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May 24, 2019

Agenda ID #17470
Ratesetting

TO PARTIES OF RECORD IN RULEMAKING 19-01-006:

This is the proposed decision of Administrative Law Judge Robert W. Haga. Until and unless the Commission hears the item and votes to approve it, the proposed decision has no legal effect. This item may be heard, at the earliest, at the Commission's June 27, 2019 Business Meeting. To confirm when the item will be heard, please see the Business Meeting agenda, which is posted on the Commission's website 10 days before each Business Meeting.

Parties of record may file comments on the proposed decision as provided in Rule 14.3 of the Commission's Rules of Practice and Procedure.

The Commission may hold a Ratesetting Deliberative Meeting to consider this item in closed session in advance of the Business Meeting at which the item will be heard. In such event, notice of the Ratesetting Deliberative Meeting will appear in the Daily Calendar, which is posted on the Commission's website. If a Ratesetting Deliberative Meeting is scheduled, ex parte communications are prohibited pursuant to Rule 8.2(c)(4)(B).

/s/ ANNE E. SIMON
Anne E. Simon
Chief Administrative Law Judge

AES:avs

Attachment

Decision **PROPOSED DECISION OF ALJ HAGA (Mailed 5/24/2019)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Implement Public Utilities Code Section 451.2 Regarding Criteria and Methodology for Wildfire Cost Recovery Pursuant to Senate Bill 901 (2018).	Rulemaking 19-01-006

DECISION ADOPTING CRITERIA AND METHODOLOGY FOR WILDFIRE COST RECOVERY PURSUANT TO PUBLIC UTILITIES CODE SECTION 451.2

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DECISION ADOPTING CRITERIA AND METHODOLOGY FOR WILDFIRE COST RECOVERY PURSUANT TO PUBLIC UTILTIES CODE SECTION 451.2

Summary

This decision adopts a methodology to implement Public Utilities Code § 451.2(b). In the normal course of regulation of investor-owned utilities, a utility seeks recovery of its anticipated costs of operations and a reasonable return on its investments from ratepayers and seeks equity and debt from public markets to fund those operations in advance of the recovery permitted from ratepayers. In the case of a utility exposed to extraordinary costs as a result of a catastrophic 2017 wildfire, however, Senate Bill 901 (Ch.626, Stats.2018) adds an exception to the process of rate regulation of investor-owned utilities. Public Utilities Code Section 451.2(b) enacts a new limitation on recovery of such costs from ratepayers, and requires the Commission to determine the maximum amount, after assessing the financial status of the electrical corporation (also referred to as an investor-owned utility), that the corporation can pay without harming ratepayers because of an increased cost for access to capital markets, or materially impacting its ability to provide adequate and safe service from inadequate financial resources.

This decision adopts a methodology for conducting a financial "Stress Test" to consider an electrical corporation's financial status and determine the maximum amount the corporation can pay for 2017 catastrophic wildfire costs without harming ratepayers or materially impacting its ability to provide adequate and safe service, as required by Public Utilities Code Section 451.2(b). This decision does not adopt a specific outcome but the methodology may be applied in a future application for 2017 wildfire cost recovery by an electrical corporation. An electrical corporation that has filed for relief under chapter 11 of

the Bankruptcy Code may not access the Stress Test to recover costs in an application under Section 451.2(b), because the Commission cannot determine the corporation's "financial status," which includes, among other considerations, its capital structure, liquidity needs, and liabilities, as required by Section 451.2(b) as well as its capacity to take on additional, and all cash or resources that are reasonably available to the utility.

Any reorganization plan of an electrical corporation in a chapter 11 case confirmed by the Bankruptcy Court and approved by the Commission in the future will inevitably address all pre-petition debts, including 2017 wildfire costs, in the bankruptcy process. This proceeding is closed.

1. Factual Background

On September 21, 2018, Senate Bill 901 (SB 901 (2018))[1] was signed by Governor Brown adopting, among many other things, Public Utilities Code § 451.2[2] which governs the Commission's review of applications by electrical corporations that request recovery of costs and expenses from catastrophic wildfires having an ignition date in 2017.

The statutory charge of SB 901 (2018) to the Commission in this instance is limited in scope. Consistent with the urgency set forth in the legislation, the Commission moved quickly after its adoption to discharge that statutory obligation. Yet since SB 901 (2018) was adopted, the tragedy of the 2018 fires occurred. Further, after this rulemaking was initiated, Cal Fire found that Pacific Gas and Electric Company's (PG&E's) infrastructure is not implicated in the

[1] Ch. 626, Stats. 2018.

[2] All subsequent references are to the Public Utilities Code unless otherwise noted.

Footnote continued on next page

Tubbs fires of 2017,[3] PG&E filed for chapter 11 bankruptcy,[4] and credit rating agencies have downgraded multiple California utilities.[5]

Governor Newsom is leading a Task Force to address the many issues related to wildfires, including wildfire costs, and published a report titled "Wildfires and Climate Change: California's Energy Future" on April 12, 2019.[6] The Commission on Catastrophic Wildfire Cost and Recovery, created by SB 901 (2018), has been convened, sought comments from the public in April, hosted four meetings, and is working towards a statutory requirement of publishing a report and recommendations to the Governor and Legislature by July 1, 2019.[7]

Legislative action from these efforts may result from these efforts. However, under existing law, per the legislative direction given to the Commission in SB 901 (2018), the methodology developed in this proceeding applies to costs incurred by an investor-owned utility due to a 2017 fire.

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[3] Report of Cal Fire is available online at: http://calfire.ca.gov/fire_protection/downloads/FireReports/17LNU010045_tubbs_le80_Redacted_2.12.18.pdf. While not directly pertinent to this proceeding based on the specific wording of Pub. Util. Code § 451.2, Cal Fire has also recently announced that it has determined that the 2018 Camp Fire was caused by electrical transmission lines owned and operated by PG&E. *See,* http://calfire.ca.gov/communications/downloads/newsreleases/2019/CampFire_Cause.pdf. Reference to the report and press release are not an indication of the outcome of the Commission's independent investigation into the fire, but merely to provide context to this proceeding.

[4] PG&E Corporation and Pacific Gas and Electric Company Chapter 11 Cases, U.S. Bankruptcy Court, Northern District of California, San Francisco Division, Case No. 19-30088 (DM).

[5] Southern California Edison Company (SCE) OIR Comments at 1, 8-11, Institutional Equity Investors (IEI) Staff Proposal Reply at 4, 7-9. *See also,* PG&E Staff Proposal Comments at 10, SCE Staff Proposal Reply at 5-6.

[6] State of the State Address by Governor Gavin Newsom, February 12, 2019. Available here: https://www.gov.ca.gov/2019/02/12/state-of-the-state-address/.

[7] Cal. Pub. Resources Code Section 4205(c)(1).

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Financially viable utilities are inherently necessary to provide safe and reliable service at a reasonable cost to ratepayers. The Commission remains committed to finding the best solution which provides Californians safe and reliable service at just and reasonable rates.

1.1. Procedural Background

As explained in the Rulemaking adopted by the Commission,[8] § 451.2(a) describes how the Commission will review applications by electrical corporations that request recovery of costs and expenses from wildfires in 2017, and § 451.2(b) requires the Commission to "consider the electrical corporation's financial status and determine the maximum amount the corporation can pay without harming ratepayers or materially impacting its ability to provide adequate and safe service…" and to make disallowances of imprudent costs and expenses reviewed pursuant to § 451.2(a) by taking the total imprudently incurred amount into consideration.

In undertaking the adoption of criteria and methodology to consider the electrical corporation's financial status and determine the maximum amount a corporation can pay, the Commission is mindful of both the finite resources of California ratepayers, and the importance of maintaining financially viable utilities to provide safe and reliable service and not saddle ratepayers with costs associated with utilities that have difficulty accessing the financial markets.

The criteria and methodology adopted in this proceeding may be invoked in future applications for cost recovery pursuant to § 451.2(a). Pursuant to § 451.2, this proceeding will not adopt any specific financial outcome for future applications.

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[8] Rulemaking (R.) 19-01-006 (adopted January 10, 2019).

Notice of the Rulemaking appeared on the Commission's Daily Calendar January 11, 2019. In the Rulemaking the Commission preliminarily categorized this proceeding as ratesetting and determined hearings were not necessary. A Prehearing Conference (PHC) was held on February 20, 2019, to discuss the issues of law and fact and to determine the need for hearing and schedule for resolving the matter. A Scoping Memo was issued on March 29, 2019, confirming the determinations to categorize the proceeding as ratesetting and that evidentiary hearings were not necessary as no party identified material issues of disputed fact.

1.2. Initial Comments in Response to the Rulemaking

The Rulemaking adopted by the Commission established a preliminary schedule with initial comments to be filed on February 11, 2019, and reply comments on February 25, 2019. Initial Comments were filed on February 11, 2019 by the following entities: IEI; Mussey Grade Road Alliance; SCE; Solar Energy Industries Association; Bear Valley Electric Service; Public Advocate's Office of the Public Utilities Commission; Small Business Utility Advocates; Energy Producers and Users Coalition; Independent Energy Producers Association; Coalition of California Utility Employees; The Utility Reform Network; PG&E, Liberty Utilities; Large-scale Solar Association; Pacific Power, a division of PacifiCorp; American Wind Energy Association of California; San Diego Gas & Electric Company; City and County of San Francisco; Counties of Mendocino, Napa, and Sonoma; Agricultural Energy Consumers Association; and Protect Our Communities Foundation.

Reply comments were filed on February 25, 2019, by the following entities: Mussey Grade Road Alliance; Small Business Utility Advocates; The Utility Reform Network; SCE; Public Advocate's Office of the Public Utilities

Commission; Protect Our Communities Foundation; PG&E; San Diego Gas & Electric Company; The Energy Producers and Users Coalition; Bear Valley Electric Service, Liberty Utilities (CalPeco Electric) LLC, and PacifiCorp; Agricultural Energy Consumers Association and California Large Energy Consumers Association (jointly); Agricultural Energy Consumers Association; Wild Tree Foundation; IEI; and City and County of San Francisco.

Pursuant to our rules, all of those entities are parties to this proceeding. In addition, at or after the Prehearing Conference the following entities became parties to the proceeding: William B. Abrams; California Farm Bureau Foundation; California Manufacturers and Technology Association; City of Santa Rosa; Public Watchdogs; South San Joaquin Irrigation District; and Western States Petroleum Association. A summary of comments follows. Comments that were repetitive or duplicative of other parties are not summarized. Comments that do not address the substantive issues raised in this Rulemaking are similarly not included in the summary.

