at p. 287.

30 Opening Brief of TURN and UCAN on Issues Common to SCG and SDG&E, pp. 49-50.

incentive compensation.[31] As explained more fully in SCE's opening brief, the Commission has warned that it will not micromanage the various components of compensation.[32] Instead, the Commission focuses on total compensation. "As long as [a utility's] total compensation levels are appropriate we will not dictate how [the utility] distributes compensation among various types of employment benefits."[33]

The total compensation studies establish that the Sempra Utilities' compensation is appropriate. Both SCG and SDG&E's total compensation are within five percent of the market average,[34] which is the Commission's definition of reasonable compensation.[35] The other parties fail to acknowledge that cutting incentive compensation would require reanalyzing the totality of the Sempra Utilities' compensation levels. Otherwise, piecemeal reductions may drop total compensation below the range of competitiveness. This would violate cost-of-service principles by not requiring ratepayers to cover all reasonable costs of service.[36] The resulting below-market compensation would also jeopardize the Sempra Utilities' ability to attract and retain the workforce necessary to provide safe and reliable service.[37]

In addition, TURN and UCAN's argument is inconsistent with the facts of this case. The intervening parties allege that the utilities' executives receive "lavish" incentives and "inflated" compensation.[38] However, the target compensation for SCG executives is 10.8% below the competitive market average.[39] Stripping incentives from executives would push their

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[31] Opening Brief of DRA, pp. 337, 341.

[32] *See* Opening Brief of SCE, pp. 1-2 (citing *Re Southern California Edison Co.*, D.04-07-022, pp. 206-08; *Re Time Schedules for the Rate Case Plan & Fuel Offset Proceedings*, D.97-07-054, 73 CPUC 2d 469, 518; *Re Southern California Gas Co.*, D.93-12-043, 52 CPUC 2d 471, 496; *Re Pacific Gas & Electric Co.*, D.92-12-057, 47 CPUC 2d 143, 201).

[33] *Re Time Schedules for the Rate Case Plan & Fuel Offset Proceedings*, D.97-07-054, 73 CPUC 2d 469, 518.

[34] Ex. 372, pp. 3-4; Ex. 375, pp. 3-4.

[35] *Re Pacific Gas & Electric Co.*, D.95-12-055, 63 CPUC 2d 570, 591.

[36] *See* Ex. 589, pp. 2-4.

[37] *See* Ex. 374, p. 2; Ex. 377, p. 2. *Cf. Re Southern California Edison Co.*, D.09-03-025, p. 135-36 (noting that compensation levels must remain sufficient to attract and retain employees).

[38] Opening Brief of TURN and UCAN, pp. 50, 58.

[39] Ex. 375, app. 1, p. 4.

compensation further below the market average. TURN and UCAN respond that the nature of compensation studies leads to rising executive compensation.[40] If this were true, the compensation studies would be expected to find that executives at both companies receive less than the market average, thus justifying increases. However, the target compensation for SDG&E executives slightly exceeds the market average.[41]

Finally, TURN and UCAN criticize the methodology for selecting peer companies.[42] DRA, which represents ratepayers, helped develop the peer group selection criteria and agreed with the actual companies selected for inclusion.[43] DRA did not object to the selection methodology, and its participation in the study process confirms that total compensation studies remain valuable tools for evaluating reasonableness.

18.4 SDG&E Should Receive a Full Rate of Return on Its Electromechanical Meters

Contrary to the arguments of DRA and TURN, the Commission should not adopt a rate of return of zero for SDG&E's legacy meters.[44] As explained in SCE's opening brief, adopting a zero rate of return would (1) send a clear signal to company management and investors that investing in technological change places the return on existing assets at risk, whereas investing in old, existing technology does not; (2) increase the overall risk of investing in a utility; and (3) punish investors twice by confiscating investors' return on their equity investments and then requiring common equity holders to pay dividends to preferred equity holders and interest and principal to bondholders.[45] DRA's alternate proposal of a rate of return roughly equal to the cost of debt suffers from the same defects.[46]

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40 Opening Brief of TURN and UCAN, pp. 58-61.
41 Ex. 372, app. 1, p. 4.
42 Opening Brief of TURN and UCAN, pp. 58-61.
43 Tr. 4263:1-9 (Kanter, DRA).
44 *See* Opening Brief of DRA, pp. 199-203; Opening Brief of TURN, pp. 123-37.
45 Opening Brief of SCE, p. 5. *See also* Ex. 589, pp. 25-26.
46 *See* Opening Brief of SCE, pp. 5-6. *See also* Ex. 589, p. 26.