The Agricultural Energy Consumers Association (AECA) seeks to protect their agricultural ratepayers from bearing wildfire costs created by the utilities and identifies the crux of the proceeding as who will pay the price for securitized SB 901 (2018) wildfire liability. AECA argues utilities should absorb all liability they can before passing any onto the ratepayers and agrees with other parties calling for the suspension of dividends and sale of assets that do not impact safe and reliable service before the Stress Test process could be utilized.

The American Wind Energy Association of California (AWEA-CA), Large-scale Solar Association (LSA), and Solar Energy Industries Association (SEIA) (collectively the Renewable Parties) argue that if California falters on its renewables investments now, it will be harder for California to ultimately reach its long-term renewable goals. The Renewable Parties argue the Commission should include two financial factors: 1) the contractual obligation for existing Power Purchase Agreements; and 2) the transmission owner obligations in interconnection agreements. They also argue the Commission should not create a rigid methodology so it can exercise its expert judgement in future proceedings based on the facts in those proceedings. Lastly, the Renewables Parties argue case law and the Commission's inherent constitutional and statutory authority allow it to consider costs outside of 2017 as part of a Stress Test.

Bear Valley Electric Service (BVES), Liberty Utilities (CalPeco Electric) LLC (Liberty), and PacifiCorp, d.b.a. Pacific Power (PacifiCorp) (collectively, the California Association of Small and Multi-Jurisdictional Utilities (CASMU)) ask that special considerations be given for small utilities. They also advocate for the creation of an insurance pool, a flexible cost recovery methodology, and recognition that changes in rates are linked to the financial health of their utilities. CASMU argues that the Commission has authority to consider wildfire liability beyond 2017, and that any adopted criteria or methodologies should strive to maintain utility investment grade credit ratings. CASMU also advocates that when defining material harm and ratepayer harm, the Commission must consider a utility's access to capital. CASMU also notes that the majority of parties agree that hearings are not necessary.

The City and County of San Francisco (CCSF) argues the bankruptcy court will consider how to resolve PG&E's situation, and that the Commission should not allocate any 2017 wildfire costs to ratepayers under the Stress Test analysis for PG&E. CCSF argues that the PG&E bankruptcy makes any application of § 451.2 impossible, and that consideration of wildfire costs outside of 2017 are beyond the bounds of the statute.

The Coalition of California Utility Employees (CUE) claims that a rulemaking is inappropriate because the Commission is making a specific determination about PG&E and not creating a framework that would be used repeatedly and apply to multiple utilities.

The Counties of Mendocino, Napa, and Sonoma (collectively the Three Counties) seek to protect their constituents from incremental financing costs created by wildfires and PG&E's bankruptcy.

The Energy Producers and Users Coalition (EPUC) calls the Rulemaking's call for a "methodology" to inform the Commission's application of § 451.2 a reasonable near-term goal. However, EPUC says it is premature to identify specific "metrics" until a general methodology has been framed. EPUC also calls for the scope to be expanded to define costs and expenses, the PG&E bankruptcy, and to develop a "Regulatory Plan" to increase utility cash flows to pay wildfire liabilities, though it also supports a limited scope as the only approach providing any opportunity to timely resolve this proceeding. EPUC states that regulatory actions crafted to affect credit ratings will not sufficiently account for other elements of the public interest, and that protecting shareholders from liability does not alone prevent harm to ratepayers. Thus, EPUC claims the Commission must keep the need to achieve ratings results in the context of the broader public interest.

The Independent Power Producers (IPP) cautions the Commission to consider the impacts the proceeding could have on existing and future contracts, the utilities operations, and financial markets.

IEI advocates that SB 901 (2018), specifically the addition of § 451.2(b), preserves the long-standing regulatory compact that balances utility and ratepayer concerns. IEI claims the high costs and lack of willingness of insurers as important criteria to determine utilities' financial health. IEI proposes the methodology should allow for reasonable estimates of liability to be made quickly and that both liabilities above and below a maximum amount be securitized. IEI also advocates to have the methodology apply to 2017 and 2018 fire liability and in all future years. IEI states that the primary consideration should be retaining investment grade credit ratings. IEI says that the maximum amount of equity a utility can raise is important, but disagrees with other parties calling for suspension of dividends, concerns about accounting gimmicks, and the need to defer of capital investments. IEI calls for a single framework to provide a reasonable ability to predict the outcome, though it need not be a rigid formula. IEI also seeks a predictable timeline for recovery, as well as securitization early, before a reasonableness determination is made. IEI agreed that no evidentiary hearings are needed in this proceeding but that they would be necessary to consider a utility application to apply the Stress Test.

Mussey Grade Road Alliance (MGRA) is concerned that a utility bailout will not provide proper incentives to pursue wildfire safety measures. MGRA states the financial harms thrust upon the utilities from wildfires need to be balanced against the increased risk of wildfires if they are not held accountable. MGRA states proposals by SCE and San Diego Gas & Electric Company (SDG&E) would change the prudent manager standard; a change the legislature rejected. MGRA says the proposals create a moral hazard problem. MGRA also states that any market instability problem is caused by the utilities, not the Commission, and that the scope should only include 2017 catastrophic wildfires.

PG&E says the Commission should modify the scope to include determining the maximum dollar amount it can pay for 2017, 2018, and future wildfires because it is critical to the bankruptcy process. PG&E also calls to expand the scope to provide standards for evaluating prudence of utility conduct in the future. PG&E states its financial health goal should be an S&P credit rating of bbb- when it first comes out of bankruptcy with the opportunity over time to get to a-. PG&E states that once the Commission determines how much debt it can take on to get to a bbb- rating, the Commission can determine the implied Customer Harm Threshold (ratepayer harm). PG&E claims an important part of its proposal is determining the Customer Harm Threshold in this proceeding so it can emerge from bankruptcy at the end of 2020 with an investment grade credit rating. PG&E argues that a decision by June 2019 is necessary to avoid more credit downgrades for all California electric utilities. PG&E agrees that evidentiary hearings are not necessary, and that workshops can better facilitate the timely discussion of methodologies, applications, and outcomes.

Protect Our Communities Foundation (POC) recommends the Commission consider the totality of the circumstances regarding a utility's financial status when making decisions regarding cost recovery for wildfire events. POC does not believe it is appropriate to develop a single, inflexible set of factors or metrics to guide this inquiry, but instead consider the totality of the circumstances in each utility's application for a bailout. POC states the scope of this proceeding, and § 451.2(a)-(b), are limited to wildfires with an ignition date in 2017. POC also says the Commission should adopt threshold benchmarks that utilities must meet before requesting a bailout.

The Public Advocate's Office of the Public Utilities Commission recommends the Commission consider the market value of an electrical corporation's assets as a key financial metric, and that the consideration of material impact and ratepayer harm should occur within the context of each application for cost recovery of expenses related to the 2017 wildfires. Section 451.1 clarifies that compliance with the relevant wildfire mitigation plan is one of many factors for the Commission to consider in its reasonableness review. The Public Advocate's Office of the Public Utilities Commission supports a fact specific approach and argues that this Rulemaking should not pre-determine an overly restrictive definition of material impact or ratepayer harm, or any resulting methodology.

SDG&E states the Commission should use this Rulemaking to restore greater certainty to the regulatory cost recovery process, which will also promote investment grade credit ratings and send the appropriate signals to investors. SDG&E urges the Commission to allow wildfire liabilities to be securitized on an expedited basis—before the amounts are actually known or paid as this will reduce balance sheet shocks that result in investors requiring a higher cost of capital. SDG&E argues the scope must include a cost recovery framework, not just a methodology for the maximum disallowance. SDG&E also seeks to include 2018 wildfire costs as part of this Rulemaking. SDG&E argues the Commission should try to provide the highest level of specificity regarding the maximum threshold calculation. SDG&E also advocates for an expedited schedule and that workshops should be held.

Small Business Utility Advocates (SBUA) is concerned with how this Rulemaking could increase rates, impact the reliable provision of energy service, and possibly delay services such as connecting new customers. SBUA states that the plain meaning of the text and the overall statutory language indicate that § 451.2 is limited to wildfires with ignition dates in 2017. SBUA argues the Commission should authorize securitization only after determining: (i) that cost recovery is proper; and (ii) the amount the utility may recover from its customers.

SCE urges the commission to expand the scope of this proceeding to include three phases: 1) a framework to assess cost recovery; 2) determination of the maximum amount of allowed cost recovery; and 3) creation of means for utilities to finance wildfire costs. SCE states the amount of liability a utility can pay should be related to what comparable companies can obtain as equity financing relative to their total equity. SCE also recommends an expedited schedule.

The Utility Reform Network (TURN) states SB 901 (2018) limits the scope of this Rulemaking and any utility application to costs related to wildfires that occurred in 2017. TURN proposes the creation of a pre-Stress Test screen which would filter SB 901 (2018) from applying to SCE and SDG&E. TURN opposes expanding the scope of the proceeding and advocates for evidentiary hearings. TURN encourages the Commission to look beyond just placating the rating agencies but to instead protect ratepayers from increases in cost of capital caused by imprudence and requiring the utilities to exhaust all efforts at their disposal to pay for costs stemming from imprudence.

1.3. Initial Staff Proposed Stress Test Framework

On April 5, 2019, the assigned Commissioner, President Picker, issued a ruling releasing a Staff Proposal of a framework to conduct a financial "Stress Test" to consider an electrical corporation's financial status and determine the maximum amount the corporation can pay for catastrophic wildfires with an ignition date in 2017, pursuant to § 451.2(b). The Staff Proposal sought to focus the discussion by parties on the issues within the scope of the proceeding to create the criteria and methodology required by § 451.2(b).

The Staff Proposal discussed the statutory requirement that the Commission undertake additional considerations should a utility apply to recover costs and expenses incurred as a result of a catastrophic wildfire with an ignition date in 2017. Section 451.2(b) requires the Commission undertake further consideration of the utility's financial status when allocating costs between shareholders and ratepayers, if it finds that some costs would be disallowed for recovery in rates under the ordinary just and reasonable standard.

Staff proposed the Commission adopt the following Stress Test framework as the process for determining what additional wildfire costs, if any, to allocate to ratepayers under § 451.2(b) (Stress Test Costs):

- A utility requests application of the Stress Test to determine if disallowed wildfire costs should be allocated to ratepayers. This may be in a second phase within an existing application, or by filing a new application, following a Commission determination that all or some wildfire costs are disallowed. The proposed process will conserve administrative resources while allowing for a rapid determination under the Stress Test framework adopted through this proceeding.
- The Commission applies a three-factor model to determine the maximum amount the utility can pay, which is the "Customer Harm Threshold." The amount of Stress Test Costs allocated to ratepayers equals the total disallowed wildfire costs presented in the application for recovery, minus the Customer Harm Threshold amount.
- The Commission considers potential ratepayer protection measures as conditions on the utility's authorization to recover Stress Test Costs. These potential conditions are concepts that are intended to mitigate ratepayer impacts given that the determination of Stress Test Costs will be final and not subject to future revision.

The Staff Proposal prescribes a thorough examination of a utility's financial status and ability to pay for the greatest share of disallowed wildfire liability costs while retaining a minimum investment grade credit rating. The proposal also offers potential options to enable ratepayers to participate in a utility's financial upside.

On April 10, 2019, a Workshop on the Staff Proposal was convened in the Commission auditorium to allow staff an opportunity to present the proposal to the public and parties and to address questions anyone had about the proposal.

On April 11, 2019, TURN made an email motion to the assigned Administrative Law Judge requesting an additional week to submit comments and reply comments on the Staff Proposal.

On April 12, 2019, the assigned Administrative Law Judge granted five additional days for parties to submit comments and reply comments on the Staff Proposal. In the ruling partially granting the request for additional time, the assigned Administrative Law Judge also posed a number of questions for parties to address in their comments and reply comments on the Staff Proposal.

1.3.1. Comments on the Stress Test Framework Staff Proposal

On April 24, 2019 Comments on the Stress Test Framework Staff Proposal were filed by Wild Tree Foundation, AECA, California Large Energy Consumers Association, SDG&E, PacifiCorp, William B. Abrams, California Farm Bureau Federation, POC, Western States Petroleum Association, PG&E, SCE, CUE, EPUC, CCSF, TURN, Public Advocate's Office of the Public Utilities Commission, IEI, South San Joaquin Irrigation District, and MGRA.

On May 1, 2019, Reply Comments on the Stress Test Framework Staff Proposal were filed by CUE, PacifiCorp, Western States Petroleum Association, AECA, SDG&E, SCE, PG&E, TURN, POC, The Public Advocate's Office of the

Public Utilities Commission, California Large Energy Consumers Association, William B. Abrams, CCSF, IEI, Wild Tree Foundation, EPUC, and MGRA. A summary of comments follows. Comments that were repetitive or duplicative of other parties are not summarized. Comments that do not address the issues within the scope of this Rulemaking are similarly not included in the summary. Though we have considered all comments submitted, we do not attempt to replicate the entirety of the parties' comments in the summary or during the discussion of the issues.

1.3.1.1. Mussey Grade Road Alliance Comments on Staff Proposal

MGRA is skeptical that the Stress Test concept as laid out in § 451.2(b) is actually workable and in the public interest. MGRA claims the statute ignores the potential for resident and customer harm due to utilities that are fundamentally incapable of providing safe and reliable service. MGRA provides several proposals to prevent some of the potential harm to residents and ratepayers: 1) add a "Safety and Adequacy" component to the Stress Test Threshold; 2) initiate an investigation of safety capabilities if the Stress Test is invoked; 3) examples using SCE and PG&E cases should be provided; 4) additional details regarding utilities in bankruptcy and their ability to utilize the Stress Test should be provided; 5) if a revised Stress Test is unable to show the outcome for PG&E due to uncertainty, PG&E's use of the Stress Test should be addressed in a future phase after I.15-08-019 is complete; and 6) safeguards are needed if Stress Test applies before determination of reasonableness.

1.3.1.2. Energy Producers and Users Coalition Comments on Staff Proposal

EPUC raises a number of concerns about the Staff Proposal. EPUC appears to support the maximum incremental debt capacity component with the caveat that the final Customer Harm Threshold should be bolstered by measures that increase funds from operations and therefore increase the Customer Harm Threshold. EPUC agrees that there is a low risk the credit rating agencies will not give an investment grade rating if a sound pathway toward an investment grade credit rating is established. EPUC is concerned about the interplay of bankruptcy and the Stress Test. EPUC also proposes an accelerated depreciation concept that effectively operates as a loan that will provide ratepayer protection.

1.3.1.3. Wild Tree Foundation Comments on Staff Proposal

Wild Tree Foundation (Wild Tree) reiterates its opposition to the proceeding, claiming § 451(b) does not require a methodology be developed in advance of a utility application. Wild Tree claims that developing a methodology is premature and not necessary after PG&E's choice to file bankruptcy. Wild Tree also reiterates its position that the timeline of the proceeding and lack of a fully fleshed out proposal is not leading to a well-informed outcome. Wild Tree disagrees with a focus on credit ratings versus rate impacts and sees a need to modify the excess cash component to avoid it being drawn down to pay for liabilities after executive compensation, imprudent attorney's fees, and dividends are removed. Wild Tree supports the ratepayer protection measures but says they are underdeveloped.

1.3.1.4. Institutional Equity Investor Comments on Staff Proposal

IEI is supportive of the Maximum Incremental Debt Capacity concept. IEI prefers debt financing over equity and supports the use of the rating agencies' publicly available frameworks. IEI advocates for a target rating of two notches above minimum investment grade. IEI does express concern about the excess cash component as not being clearly defined and therefore is an element that creates speculation. IEI dislikes the Regulatory Adjustment and asks that its criteria be more specifically defined. IEI advocates for an annually calculated Customer Harm Threshold to avoid long-term warehousing costs for wildfire liability. IEI reiterates its desire that the Stress Test apply to all future years, not just 2017. IEI dislikes the ratepayer protection measures and argues against adopting them.

1.3.1.5. City and County of San Francisco Comments on Staff Proposal

CCSF claims the "Maximum Incremental Debt Capacity methodology is fundamentally flawed because it does not analyze [all] harm to ratepayers" as there are other harms not considered by looking at just credit ratings. CCSF is also concerned that credit "ratings agencies have been aggressive on behalf of the [investor-owned utilities] in demanding quick decisions about how much money ratepayers will pay to the utilities to ensure their financial health." CCSF calls for the methodology to be modified to include dividend suspension and reiterates its argument that PG&E cannot use the provisions of § 451.2(b) because of PG&E's decision to file for bankruptcy.

1.3.1.6. William B. Abrams Comments on Staff Proposal

Abrams is concerned the methodology is fundamentally and foundationally flawed and offers some modifications to "focus on the long-term safety of our residents." Abrams would like the Commission to consider measured and independently verified wildfire risk mitigation in any Stress Test methodology. Abrams also claims the use of incremental debt capacity to determine the Customer Harm Threshold is misplaced, and argues that the Stress Test methodology should be closely aligned with wildfire risk mitigation efforts.

1.3.1.7. California Large Energy Consumers Association Comments on Staff Proposal

California Large Energy Consumers Association (CLECA) is concerned that industries will leave California if rates go up as other western states are attractive to them already. CLECA agrees that minimum investment grade is a good target, as some entities (insurance, mutual funds, pensions) will not finance debt with junk ratings and access to capital should be a concern for the Commission. CLECA advocates for the Commission to look more closely at the incremental ability to raise Debt and Equity. CLECA also calls for closer scrutiny of assets that are unnecessary for utility operation, and parent company assets. CLECA believes that asset sales should occur after the Stress Test to avoid distressed sale prices. CLECA also calls for suspension of dividends to pay down wildfire expenses as more effective than return on earnings de-escalation which reduces earnings.

1.3.1.8. The Public Advocate's Office of the Public Utilities Commission Comments on Staff Proposal

The Public Advocate's Office of the Public Utilities Commission expresses due process concerns related to its concerns about the ability of parties to engage with the material given potential financial outcomes. The Public Advocate's Office of the Public Utilities Commission is critical of the Staff Proposal's preference for debt financing and would like a further consideration of equity financing. The Public Advocate's Office of the Public Utilities Commission notes cost of capital issues may be out of scope (*i.e.*, return on equity de-escalation and debt vs. equity financing). The Public Advocate's Office of the Public Utilities Commission also raises concerns about warrants because it may conflate ratepayer and shareholder interests, and lacks specificity about the governance and operation of a trust/fund that would have to be involved. Lastly, the Public Advocate's Office of the Public Utilities Commission agrees with the procedural order in the Staff Proposal as securitized costs will be final and irrevocable.

1.3.1.9. Protect Our Communities (POC) Foundation Comments on Staff Proposal

POC recommends that the Commission adopt a comprehensive, fact-based approach rather than a one-size-fits-all single Stress Test methodology. POC claims the Staff Proposal is flawed because it is premised on an illegal delegation of Commission authority to a self-interested third party, *citing, S. California Edison Co. v. Pub. Utilities Com.*, 227 Cal. App. 4th 172, 195 (2014), as modified (June 18, 2014). POC argues that if a modified Staff Proposal is adopted the Commission should not allow ratepayer bailouts for a utility that lacks an investment-grade credit rating or is under investigation for an inadequate culture of safety because such a utility may not serve ratepayers in the near future.

1.3.1.10. The Utility Reform Network Comments on Staff Proposal

TURN proposes any Stress Test Costs be provided in the form of a loan from ratepayers, which would eventually be repaid by requiring a utility to limit its dividends through the course of repayment, and submitted a proposed sample model for how its proposal could work. TURN is supportive of determining incremental debt capacity of a utility to inform the Customer Harm Threshold, so long as its loan ratepayer protection measure is adopted. TURN also advocates for ratepayers to realize the benefits of net operating losses realized by the utility. In addition, TURN advocates against the application of the Stress Test to PG&E as they have availed themselves to the protections of bankruptcy.

1.3.1.11. PG&E Comments on Staff Proposal

PG&E requests the Commission adopt a methodology consistent with the Staff Proposal's focus on investment-grade credit ratings. PG&E also urges the Commission to modify the Staff Proposal methodology to implement a process that permits determination of the Customer Harm Threshold with as much specificity as possible in advance of any reasonableness review. PG&E argues that a utility can avail itself of the Stress Test by demonstrating a pathway back to investment-grade credit ratings, which in PG&E's case could involve a Plan of Reorganization "that will in turn by influenced by the Commission's development and application" of the Stress Test. PG&E urges the Commission to not adopt the ratepayer protection concepts identified in the Staff Proposal because they are inequitable, unmanageable, and without any basis in the statute.

1.3.1.12. SCE Comments on Staff Proposal

SCE asks the Commission to expand the scope of this proceeding or to adopt a process that allows the application of the Stress Test before making an allowed/disallowed determination. SCE also argues that the Commission should use equity, not debt, as the primary source of capital for determining the Customer Harm Threshold. SCE states that the Commission could analyze the greater of equity issuance or debt issuance. SCE dislikes the proposed ratepayer protection measures, as the Commission could just penalize the utilities to address moral hazard risk. SCE also argues against consideration of the suspension of dividends as part of the methodology.