DRA's opening brief cites nine decisions that it claims support a zero or reduced return. However, all but one of those decisions involve generation plant or a liquefied natural gas facility, not meters, and are not situations where the Commission ordered the implementation of a new technology.[47] Only the Commission's recent decision regarding PG&E's legacy meters, which granted a rate of return surpassing the return on debt, applies to the present situation.[48]

TURN alleges that there is a lack of evidence or argument to support a return on equity higher than the 6.55% adopted for PG&E.[49] In fact, SCE presented cogent evidence and argument for continuing a full return for the legacy meters. As SCE's rebuttal testimony explained, a reduced rate of return will diminish investors' willingness to invest in technological change.[50] This hesitation will occur even when the Commission desires adjustments to transmission and distribution infrastructure, as is the case here.[51] Accordingly, if the Commission reduces the rate of return on the electromechanical meters, there may be adverse, long-term consequences for utility operation and the implementation of Commission policy.

19.1.1.1 The Sempra Utilities Properly Account for Third-Party Reimbursements

TURN and UCAN argue that the Sempra Utilities improperly account for third-party reimbursements. They propose fundamental changes to SCG and SDG&E's accounting for reimbursed retirements – specifically, that all payments collected, less expenses, be recorded to accumulated depreciation as gross salvage.[52]

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47 DRA's opening brief mentions nine decisions in its discussion of the return on legacy meters. Of the nine, seven are related to generation plant: D.85-08-046 (Humboldt Bay plant retirement), D.85-12-108 (SDG&E power plants), D.92-12-057 (Geysers Unit 15 retirement), D.92-08-036 (non-precedential SONGS 1 settlement), D.95-12-063 (transition cost recovery regarding generation plant), D.97-11-074 (transition cost recovery regarding generation plant), D.96-01-011 (SONGS 2 & 3 sunk cost recovery). Regarding the other two decisions, D.84-09-089 involved a liquefied natural gas project, which is more analogous to generation and power supply than to metering customers' usage. D.11-05-018 is the Commission's decision regarding PG&E's legacy meters.

48 *See* D.11-05-018, pp. 62-63

49 See Opening Brief of TURN, p. 125.

50 Ex. 589, p. 25.

51 *Id.* at pp. 25-26.

52 *See* Opening Brief of TURN and UCAN on Issues Common to SCG and SDG&E, pp. 72-76.

As discussed in SCE's rebuttal testimony and opening brief, a holistic review of third-party reimbursement accounting must consider all three relevant scenarios: (1) construction and installation of a new asset; (2) retirement of an existing asset; and (3) replacement, which includes construction and installation of a new asset and retirement of an existing asset.[53] TURN and UCAN's proposal is flawed because it fails to distinguish between new construction and retirement for replacement activity.

For replacements, the Sempra Utilities charge the third party for the total cost of the replacement, including the construction and installation of the new asset as well as the retirement of the existing asset, along with any related expenses. Because the utilities bill for construction, installation, and retirement, they appropriately apply a credit to offset both plant-in-service and accumulated depreciation. This treatment is consistent with Federal Energy Regulatory Commission (FERC) accounting and the National Association of Regulatory Utility Commissioners' (NARUC) Interpretation of Uniform System of Accounts.[54] TURN and UCAN's repeated reference to NARUC's publication on depreciation studies is out of context because it discusses retirement activities without considering construction. SDG&E and SCG properly follow the FERC's regulatory accounting policy. Indeed, TURN and UCAN's proposal is not the result of new accounting interpretations or audit findings, but simply a desire to defer costs.

TURN and UCAN's proposal would effectively require the Sempra Utilities to record more reimbursements associated with new construction costs to gross salvage. Over time, this treatment would result in lower net salvage and, consequently, lower depreciation rates. The plant base, however, would increase absent the offsets from reimbursements, and depreciation expense levels would remain the same (despite lower rates). Higher plant with level depreciation

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[53] *See* Ex. 589, pp. 14-16; Opening Brief of SCE, pp. 6-8.
[54] *See* Ex. 589, pp. 14-16.

expense results in a higher rate base. TURN and UCAN's efforts to lower current costs will ultimately result in customers paying more in total over the lives of the assets.

19.1.1.2 Shareholders Risk Non-Recovery from Deferred Depreciation

TURN and UCAN claim that even if depreciation rates are reduced, shareholders will still recover their investments over time.[55] Their proposals in this case, however, directly conflict with that premise. For example, TURN proposes limiting the capital recovery for the undepreciated costs of retired legacy meters.[56] From this proposal, investors can conclude that deferring depreciation to future periods places the utilities' capital investments at risk of not being fully depreciated upon retirement, a situation which – according to TURN – warrants decreasing or eliminating the return on the invested capital. TURN and UCAN's proposal to reduce depreciation rates would therefore endanger the utilities' ability to attract capital.