1.3.1.13. SDG&E Comments on Staff Proposal

SDG&E generally supports the approach in the Staff Proposal, with certain modifications. SDG&E does not support the proposals to de-escalate return on equity and to provide equity warrants to ratepayers. SDG&E claims that ratepayer protection measures have no basis in the language of § 451.2 and their inclusion are contrary to the statements that the Commission intends the scope of this proceeding to follow a narrow, strict interpretation of the language of § 451.2, and suffer from other insurmountable flaws as well.

1.3.1.14. Agricultural Energy Consumers Association Comments on Staff Proposal

Agricultural Energy Consumers Association (AECA) urges the Commission to implement § 451.2(b) in a way that is sustainable for the state's economy and climate programs. AECA points out affordability is a major issue, claiming "California's electricity rates are already 60 percent higher than" the rest of the country. AECA is concerned that, based on myriad of factors, such as wildfire mitigation spending, Renewables Portfolio Standard, and now wildfire liability, rates could rise an additional 30% or more in just the next few years. AECA advocates for suspended dividends tied to the application of the Stress Test as PG&E could have done a lot to mitigate wildfire risks with the $4.5 billion of dividends issue since 2015.

1.3.1.15. Western States Petroleum Association Comments on Staff Proposal

Western States Petroleum Association (WSPA) claims the Stress Test was designed to prevent rate shock, but the Staff Proposal "is a utility shareholder protection Stress Test, not a ratepayer protection Stress Test." WSPA argues that the plan should do more to increase funds from operations (FFO), and reduce discretionary cash flows to maximize excess cash. WSPA advocates for the methodology to "provide customers full compensation" and a return on the extraordinary support provided to utilities to pay wildfire damage claims.

1.3.1.16. PacifiCorp Comments on Staff Proposal

PacifiCorp agrees with the maximum incremental debt component but advocates for a higher target credit rating. PacifiCorp argues that excess cash should be a fact specific inquiry which considers upcoming obligations such as "a debt maturity event, a large pension funding deadline or approved capital expenditure, etc." PacifiCorp opposes the ratepayer protection measures. PacifiCorp states the return on equity de-escalation could contribute to credit rating downgrades, and that warrants cannot be applied to a privately-owned utility and have no clear nexus to enhanced equity values of a diversified holding company, and even if applicable, they would have liquidity problems and raise significant securities legal issues. In addition, PacifiCorp claims warrants would have a diluting effect on the utility's equity that could adversely impact utility investment and credit metrics.

1.3.1.17. Coalition of California Utility Employees Comments on Staff Proposal

CUE is supportive of the Customer Harm Threshold part of the proposal and encourages the Commission to be cautious when applying a Regulatory Adjustment to ensure an investment grade credit rating is retained. CUE opposes the ratepayer protection measures as it states that they are outside the scope of § 451.2(b). CUE advocates for the Stress Test to be applied prior to the disallowed cost determination.

1.3.1.18. South San Joaquin Irrigation District Comments on Staff Proposal

South San Joaquin Irrigation District (SSJID) asks the Commission to revise the Stress Test methodology to specifically include municipalization as an asset sale consideration.

1.3.1.19. California Farm Bureau Foundation Comments on Staff Proposal

California Farm Bureau Foundation (CFBF) supports applying the Stress Test only to catastrophic wildfires with an ignition date in 2017. CFBF also supports the inclusion of the Regulatory Adjustment and the ratepayer protection measures as key parts of the proposed Stress Test methodology so that "ratepayer impacts are appropriately accounted for."

2. Discussion of the Stress Test Methodology

In accordance with the schedule adopted by the Order Initiating Rulemaking adopted by the Commission and as modified in the Scoping Memo in this proceeding, Commission staff released a proposed methodology (Staff Proposal) on April 5, 2019, providing some initial concepts to be considered in this proceeding. As stated in the Scoping Memo and in the ruling announcing the release of the Staff Proposal,

> [O]ther efforts … may impact this proceeding. Governor Newsom is leading a Task Force to address the many issues related to wildfires, including wildfire costs. The Commission on Catastrophic Wildfire Cost and Recovery, created by SB 901, has been convened, hosted three meetings, and is working towards a statutory requirement of publishing a report and recommendations to the Governor and Legislature by July 1, 2019. Legislative action from these efforts may impact this proceeding.

> The Commission applies existing law and, in this proceeding, the statutory directive of SB 901 (codified in part as Public Utilities Code Section 451.2) is limited to costs accrued due to a 2017 fire. The Staff Proposal is provided as a starting point for a discussion to ensure California has financially viable utilities to provide safe and reliable electrical service in the future.[9]

Modifications to the criteria and methodology in the Staff Proposal, as appropriate after receiving the input of parties, are discussed below and the adopted Staff Methodology is set forth in Attachment A.

2.1. Financial Status of the Electrical Corporation

CCSF argues that applying § 451.2 in an application by a company in chapter 11 bankruptcy is impossible. The Commission agrees. Section 451.2(b) require the Commission to consider the electrical corporations "financial status." To implement this requirement the Commission must be able to assess, among other considerations, the electrical corporation's capital structure, liquidity needs, and liabilities as well as its capacity to take on additional debt, and all cash or resources that are reasonably available to the utility. An electrical corporation that has filed for relief under chapter 11 of the Bankruptcy Code may not access the Stress Test to recover costs in an application under Section 451.2(b), because the Commission cannot determine the essential components of the corporation's "financial status." Any reorganization plan of an electrical corporation in a chapter 11 case confirmed by the Bankruptcy Court and approved by the Commission in the future will inevitably address all pre-petition debts, including 2017 wildfire costs, in the bankruptcy process.

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[9] Assigned Commissioner's Ruling, April 5, 2019 (footnotes omitted).

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2.2. Maximum Incremental Debt Capacity

While some parties disagreed with any financial framework that does not define customer impacts,[10] others focused on the effectiveness of the credit ratings methodologies as a proxy for debt capacity.[11] The majority of comments favored the proposed methodology, though most would modify it in some way.[12] PG&E, SCE, and IEI argue that when determining the maximum incremental debt capacity, the Commission should target a higher investment grade credit rating than the minimum investment grade level as proposed by Staff.[13] They argue a higher investment grade credit ratings would provide a financial cushion in the event of an unanticipated financial shock unrelated to wildfires. However, we found more persuasive the argument of TURN that the Commission targeting of the middle of financial ratios to maintain an investment grade credit rating for a utility already provides a "cushion" that could be used to mitigate ratepayer harm.[14] While TURN would prefer targeting the low end of the range of the financial ratios to minimize harm to ratepayers,[15] TURN's comment demonstrates that there is some cushion already if Commission targets the mid-point rather than the low point of the financial metric range. TURN also articulates the expectation that Commission approval of Stress Test Costs is

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[10] Abrams Staff Proposal Comments at 3, POC at 12-13, Public Advocate's Office of the Public Utilities Commission Staff Proposal Comments at 4, Wild Tree Staff Proposal Comments at 17.

[11] CCSF Staff Proposal Reply at 4, PacifiCorp Staff Proposal Comments at 1-2.

[12] EPUC Staff Proposal Comments at 10-11, CLECA Staff Proposal Comments at 5-6, 10, 15, IEI Staff Proposal Comments at 10, PG&E Staff Proposal Comments at 1, SDG&E Staff Proposal Comments at 4.

[13] PG&E Staff Proposal Comments at 9, SCE at 5, IEI Staff Proposal Comments at 15.

[14] TURN Staff Proposal Comments at 7-9, TURN Staff Proposal Reply at 13-14.

[15] TURN Staff Proposal Comments at 7-9.

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likely to improve the non-financial factor scores given to the utility, leading to an increase in the utility's financial ratings.[16] We agree that allocating otherwise disallowed costs from shareholder to ratepayers is expected to improve the non-financial factors and thus could provide further "cushion" on the amount of incremental debt the utility can assume while maintaining a minimum investment grade. After considering the arguments, the Commission will target the midpoint of the desired financial ratios, but in applying the methodology, the Commission may, in the exercise of its regulatory expertise, use its discretion to select financial ratios within the range that achieve investment grade ratings and minimize rate impacts. Therefore, the Commission will select ratios in tandem with the utility's forecasted financials to calculate the Maximum Incremental Debt Capacity the utility could take on and achieve the target investment grade credit rating.

2.3. Excess Cash

Parties generally supported the concept of raising the Customer Harm Threshold based on cash or cash equivalents a utility could direct to satisfy wildfire liabilities.[17] However, parties differed on defining excess cash.[18] CUE and IEI point out that the methodology should not be designed to encourage utilities to have a low cash balance when applying for a Stress Test

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[16] TURN Staff Proposal Comments at 8.

[17] CLECA Staff Proposal Comments at 7, CUE Staff Proposal Comments at 3, SCE at 7-8, POC Staff Proposal Comments at 25.

[18] IEI Staff Proposal Comments at 16-17, PacifiCorp Staff Proposal Comments at 2-3, POC Staff Proposal Comments at 25, SCE Staff Proposal Comments at 7-8, SDG&E Staff Proposal Comments at 4-5, TURN Staff Proposal Comments at 10-11,

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determination.[19] Wild Tree is concerned that use of excess cash in the methodology would create a high risk of manipulation and would not address the problem of imprudent spending.[20] SDG&E urges the Commission to be flexible in the calculation of excess cash depending on the circumstances.[21] SCE agrees with using the historic daily average prior to the catastrophic event, but that it should be adjusted based on near-term cash requirements, short-term investment returns, and take into account the cost of short-term financing (*e.g.*, commercial paper, credit facilities).[22] POC would use a more expansive foundation, calculating excess cash based on the monthly cash-on-hand for the previous ten years.[23] PG&E opposes including an excess cash component claiming it is duplicative of rating agency assessments[24] and that cash necessary for ongoing operations should not necessarily be counted toward wildfire related liabilities.[25]

Numerous parties focused on the concept of requiring adjustments to dividend policies or counting dividends as excess cash within the methodology. IEI urges the Commission not to adopt any of the proposed restrictions on dividend payments as such a restriction would only harm customers in the end.[26]

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[19] CUE Staff Proposal Comments at 3, IEI Staff Proposal Comments at 16-17.

[20] Wild Tree Staff Proposal Comments at 12-17.

[21] SDG&E Staff Proposal Comments at 4-5 (excess cash should also exclude customer deposits or other non-utility cash).

[22] SCE Staff Proposal Comments at 7-8.

[23] POC Staff Proposal Comments at 25.

[24] *See also,* IEI Staff Proposal Comments at 16-17.

[25] PG&E Staff Proposal Comments at 12-13.

[26] IEI Staff Proposal Reply at 13-14.

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SCE states that aggressive dividend payouts are already limited by conditions the CPUC established in holding company decisions.[27] SCE also points out that dividends are necessary to attract long term capital and that rating agencies look negatively on restrictions on dividends.[28]

WSPA disagrees with the position that dividend payments should not be looked at as part of the calculation, calling for all efforts to be directed at eliminating the wildfire obligations and/or incremental debt as soon as possible while preserving reasonable rates to customers. To do so WSPA would: 1) eliminate dividends; 2) maintain any net operating losses at the utility level; 3) reduce discretionary capital investment; 4) reduce burdens of costly and discretionary programs; and 5) restrict other discretionary cash payments (*i.e.* incentive compensation could be limited to stock or options).[29] Similarly, EPUC would modify the calculation of excess cash to suspend dividend payments, record wildfire damage costs as a tax expense at the utility level, and prohibit cash incentive payments to executives.[30]

TURN provides the most persuasive approach with respect to how to address dividend disbursements. TURN would have dividends paid within a year prior to a utility's Stress Test application be counted towards excess cash. TURN points out that because the Funds From Operations and Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA) are affected by a dividend payout, "by issuing a dividend, a utility would be able to lower Component B of the [Customer Harm Threshold] without increasing Component

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[27] SCE Staff Proposal Comments at 8-9.

[28] SCE Staff Proposal Reply at 8-9

[29] WSPA Staff Proposal Comments at 7.

[30] EPUC Staff Proposal Comments at 11.

A, which effectively allows a utility to game the system and increase the amount ratepayers would pay while rewarding its shareholders." Thus, TURN urges the Commission to account for dividend payments as part of the excess cash calculation because the Regulatory Adjustment may not be large enough to capture the full impact of issuing dividends. We agree with TURN as the proposal strikes a reasonable balance between shareholders and ratepayers, and thus modify the methodology to include in the Component B calculation of excess cash any dividend payouts made in the year prior to a utility Stress Test application. This calculation shall be included in any Stress Test application submitted by a utility.

CUE argues that while the Commission may consider asset sales, it should do so carefully and evaluate the effects on debt capacity because of the potential loss of revenues.[31] As discussed more fully below in section 2.3 Regulatory Adjustment, parties differ on the potential value of asset sales and our inclusion of asset sales in the Regulatory Adjustment. In order to address the concern raised by CUE and other parties we adjust the methodology to consider pending and potential near-term asset sales as part of the calculation of excess cash. While the Commission may consider potential asset sales in the Regulatory Adjustment (both used and useful as well as non-revenue generating assets where the value of the asset is not clearly defined at the time of the Stress Test), the primary consideration of asset sales will be completed as part of the excess cash calculation. By moving the consideration of asset sales to the excess cash component we address the concern that a utility could sell a large asset and generate cash proceeds in excess of the potential Regulatory Adjustment. We

[31] CUE Staff Proposal Comments at 4.

clarify that asset sales are intended to capture identifiable cash proceeds from pending or rate mitigating asset sales. The excess cash component shall also consider prudent alternatives available to the utility to monetize non-core assets as determined to be in the best interest of ratepayers. The utility shall provide a detailed analysis and explanation of the potential opportunities to effectuate ratepayer mitigating non-core asset sales. The analysis of ratepayer mitigating non-core asset sales will consider the market environment implications of forced sales of assets and the implications of such asset sales on the Customer Harm Threshold as well as the utility's access to capital on acceptable terms.

TURN and WSPA also point out that a utility making a Stress Test application is likely to have access to tax benefits in the form of net operating loss carry forwards (NOLs). We agree that NOLs may have significant impacts on a utility's cash flow (and financial health) and should be accounted for in the methodology. The NOLs will be generated even if ratepayers fund wildfire liabilities. TURN explains the benefit as:

> The net loss offsets taxable income that must be paid in the current year the liability is incurred, but potentially for multiple years in the future because the wildfire liability will likely be significantly larger than the current year's taxable earnings. When wildfire costs paid by the utility are then allocated to ratepayers as securitized Stress Test Costs, the amount of losses on the income statement may still be deducted by the utility in the year the liability is incurred. For example, a $6 billion liability ultimately funded by ratepayers would still create a dollar-for-dollar deductible NOL offset of $6 billion cash which the utility would use to reduce the amount of income taxes it will pay for many years into the future years. Left within the utility, that cash would typically be used in the place of debt or equity to fund capital investments. These tax benefits, and related cash flow, will be

an important means by which the utility will be able to regain its financial health.

We agree that the net operating loss carry forwards related to catastrophic wildfire expenses may represent a real and tangible asset at the time of the Stress Test application. However, absent a sale of the NOLs to a third party it would be difficult to quantify the present value of the NOLs at the time of the application. Further, the value of NOLs depend on the tax situation of the company when it files the application to recover Stress Test Costs.[32] Accordingly, to account for the NOLs separately from the determination of excess cash, a new section IV is added to require that a Stress Test application consider and adjust for any tax consequences of the relief sought under the Stress Test, with the Commission maintaining appropriate remedies to address and preserve for ratepayers (without duplication) such tax benefits associated with losses from events that give rise to the Stress Test application. Future tax benefits from NOLs are separate and will not be considered in the Regulatory Adjustment.

2.4. Regulatory Adjustment

Parties generally support or do not object to some exercise of regulatory expertise by the Commission through a Regulatory Adjustment component of the Stress Test methodology.[33] However, parties differ as to the potential size,

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[32] For example, if a utility already has a surplus of NOLs, then NOLs from the wildfire losses would not increase cashflows by decreasing tax liability. In such a scenario, the benefit of NOLs should be accounted for through a balancing account. If a utility does not have a surplus of NOLs, then the benefit of wildfire loses would increase funds from operation (FFO) by reducing tax liability. The total impact of NOLs would be reflected in the maximum incremental debt capacity (MIDC) because of their positive impact on FFO. If the benefits of NOLs are partially captured with the MIDC (through increased FFO) and some might occur later in time, then that residual benefit should be captured through a balancing account.

[33] CFBF Staff Proposal Comments at 4-5, CLECA Staff Proposal Comments at 7-8, CUE Staff Proposal Comments at 4, EPUC Staff Proposal Comments at 14, IEI Staff Proposal Comments at

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direction, and application of the adjustment. CCSF says limiting the adjustment to 20% improperly restricts the Commission's broad discretion.[34] CLECA argues for an adjustment up to 40% of the Customer Harm Threshold and that a 5% of disallowed cost limit is too low for a utility below investment grade.[35] CUE would limit the upward adjustment.[36] EPUC argues that any Regulatory Adjustment should be a one way adjustment to increase the Customer Harm Threshold in order to correct for the overall methodology too heavily favoring shareholders.[37] IEI supports a Regulatory Adjustment based on specific criteria that are clearly defined, as clearly defined criteria will lead to lower capital costs.[38] PG&E does not object to the 20% proposed level for the Regulatory Adjustment, although it asserts a smaller (10%) margin would be better because it would assure investors and rating agencies that the methodology will not be overly vulnerable to subjective judgments.[39] SCE supports the Commission having discretion to adjust the Customer Harm Threshold, but argues the adjustment should be limited to 10% to provide greater predictability to capital markets and lower cost access to capital.[40] SDG&E agrees that a Regulatory Adjustment is appropriate as long as there are no ratepayer protection

17-18, PG&E Staff Proposal Comments at 15, SCE Staff Proposal Comments at 9, SDG&E Staff Proposal Comments at 5, TURN Staff Proposal Comments at 12-14.

34 CCSF Staff Proposal Comments at 4.

35 CLECA Staff Proposal Comments at 7-8.

36 CUE Staff Proposal Comments at 4.

37 EPUC Staff Proposal Comments at 14-15.

38 IEI Staff Proposal Comments at 17-18.

39 PG&E Staff Proposal Comments at 15.

40 SCE Staff Proposal Comments at 9.

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measures.[41] Wild Tree calls the 20% figure arbitrary and rejects the Regulatory Adjustment as generally flawed for relying on utilities' self-assessment.[42] TURN proposes the Regulatory Adjustment be 20% of disallowed costs, not 20% of the Customer Harm Threshold, in all instances. TURN argues that there is a perverse incentive for a utility to strategically time its Stress Test application when its credit ratings are low and that using 20% of disallowed costs will motivate the utility to make a "strong showing regarding alternative options that it has considered to satisfy disallowed wildfire costs" before turning to the Stress Test. TURN also argues that a 5% Regulatory Adjustment of disallowed costs is too low as it does not fully account for all of the measures the methodology requires a utility to consider before invoking the Stress Test.[43]

The Commission's aim in applying the Regulatory Adjustment is to ensure the applicant utility can maintain or reach an investment grade credit rating while protecting ratepayers from unnecessary rate increases (harm to ratepayers). The Regulatory Adjustment proposed by staff protects ratepayers and provides a high degree of certainty to financial markets. Further, the Commission's unique expertise in ratemaking for California utilities warrants maintaining some level of discretion to account for the subjective elements of the credit agencies' analyses. Accordingly, we will maintain the Regulatory Adjustment proposed by staff in the final methodology. We also agree with comments that the Regulatory Adjustment should be based on the greater of the 20% of the Customer Harm Threshold or 5% of disallowed cost and have adjusted the methodology accordingly.

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[41] SDG&E Staff Proposal Comments at 5.

[42] Wild Tree Staff Proposal Comments at 11.

[43] TURN Staff Proposal Comments at 12-14.

As part of the consideration for setting the Regulatory Adjustment the Commission will consider how the utility exhausted every reasonable opportunity at the utility's disposal to satisfy disallowed wildfire costs, or to otherwise access capital on reasonable terms. Parties generally supported this review as part of the Commission's application of the Regulatory Adjustment and brought forth a number of areas the Commission should examine. CCSF stated a utility that uses the Stress Test should be prohibited from issuing dividends.[44] AECA agrees that asset sales should be considered and that dividends should not be issued during any period in which wildfire costs are being imposed on ratepayers in connection with wildfires.[45] CLECA agrees that dividends should be suspended and that capital flows with parent companies should be examined as well looking at assets the parent could sell. However, CLECA warns that care should be taken to avoid distressed prices for assets sold by the utility.[46] CUE argues that the sale of assets should also consider the impact the asset has on revenues and debt capacity. CUE agrees with the proposal that the issuance of equity would raise the cost of capital, and points out that any review should be based on objective actions that a utility can take rather than subjective second-guessing of the other two components of the Customer Harm Threshold.[47] EPUC argues that suspension of dividend payments would increase funds from operations until ratepayers are repaid. EPUC explains that this will increase a utility's ability to sell debt which offsets

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[44] CCSF Staff Proposal Comments at 4.