20.1.1 Tax Normalization Regulations Require Adjusting Rate Base for Accumulated Deferred Income Taxes Associated with Net Operating Losses

Due to bonus depreciation, SDG&E and SCG will both recognize net operating losses (NOLs) for tax purposes.[57] The Sempra Utilities propose adjusting rate base for accumulated deferred income taxes ("ADIT") associated with NOLs generated during the test year as well as any carryover from previous years.[58] DRA argues that the carry-forwards conflict with Commission precedent.[59] Not only do the carry-forwards not conflict with Commission precedent,[60] but failing to adjust rate base for ADIT associated with these NOLs will cause draconian tax and ratemaking implications for ratepayers and shareholders.

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[55] *See* Opening Brief of TURN and UCAN on Issues Common to SCG and SDG&E, pp. 64-65 (quoting *Re Pacific Gas & Electric Co.*, D.00-02-046, 4 CPUC 3d 315, 479).
[56] *See* Opening Brief of TURN, pp. 123-25.
[57] Ex. 302, p. 4.
[58] *Id.*
[59] *See* Opening Brief of DRA, pp. 359-61.
[60] *See* Opening Brief of SCE, pp. 8-11.

Utilities may use accelerated tax depreciation only if they follow the Internal Revenue Code's normalization provisions.[61] The normalization provisions require utilities to use consistent estimates.[62] This consistency requirement explicitly includes ratemaking treatment.[63] In particular, the rules specify that:

> The procedures and adjustments which are to be treated as inconsistent for purposes of [the normalization rules] shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (A)(ii) unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.[64]

This statute requires the adopted ratemaking to include consistent estimates of tax expense, depreciation expense, deferred tax reserve, and rate base. It would be inconsistent with the normalization requirements if the deferred tax reserve attributable to bonus depreciation that is used to reduce rate base includes a portion of the deferred tax reserve attributable to the NOL. This conclusion is supported by Treasury regulations[65] and the Internal Revenue Service's Private Letter Ruling (PLR) 8818040.[66] In the PLR, a utility used accelerated depreciation that resulted in an NOL position. The utility carried forward the NOL to a future tax year, and it did not record the associated deferred taxes until the NOL offset an actual tax liability. Thus, the deferred tax reserve amount used to reduce rate base did not include the deferred tax amount attributable to the NOL. The IRS concluded that excluding this otherwise deferred tax amount

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61 Ex. 590, p. 21.
62 26 U.S.C. § 168(i)(9).
63 *Id.* at § 168(i)(9)(B)(i).
64 *Id.* at § 168(i)(9)(B)(ii) (emphasis added).
65 *See* 26 C.F.R. § 1.167(l)-1(h)(1)(iii).
66 *See* Ex. 590, attachment 5.

from the deferred tax reserve that was used to reduce rate base complied with the normalization requirements.[67]

In contrast, DRA proposes the inconsistent treatment of rate base and deferred tax reserve by recognizing accelerated depreciation while denying NOL carry-forwards.[68] It further claims, contrary to the statutory requirements described above, that accounting for regulatory purposes may differ from accounting for tax filing purposes.[69] This treatment, however, would result in the disallowance of the Sempra Utilities' accelerated depreciation deductions. Without the deductions associated with accelerated tax depreciation, the Sempra Utilities' rate base would increase because of the elimination of associated ADIT, leading to increased revenue requirements. Ratepayers would only be spared from this unnecessary increase if the Commission adopts the Sempra Utilities' proposal to adjust rate base for the ADIT associated with current-year and carry-forward NOLs.

20.1.2 This Proceeding Should Only Consider Taxes Associated with Rate Case-Related Income

TURN and UCAN incorrectly propose to include in this proceeding taxes associated with income from other proceedings.[70] TURN and UCAN propose that the utilities' NOL-based adjustments should be offset by alleged income "attributable to the utility" even though such income is "outside of the rate case."[71] This is a fundamentally flawed ratemaking proposal that would unfairly take the tax benefits that were properly given to the Sempra Utilities' ratepayers in other rate proceedings (e.g., power procurement) and give those same tax benefits again to ratepayers of this proceeding, even though the ratepayers in this proceeding did not pay for the related costs. It would be inappropriate and inequitable to mix costs and revenue from other

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67 *Id.*
68 *See* Opening Brief of DRA, p. 359.
69 *Id.* at p. 361.
70 *See* Opening Brief of TURN and UCAN on Issues Common to SCG and SDG&E, pp. 106-08.
71 *Id.* at p. 106.

proceedings with costs and revenues from this proceeding, as such a treatment would result in giving the same benefit (e.g., tax benefits) twice to ratepayers.