[45] AECA Staff Proposal Comments at 6-7.

[46] CLECA Staff Proposal Comments at 7-8.

[47] CUE Staff Proposal Comments at 4.

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the claims made by utilities, and others, that suspending dividend payments will hurt their ability to attract capital.[48] IEI says that suspension of dividend payments would threaten access to equity markets, likely result in low market capitalization, and thus hinder credit ratings. IEI also claims that departures from well-established accounting practices (*i.e.* depreciation) will increase perceived regulatory risk and thereby increase future financing costs.[49] PG&E rejects the position that any alternative business opportunities that it has not taken should be considered as a basis to adjust the Customer Harm Threshold.[50] POC would not limit the Commission's application of the Regulatory Adjustment by requiring a utility to identify and act on alternative business opportunities. POC is concerned with a utility manipulating the Stress Test and depleting cash reserves by increasing dividends or discretionary spending.[51] SDG&E takes a more neutral position stating that alternative business opportunities may be considered on a case-by-case basis.[52] SSJID urges the Commission to modify the methodology to include municipalization as an asset sale.[53] SCE dislikes the consideration of asset sales or leasebacks calling them problematic and likely will cost as much or more than is gained through the transaction in order to continue to provide service.[54]

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48 EPUC Staff Proposal Comments at 5, 9, 13.

49 IEI Staff Proposal Comments at 18-19.

50 PG&E Staff Proposal Comments at 15.

51 POC Staff Proposal Comments at 9-12.

52 SDG&E Staff Proposal Comments at 5.

53 SSJID Staff Proposal Comments at 4.

54 SCE Staff Proposal Comments at 10-11.

We agree with the Staff Proposal to have the Commission consider every reasonable opportunity at the utility's considered disposal to satisfy disallowed wildfire costs, or to otherwise access capital on reasonable terms, is a fair and necessary part of setting the Regulatory Adjustment. As SDG&E points out, our review will necessarily be on a case-by-case basis, and we decline to adopt an exhaustive list of considerations at this time. Parties may litigate all of the reasonable opportunities at the time of a Stress Test application. Applications made pursuant to § 451.2(b) shall include a complete accounting of every reasonable opportunity the utility considered to satisfy disallowed wildfire costs, or to otherwise access capital on reasonable terms. This could include, for example: asset sales not already included in the excess cash calculation (both used and useful as well as non-revenue generating assets where the value of the asset is not clearly defined at the time of the Stress Test); financial policy enhancements; adjustments to dividend policies;[55] assessment of equity flows to or from the parent corporation; reducing or deferring discretionary spending; and reducing, deferring, or changing the composition of executive compensation and bonuses. The utility must also present its assessment of whether it could feasibly raise additional equity capital based on observed equity market transactions.

2.5. Stress Test Assumptions

The Stress Test begins with an assessment of the Maximum Incremental Debt Capacity a utility can take on while maintaining an investment-grade

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[55] Consideration here would be for adjustments separate and apart from any excess cash adjustment due to dividends paid within one year of the filing of the Stress Test application as discussed in Section 2.2 *supra*.

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rating. The focus is on investment grade debt as it provides a simpler, more predictable, and more durable assessment of the utility's ability to access a specified amount of capital compared to incremental equity.[56] Thus, the Stress Test will calculate the Customer Harm Threshold based on the ability to raise additional debt capital. However, nothing in the Stress Test methodology forecloses direct equity financing, and in fact, requires the utility to at least present an analysis of whether equity financing is a reasonable option. Further, a utility may issue debt or equity based on the utility's business judgement to finance the unrecoverable wildfire costs determined to fall under the Customer Harm Threshold.[57]

Thus, while direct equity is an alternative form of consideration that could be used instead of or in connection with (i.e. on top of) debt capacity,[58] the Commission believes looking to equity causes more ratepayer harm than benefit. To ensure safe, affordable, and reliable service and to deliver on the State's clean energy goals, the Commission believes basing the Stress Test evaluation on debt financing is preferable as it will create more certainty and cost less. Adding incremental equity financing introduces more speculation about the value shareholders will pay to acquire new shares and dilutes the utility's ownership, which in turn can impact credit ratings and returns on equity. Further, issuing additional debt to fund the disallowed portion of wildfire costs has less impact

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[56] *See*, CCSF Staff Proposal Comments at 2-3; Public Advocate's Office of the Public Utilities Commission Staff Proposal Comments at 5, CLECA Staff Proposal Comments at 5-6, 10, and 15, SCE Staff Proposal Comments at 6-7, and 10-11, and EPUC Staff Proposal Reply at 10-11. *Cf.*, IEI Staff Proposal Comments at 10, 18-19, and PG&E Staff Proposal Comments at 9.

[57] Compliance with all other Commission financing requirements continue to apply.

[58] Consistent with the Regulatory Adjustment component, the Stress Test requires the utility to present an analysis of whether equity financing is a reasonable option to allow the Commission to evaluate the appropriateness of equity financing.

on ratepayers than issuing equity because debt reduces the effective return on equity as the shareholders cannot recover the debt financing costs. Finally, when a utility is already in a stressed situation, the cost of equity is more costly given the uncertainty of economic and ownership dilution.

Parties had different views when it came to potentially applying the Stress Test to a utility below investment grade at the time of the application. CCSF states that a utility that lacks an investment grade credit rating may not be a good candidate for the Stress Test, and that the pathway to investment grade should not simply be additional ratepayer contributions.[59] SDG&E generally agrees with the approach presented to allow a utility that is below investment grade to apply with a showing of a pathway to get to investment grade, but could see situations where non-financial factors put the achievement of investment grade out of the utility's control.[60] Wild Tree disagrees that a pathway to investment grade is sufficient to qualify a utility to be eligible to utilize the Stress Test,[61] while PG&E argues that a pathway to investment grade can be satisfied through a Plan of Reorganization for a company emerging from bankruptcy.[62] TURN asserts that a utility below investment grade or in bankruptcy should not get Stress Test cost recovery. TURN argues that a utility below investment grade has ample notice and opportunity to take steps to generate cash before it is downgraded to junk status, and therefore "a utility that

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59 CCSF Staff Proposal Comments at 5.

60 SDG&E Staff Proposal Comments at 6-7.

61 Wild Tree Staff Proposal Comments at 19.

62 PG&E Staff Proposal Comments at 20-21.

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nevertheless allows its credit rating to sink below investment grade should not be entitled to benefit from Stress Test Costs."[63] TURN points out that

> SB 901, which directed this rulemaking be opened to establish a Stress Test Methodology, was enacted to prevent utilities from going into bankruptcy as a result of wildfire liabilities in excess of their ability to pay. A utility that voluntarily pursues bankruptcy subsequent to the passage of SB 901, for which utilities vigorously lobbied and advocated in all available venues, has broken faith with its customers, regulators, legislators and other industry participants by suggesting through its actions that its regulatory environment is untenable.
>
> Application of the Stress Test methodology should not be made available to a utility whose credit ratings are below investment grade due to voluntary bankruptcy unless and until it has an approved Bankruptcy Plan of Reorganization (Bankruptcy Plan). Through the bankruptcy reorganization process, a Chapter 11 debtor may have more access to capital and resources than a utility that has simply been downgraded to junk status. It may be able to abrogate uneconomic contracts and obligations which it would be forced to honor and fund under other circumstances. Through bankruptcy, there is a clear procedural path under federal jurisdiction to resolve debts. Unlike a junk grade utility, the bankruptcy debtor's assets and liabilities are not known until there is an approved Bankruptcy Plan. Thus, as a practical matter, the determination of the Customer Harm Threshold cannot be reliably made without an approved Bankruptcy Plan which would incorporate all protections and special arrangements available from the Chapter 11 reorganization process, reflecting the most likely financial outlook for the utility going forward.[64]

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[63] TURN Staff Proposal Comments at 15-17

[64] TURN Staff Proposal Comments at 15.

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POC opposes allowing a utility below investment grade from using the Stress Test and that allowing a utility that "has chosen the protection of bankruptcy courts" to use the Stress Test would result in significant ratepayer harm.[65] WSPA states that customers should not have to pay more without a clear and verifiable path to financial recovery.[66] EPUC would allow a below investment grade utility to use the Stress Test as long as it continues to provide reliable service and repays ratepayers.[67] AECA recommends the Commission refrain from applying the Stress Test to PG&E until after the bankruptcy court proceedings are complete.[68]

IEI argues that the statute does not limit the applicability of the Stress Test and the Commission should allow all utilities regardless of financial condition to apply.[69] SCE seeks to have the Commission adopt a process that is both accessible and supportive of investment grade ratings, and would have the Stress Test apply no matter what the initial investment grade is of the utility.[70]

We agree with SCE that the statutory a goal of preventing customer harm suggests that the Commission should ensure that utilities achieve investment grade credit ratings, however, we recognize that a utility may not have an investment grade credit rating at the time it makes a Stress Test application. Thus, to the extent a utility has a credit rating below investment grade we

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[65] POC Staff Proposal Comments at 2.

[66] WSPA Staff Proposal Comments at 8.

[67] EPUC Staff Proposal Comments at 16.

[68] AECA Staff Proposal Comments at 8.

[69] IEI Staff Proposal Comments at 21.

[70] SCE Staff Proposal Comments at 14-15.

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require an additional showing from that utility of how it will achieve the investment grade rating. We do not require a similar showing from a utility that has an investment grade rating at the time of the application as we have no reason to believe its rating will fall below investment grade during the Stress Test process.

We agree with the Public Advocate's Office of the Public Utilities Commission[71] that determination of what is a material impact on a utility's ability to provide safe and adequate service or ratepayer harm is fact specific to each utility and should be determined in a Stress Test application. We incorporated the alternatives offered (*e.g.,* access to low cost capital; impairment of the ability to fund activities) in developing the Stress Test methodology. Determination of a material impact will encompass an evaluation of the many factors presented in the Stress Test methodology.

With respect to utilities in bankruptcy, we agree with TURN that "as a practical matter, the determination of the Customer Harm Threshold cannot be reliably made without [a confirmed chapter 11] Plan which would incorporate [the] protections and special arrangements available [in the chapter 11] reorganization process, reflecting the most likely financial outlook for the utility going forward."[72] While PG&E argues that demonstrating a path to investment grade may "involve" a Plan of Reorganization or be shown "through" a Plan of Reorganization, PG&E also contends that the Plan of Reorganization itself will be influenced by the Stress Test. We note that for PG&E to emerge from chapter 11, the treatment of all of PG&E's pre-petition debt, including PG&E's wildfire

[71] Public Advocate's Office of the Public Utilities Commission OIR Comments at 2-3, se*e also*, SDG&E OIR Comments at 18-19.