24.1.1 Collective Bargaining Agreements Are the Most Accurate Source of Union Labor Cost Escalation

TURN and UCAN correctly explain that the Commission's primary goal is to develop a forecast of what the Sempra Utilities will spend to provide service during the 2012 test year.[72] To achieve that goal, they repeatedly state that escalation should follow actual costs. TURN and UCAN emphasize that "escalation rates should be set, to the extent possible, based on actual escalation observed."[73] They further "recommend reliance on actual recorded figures where available."[74] TURN and UCAN specifically apply these policies to certain labor costs.[75]

Nevertheless, for unionized labor costs, TURN and UCAN abandon these policies and request an imprecise escalation rate.[76] The Sempra Utilities entered into collective bargaining agreements, thereby establishing their actual labor costs. According to TURN and UCAN's stated escalation principles, unionized labor rates should be escalated based on the actual costs. In other words, the existence of defined rates in the collective bargaining agreements makes it unnecessary to use general indexes to guess how costs increased. The agreements are the most accurate source of the Sempra Utilities' actual labor costs. TURN and UCAN correctly advocate relying on actual costs; the Commission should apply this principle equally to all labor costs and base escalation on bargained wage increases.

DRA similarly argues that the collective bargaining agreements should be ignored in favor of the Global Insight Power Planner forecast for All Utility Workers.[77] Like TURN and

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[72] Opening Brief of TURN and UCAN on Issues Common to SCG and SDG&E, p. 7.
[73] *Id.* at pp. 109-10.
[74] *Id.* at p. 111.
[75] *See id.* at pp. 109-11.
[76] *See id.* at pp. 112-13.
[77] *See* Opening Brief of DRA, p. 369.

UCAN, DRA alleges that unionized labor rates must remain in lockstep with a statistical index. This argument, if accepted, would damage labor-management relations. Collective bargaining agreements are the product of complex negotiations over various terms and conditions of employment. Unlike the Global Planner index, they often cover non-compensation issues such as seniority, dispute resolution, and workplace safety. The reasonableness of a collective bargaining agreement depends on evaluating all of its terms, comparing it to previous agreements, and considering the history of labor-management relations. It is overly simplistic to judge one element — compensation — devoid of the full context.

Moreover, if the Commission requires labor wages to match an index, it would remove a major negotiating item. The loss of a central bargaining topic could undercut the collective bargaining process. Indexing also ignores the fact that different bargaining units, and particularly those at different companies, do not simultaneously receive identical compensation. It may be reasonable to exceed an index's guidance in order to offer compensation that is more competitive in the labor market. Finally, it would likely be futile to expect a negotiated process to perfectly match an index's target (which is an average of industry-wide behavior) with zero margin for error. The Commission should affirm the importance of labor-management relations and recognize the labor costs memorialized in the Sempra Utilities' collective bargaining agreements.

24.1.2 The Consumer Price Index Is An Inappropriate Measure of Utility Cost Escalation

DRA and the Federal Executive Agencies (FEA) argue that post-test-year costs should be escalated based on the Consumer Price Index for All Urban Consumers (CPI-U).[78] As its name indicates, the CPI-U is designed for individual consumers. Its design reflects individual consumption, granting heavy weight to housing (41%), transportation (17%), and food (15%),

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[78] *See* Opening Brief for DRA, p. 384; Redacted Opening Brief of FEA, p. 27. FEA, but not DRA, also proposes escalating 2009 costs to test-year levels based on the CPI-U. *See id.* at pp. 22-24. This section should be construed as applying equally to that argument.

and including items such as education, recreation, and clothing.[79] These categories – and their respective weights – do not represent the costs incurred by businesses.