[72] TURN Staff Proposal Comments at 15.

liabilities for 2017 as well as 2018, must be addressed in a confirmed chapter 11 plan, subject to Commission regulatory approvals. The Stress Test may be available to utilities that had catastrophic wildfires with an ignition date in 2017,[73] but an electrical corporation that has filed for relief under chapter 11 of the bankruptcy Code may not access the Stress Test to recover costs in an application under Section 451.2(b), because the Commission cannot determine the corporation's "financial status," which includes, among other considerations, its capital structure, liquidity needs, and liabilities, as required by Section 451.2(b) as well as its capacity to take on additional, and all cash or resources that are reasonably available to the utility. Any reorganization plan of an electrical corporation in a chapter 11 case confirmed by the Bankruptcy Court and approved by the Commission in the future will inevitably address all pre-petition debts, including 2017 wildfire costs, in the bankruptcy process.

2.6. Ratepayer Protection

SB 901 (2018) adds an exception to the process of rate regulation of investor-owned utilities by providing a means to allow recovery of costs incurred as a result of events in 2017 that would otherwise be disallowed. In applying our unique expertise in ratemaking for California utilities as part of the calculation of the Customer Harm Threshold we agree with the Staff Proposal that a ratepayer protection measure will mitigate the harm to ratepayers. These measures aim to encourage the utility to increase to the Customer Harm Threshold at the time of the application and/or to provide future benefit to ratepayers. Therefore, we agree with parties that found ratepayer protections to

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73 Section 451.2(a).

Footnote continued on next page

be an important component of the Stress Test methodology.[74] However, parties had numerous criticisms of the ratepayer protection measures outlined in the Staff Proposal.[75]

Stress Test Costs are determined at a snapshot in time – a time when the utility is in financial distress – and will not be revised in the future as any cost recovery and securitization allowed will be based on the financial status of the utility at the time the Stress Test application is considered. Utilities voluntarily seeking recovery of costs that have been found to not be just and reasonable, should expect the Commission will condition the authorization to recover Stress Test Costs on utility implementation of some measures or mechanism to ensure the utility's shareholders do not obtain a windfall of all future upside as the utility recovers its financial health without returning some benefits to ratepayers.

As the Staff Proposal and the thoughtful comments from the broad range of parties demonstrate, implementing the legislative direction in § 451.2 is a complex and dynamic exercise. We believe explicit proposals for ratepayer protections are needed to achieve the Legislative directive of determining the maximum amount an electrical corporation can pay without materially impacting its ability to provide adequate and safe service OR harming

[74] AECA Staff Proposal Comments at 7, EPUC Staff Proposal Comments at 17-18, TURN Staff Proposal Comments at 17-18, CFBF Staff Proposal Comments at 5, CCSF Staff Proposal Reply at 5.

[75] *See, e.g.*, PG&E Staff Proposal Comments at 21, CLECA Staff Proposal Comments at 12, SCE Staff Proposal Comments at 15-17, SDG&E Staff Proposal Comments at 8-11, PacifiCorp Staff Proposal Comments at 3, TURN Staff Proposal Comments at 23, IEI Staff Proposal Comments at 21-26, CUE Staff Proposal Reply at 5-6.

Footnote continued on next page

ratepayers.[76] In other words the incremental harm to ratepayers is likely different depending on whether there is a ratepayer protection measure, thus changing the calculation of the Customer Harm Threshold correspondingly.

Therefore, as part of a Stress Test application, a utility must include ratepayer protection measures aimed at mitigating harm to ratepayers. The Commission's adopted methodology includes two options for a utility to include as ratepayer protections for part of its Stress Test Application. The first option requires a utility to submit a proposal for providing ratepayers with equity warrants. The second option allows a utility to submit its own proposed ratepayer protection measures.[77] These measures are intended to provide ratepayers with an opportunity to participate in a utility's financial upside as the utility's long-term financial health improves, which is expected over the long term as well as immediately upon the Commission's authorization of Stress Test Cost recovery. They are also intended as a safeguard to encourage utilities to maximize the share of disallowed costs they absorb and ensure utilities view the Stress Test as a financing mechanism of last resort. Any Ratepayer Protection Measures, if adopted, may operate along with other safeguards the Commission may adopt in other proceedings.[78]

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[76] Section 451.2(b) (emphasis added). There is no ambiguity or dispute as to the plain meaning that the statute intends to require the Commission to consider both factors as part of the determination of the maximum amount the corporation can pay for catastrophic wildfires with an ignition date in 2017. *See,* Barnhart v. Sigmon Coal Co., 534 U.S. 438, 450 (2002).

[77] We decline to include the additional proposals made by parties as we do not find they are consistent with the legislative direction provided in SB 901 (2018).

[78] *See, e.g.,* Order Instituting Investigation on the Commission's Own Motion to Determine Whether Pacific Gas and Electric Company and PG&E Corporation's Organizational Culture and Governance Prioritize Safety, I.15-08-019, which is considering utility management and board accountability.

Any application for Stress Test relief shall include meaningful ratepayer protection measures consistent with the framework adopted in this decision if the utility is seeking to recover imprudently incurred costs through the Stress Test.

2.7. Process for Seeking Stress Test Costs

The Legislature contemplated that a utility may file an application "to recover costs and expenses arising from, or incurred as a result of, a catastrophic wildfire with an ignition date in the 2017 calendar year." The Legislature also contemplated that some of the costs and expenses in such an application may include costs and expenses that were disallowed in a proceeding conducted pursuant to § 451, and directed the Commission nevertheless allocate to ratepayers some or all of those disallowed costs, thus allowing their recovery by the utility. In this way the Stress Test provides a type of relief that heretofore has never been allowed, but could be used to maintain adequate and safe service if the potential unprecedented costs related to a 2017 catastrophic wildfire could not otherwise be recovered through just and reasonable rates.

While the type of cost recovery contemplated in SB 901 (2018) is new and creates an exception to the Commission's historical approach taken when exercising its quasi-legislative authority in setting rates, the means of understanding an electric corporation's financial status and ability to provide adequate and safe service are issues this Commission has considered since its inception more than one hundred years ago. SB 901 (2018) directs the Commission to consider and implement a new way to allocate costs based on extraordinary circumstances that are limited to costs resulting from catastrophic wildfires ignited in 2017 but we do so based on the Commission's historic exercise of ratemaking expertise.

The Commission's application of decades of knowledge and experience to the new process ordered by SB 901 (2018) is a relatively simple process to consider the criteria and methodology that would be used to "consider the electrical corporation's financial status and determine the maximum amount an [electrical] corporation can pay without harming ratepayers or materially impacting its ability to provide adequate and safe service." The Commission recognizes that the criteria and methodology adopted today does not adopt any specific financial outcome for future applications from an electric corporation. Establishing a methodology pursuant to § 451.2 is not designed to make such determinations. The methodology adopted in this decision establishes a cost recovery mechanism and the quantitative elements that guide a utility's application and the Commission's evaluation of it pursuant to SB 901 (2018). The Commission is not persuaded by parties' claims that taking additional time will have any impact on its determination of the criteria and methodology.

The Staff Proposal contemplates a utility seeking to recover Stress Test Costs must request application of the Stress Test, either as a second phase within an existing application to recover 2017 catastrophic wildfire costs or by filing a new application with the Commission requesting an allocation to ratepayers of wildfire costs the Commission has disallowed. Parties generally supported the order in which the Commission would consider these costs.[79] However, the utilities and investors would prefer to have the Customer Harm Threshold

[79] CLECA Staff Proposal Comments at 13-14, CCSF Staff Proposal Comments at 7, Public Advocate's Office of the Public Utilities Commission Staff Proposal Comments at 10, TURN Staff Proposal Reply at 9-13, EPUC Staff Proposal Reply at 8-9, Wild Tree Staff Proposal Reply at 3.

Footnote continued on next page

calculated before a § 451.2(a) determination is made as to what costs, if any, are not just and reasonable.[80] The Commission is not convinced that the process proposed by the utilities could work, nor do we believe it is consistent with the purpose and language of § 451.2.

While Wild Tree is concerned about relying on utility "self-assessments"[81] we agree with POC that the normal process of litigation before the Commission will produce an evidentiary record upon which we can make full and informed decisions.[82] We do not find any merit to the speculation that a Stress Test application would be a long and drawn out proceeding. The Commission has prioritized time-sensitive proceedings and diligently and thoroughly worked through such proceedings in a timely manner in the past and will be able to do so in the future.

3. Conclusion

This decision adopts a framework for conducting a financial "Stress Test" to consider an electrical corporation's financial status and determine the maximum amount the corporation can pay for certain catastrophic wildfire costs, as required by Public Utilities Code § 451.2(b). The Stress Test methodology set forth in Attachment A is adopted in accordance with the statutory directive given to the Commission. The Stress Test methodology includes factors and financial metrics the Commission will consider when examining an electrical corporation's financial status and is intended to provide predictable and clear financial outputs, minimize negative ratepayer impacts, and incentivize utilities

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80 PG&E Staff Proposal Comments at 2-5, SCE Staff Proposal Comments at 19-21, SDG&E Staff Proposal Comments at 11, IEI Staff Proposal Comments at 12-13.

81 Wild Tree Staff Proposal Comments at 11-12.

82 POC Staff Proposal Comments at 13-14.

to carefully manage their risks to achieve the level of care, competence, and safety expected from utilities that operate inherently hazardous facilities.

4. Comments on Proposed Decision

The proposed decision in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on _______________, and reply comments were filed on ___________________ by _______________________________.

5. Assignment of Proceeding

Michael Picker is the assigned Commissioner and Robert Haga is the assigned ALJ in this proceeding.

Findings of Fact

1. SB 901 (2018) added Public Utilities Code Section 451.2 which governs the Commission's review of applications by electrical corporations that request recovery of costs and expenses from wildfires in 2017.

2. The methodology developed in this proceeding applies to costs incurred by an investor-owned utility due a 2017 fire.

3. Governor Newsom is leading a Task Force to address the many issues related to wildfires, including wildfire costs.

4. Financially viable utilities are inherently necessary to provide safe and reliable service and reduce costs to ratepayers.

5. The Stress Test methodology adopted by the Commission targets the midpoint of the desired financial ratios, but in applying the methodology, the Commission may, in its sole discretion, select financial ratios that achieve investment grade ratings and minimize rate impacts.

6. The Commission will select ratios in tandem with the utility's forecasted financials to calculate the Maximum Incremental Debt Capacity the utility could take on and achieve the target credit rating.

7. In calculating excess cash, the Commission will include any dividend payouts made in the year prior to a utility Stress Test application.