Neither DRA nor FEA explain why a composite index based on personal consumption should apply to business costs, let alone the unique subset of utility costs. Their sole argument is that the CPI-U is "simple."[80] As explained in SCE's opening brief, the Commission has rejected simplicity as a justification for using the CPI-U.[81] The Commission should reject the CPI-U because it fails to predict the Sempra Utilities' future costs.[82]

25.1.1 The Commission Should Address Audit Policy Issues in the Pending Rulemaking Proceeding

The Joint Parties raise various policy issues regarding the auditor-utility relationship.[83] Meanwhile, they recently petitioned the Commission for a rulemaking to consider the same issues.[84] For example, in this case, the Joint Parties request an order requiring utilities to rotate their primary auditor.[85] Likewise, their petition for rulemaking also seeks an order imposing mandatory auditor rotation.[86]

These policy issues should only be discussed in the pending rulemaking proceeding. "[C]ases that establish policy, including, but not limited to, rulemakings and investigations which may establish rules affecting an entire industry," are quasi-legislative cases.[87] In contrast, a general rate case addresses matters specific to one company.[88] The Joint Parties are not requesting an order specific to the Sempra Utilities; rather, they seek a broad injunction against

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79 Ex. 256.
80 *See* Redacted Opening Brief of FEA, pp. 24, 27.
81 *See* Opening Brief of SCE, pp. 12-13.
82 *See id.* at pp. 13-14.
83 *See* Opening Brief of the Joint Parties, pp. 42-50.
84 *See* Petition (P.) 12-02-016.
85 *See* Opening Brief of the Joint Parties, p. 50.
86 *See* P.12-02-016, pp. 17-18.
87 Public Utilities Code § 1701.1(c)(1). *See also* Commission Rules of Practice & Procedure 1.3(d).
88 Public Utilities Code § 1701.1(c)(2). *See also* Commission Rules of Practice & Procedure 1.3(e).

"all utilities."[89] Their request, therefore, belongs in the rulemaking, not in this utility-specific general rate case.

An identical issue should not be addressed in multiple proceedings.[90] Redundancy wastes the resources of the Commission and of all the parties. It is especially burdensome on intervening parties, which may not receive compensation for duplicative work.[91] Additionally, a decision in one matter may, through res judicata principles, preempt any progress in the other matter. ALJ Wong has already excluded certain audit policy-related testimony from evidence in the general rate case.[92] The Commission should follow the ALJ's lead and consider audit policy matters only in the rulemaking proceeding.

25.1.2 DRA's AFUDC Calculation Confuses Short-Term Debt Authorization with Actual Short-Term Debt

DRA's discussion of the Allowance for Funds Used During Construction (AFUDC) conflates the concepts of debt authorization and actual debt. The AFUDC formula includes a short-term debt component; however, this component only includes actual short-term debt incurred and the interest rate for the actual short-term debt.[93] Debt authorization limits are irrelevant to the calculation.

The AFUDC formula does not require utilities to incur any short-term debt or to finance construction work in progress (CWIP) with short-term debt, even if they have regulatory approval to issue such debt. Nevertheless, DRA claims that "it is incumbent on Sempra's

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89 Opening Brief of the Joint Parties, p. 50.

90 *See Re San Diego Gas & Electric Co.*, D.96-06-033, 66 CPUC 2d 393, 405 (questioning the value of litigating the same issue in multiple proceedings).

91 *See Re Competition for Local Exchange Service*, D.97-02-043, 71 CPUC 2d 89, 93 (declaring that "the concern over duplication of compensation awards involving work on the same issue in different proceedings is paramount").

92 *See* Administrative Law Judge's Ruling Confirming the Jan. 26, 2012 Oral Ruling Denying the Joint Parties' Motion to Accept Supplemental Testimony (filed Feb. 7, 2012).

93 18 C.F.R. § 101, Electric Plant Instructions 3(A)(17)(a); 18 C.F.R. § 201, Gas Plant Instructions 3(A)(17)(a). *See also* Opening Brief of SCE, pp. 14-16.

management to use [the $598 million in short-term debt authorized by the Commission] to reduce ratepayer exposure to higher costs whenever necessary."[94] DRA witness Grant Novack rebutted this argument, confirming that utilities are "not required to finance CWIP. [The formula] doesn't require that you actually finance CWIP with short-term debt or long-term debt or common stock or preferred stock."[95]

The Sempra Utilities retain the discretion to refuse to finance CWIP with short-term debt. As described in SCE's opening brief, prudent financial management requires matching long-lived assets with long-term securities.[96] Mismatching assets and securities may lead to prohibitive interest rates and illiquidity. Nothing in the AFUDC formula requires short-term debt. Contrary to DRA's argument, the AFUDC formula reflects a utility's actual financing decisions; it does not compel them. If the Sempra Utilities decide to forgo short-term debt, the AFUDC calculation will follow that decision.

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94 Opening Brief of DRA, p. 376.

95 Tr. 4387:4-19 (Novack, DRA). *See also* Tr. 4389:21-26 (affirming that AFUDC formula does not require financing CWIP with short-term debt); Tr. 4390:25 – 4391:1 (same); Tr. 4393:15-23 (same).

96 *See* Opening Brief of SCE, pp. 16-17.

Respectfully submitted,

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