8. The primary consideration of asset sales will be completed as part of the excess cash calculation.

9. Consideration of asset sales is intended to capture identifiable cash proceeds from pending or rate mitigating asset sales.

10. A Stress Test application must consider and adjust for any tax consequences of relief sought under the Stress Test, including net operating loss.

11. The aim of the Regulatory Adjustment is to ensure the applicant utility can maintain or reach an investment grade credit rating while protecting ratepayers from unnecessary rate increases.

12. The adopted Regulatory Adjustment protects ratepayers and provides a high degree of certainty to financial markets.

13. The Commission's unique expertise in ratemaking for California utilities warrants maintaining some level of discretion to account for the subjective elements of the credit agencies' analyses.

14. The Regulatory Adjustment proposed by staff is appropriate.

15. The Regulatory Adjustment should be based on the greater of the 20% of the Customer Harm Threshold or 5% of disallowed cost.

16. In any Stress Test application, the Commission will consider every opportunity at the utility's disposal to satisfy disallowed wildfire costs, or to otherwise access capital on reasonable terms when setting the Regulatory Adjustment.

17. Determination of what is a material impact on a utility's ability to provide safe and adequate service or ratepayer harm is fact specific to each utility and should be determined in a Stress Test application.

18. A utility that has a credit rating below investment grade at the time of a Stress Test application must demonstrate how it will achieve an investment grade rating through the Stress Test process.

19. An electrical corporation's "financial status," as the term is used in § 451.2(b), includes, among other considerations, its capital structure, liquidity needs, and liabilities, as well as its capacity to take on additional debt, and all cash or resources that are reasonably available to the utility as well as its capacity to take on additional, and all cash or resources that are reasonably available to the utility.

20. The Stress Test methodology in an application for cost recovery under Section 451.2 cannot be applied to a company that is in bankruptcy because the Commission cannot assess "financial status" of the utility in chapter 11.

Conclusions of Law

1. SB 901 (2018) is limited in scope.

2. After this rulemaking was initiated, Cal Fire found that PG&E's infrastructure is not implicated in the Tubbs fires of 2017.

3. After this rulemaking was initiated, PG&E filed for chapter 11 relief on January 29, 2019.

4. The Commission maintains appropriate remedies to address and preserve for ratepayers (without duplication) any tax benefits associated with losses from events that give rise to the Stress Test application.

5. Under existing law pursuant to SB 901 (2018), the methodology developed in this proceeding applies to costs incurred by an investor-owned utility due to a 2017 fire.

6. Section 451.2(b) requires the Commission undertake further consideration of the utility's financial status when allocating costs between shareholders and ratepayers, if it finds that some costs would be disallowed for recovery in rates under the ordinary just and reasonable standard.

7. A goal of SB 901 (2018) is to ensure that utilities achieve investment grade credit ratings.

8. Applications made pursuant to § 451.2(b) shall include a complete accounting of every reasonable opportunity the utility considered to satisfy disallowed wildfire costs, or to otherwise access capital on reasonable terms.

9. It is in the best interest of ratepayers to consider prudent alternatives available to the utility to monetize non-core assets in the excess cash component of the Stress Test.

10. A feasible chapter 11 plan will inevitably address all pre-petition debts, including 2017 wildfire costs.

11. An electrical corporation that has filed for relief under chapter 11 of the Bankruptcy Code may not access the Stress Test to recover costs in an application under section 451.2(b), because the Commission cannot determine the corporation's "financial status," which includes, among other considerations, its capital structure, liquidity needs, and liabilities, as required by 451.2(b).

O R D E R

IT IS ORDERED that:

1. The Stress Test Methodology set forth in Attachment A is adopted in accordance with the statutory directive established in Public Utilities Code Section 451.2(b).
2. Applications by electrical corporations that request recovery of costs and expenses from wildfires in 2017 shall follow the Stress Test Methodology.
3. An electrical corporation that has filed for relief under chapter 11 of the Bankruptcy Code may not access the Stress Test to recover costs in an application under Public Utilities Code Section 451.2(b).
4. To the extent they are not addressed here, any and all outstanding motions are hereby deemed denied.
5. Rulemaking 19-01-006 is closed.

This order is effective today.

Dated ____________________________, 2019, at San Francisco, California.

CALIFORNIA PUBLIC UTILITIES COMMISSION

Stress Test Methodology
May 24, 2019

R.19-01-006

Table of Contents

I. Introduction

In this document, the California Public Utilities Commission ("CPUC" or "Commission") provides a framework for conducting a financial "Stress Test" to consider an electrical corporation's financial status and determine the maximum amount the corporation can pay for certain catastrophic wildfire costs, as required by Public Utilities Code Section 451.2(b).[1]

The Commission opened an Order Instituting Rulemaking (OIR), R.19-01-006, to consider and adopt criteria and a methodology for use in utility[2] applications to recover costs from catastrophic wildfires with an ignition date in 2017. Financially viable and healthy utilities are necessary to provide safe and reliable electric service at reasonable rates. The Stress Test seeks to accomplish that goal to the extent possible under § 451.2 by resolving the key issues that the CPUC can address, while recognizing that intervening events since the passage of Senate Bill (SB) 901 may limit the value of the Stress Test to address ongoing utility financial health particularly in the face of recurrent catastrophic wildfires.

The OIR and Scoping Ruling, and hence the Stress Test, are limited in scope by legislative mandate. The Stress Test only relates to calendar year 2017 wildfire liabilities and cannot provide a global or permanent solution to current timing concerns regarding California utilities' recovery of wildfire costs. The Stress Test is adopted in accordance with the Commission's statutory directive. The Stress Test is intended to provide predictable and clear financial outputs, minimize negative ratepayer impacts, and incentivize utilities to carefully manage their risks to achieve the level of care, competence, and safety expected from utilities that operate inherently hazardous facilities.

Further, the state of wildfires in California has changed materially since SB 901 (2018) was implemented, including the most destructive wildfire in state history and the state's largest investor-owned utility filing for bankruptcy protection. An electrical corporation that has filed for relief under chapter 11 of the Bankruptcy Code may not access the Stress Test to recover costs in an application under § 451.2(b), because the Commission cannot determine the corporation's "financial status," which includes, among other considerations, its capital structure, liquidity needs, and liabilities, as required by § 451.2(b).

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[1] Public Utilities Code Section 451.2(b) was enacted by Stats. 2018, chapter 626, Section 27. All subsequent references are to the Public Utilities Code unless otherwise noted.

[2] The term "utility" in the context of this proposal refers to electrical corporations.

II. Overview of the Stress Test

Section 451.2 reads as follows:

> (a) In an application by an electrical corporation to recover costs and expenses arising from, or incurred as a result of, a catastrophic wildfire with an ignition date in the 2017 calendar year, the commission shall determine whether those costs and expenses are just and reasonable in accordance with Section 451.
>
> (b) Notwithstanding Section 451, when allocating costs, the commission shall consider the electrical corporation's financial status and determine the maximum amount the corporation can pay without harming ratepayers or materially impacting its ability to provide adequate and safe service. The commission shall ensure that the costs or expenses described in subdivision (a) that are disallowed for recovery in rates assessed for the wildfires, in the aggregate, do not exceed that amount.
>
> (c) An electrical corporation may apply for a financing order pursuant to Article 5.8 (commencing of Section 850) of Chapter 4 for the amount of costs and expenses allocated to the ratepayer as just and reasonable or as disallowed for recovery but exceeding the amount determined pursuant to subdivision (b).

In short, the statute requires the Commission to undertake additional considerations resulting from a utility application to recover costs and expenses incurred as a result of a catastrophic wildfire with an ignition date in 2017. If the Commission finds that some costs would be disallowed for recovery in rates under the ordinary just and reasonable standard,[3] then the Commission must undertake a further consideration of the utility's financial status when allocating costs between shareholders and ratepayers.

The Commission adopts the following Stress Test framework as the process for determining what additional wildfire costs, if any, to allocate to ratepayers under § 451.2(b) ("Stress Test Costs"):

3 Section 451.

- A utility requests application of the Stress Test to determine if disallowed wildfire costs should be allocated to ratepayers. This may be in a second phase within an existing application, or by filing a new application, following a Commission determination that all or some wildfire costs are disallowed. The outlined process will conserve administrative resources while allowing for a rapid determination under the Stress Test methodology. Process guidance is set forth in Section V below.
- The Commission applies a three-factor framework to determine the maximum amount the utility can pay, which is the "Customer Harm Threshold." The amount of Stress Test Costs allocated to ratepayers equals the total disallowed wildfire costs presented in the application for recovery, minus the Customer Harm Threshold amount. The Customer Harm Threshold framework is described in Section III below.
- The Commission considers ratepayer protection measures as a necessary condition on the utility's authorization to recover Stress Test Costs provided in the utility's application and vetted by stakeholders. Ratepayer Protection Measures are intended to mitigate ratepayer impacts given that the determination of Stress Test Costs will be final and not subject to future revision. Options for Ratepayer Protection Measures are discussed in Section V.

The Stress Test methodology implements the statutory directive of SB 901 (2018). As required by § 451.2(b), the Stress Test prescribes a thorough examination of a utility's financial status and ability to pay for the greatest share of disallowed wildfire liability costs while retaining a minimum investment grade credit rating. The Stress Test also enables ratepayers to participate in a utility's financial upside.

III. Determining the Customer Harm Threshold for Allocating Stress Test Costs to Ratepayers

The Stress Test methodology considers three component parts to determine the Customer Harm Threshold, which in turn determines the amount of otherwise disallowed wildfire costs that will be allocated to ratepayers for recovery in rates.

Table 1: Summary of Stress Test Model	
Maximum Incremental Debt Capacity*	**[A]**
Excess Cash	**[B]**
Regulatory Adjustment	**[C]**
Customer Harm Threshold	**[A+B+C]**
* Tax benefits in the form of net operating loss carry forwards (NOLs) will accrue to ratepayers as described in Section IV of this framework.	

The first component, and primary driver, of the Stress Test model is the implied maximum additional debt that a utility can take on and maintain a minimum investment grade issuer-level credit rating (the "Maximum Incremental Debt Capacity"). This is based on existing Moody's Corporation (Moody's) and S&P Global Ratings (S&P) analytical credit models at the time the Stress Test is performed. Credit ratings are a good proxy for a utility's overall financial status because they are based on rating agencies' views of a utility's ability to meet its contractual obligations based on (i) non-financial factors, i.e., business and regulatory environment, as well as (ii) financial factors, e.g., utilities' financial statements, accounting assumptions, and forecasted cash flow. As an example, a rating agency's rating of a utility could be downgraded if it expected that a utility would issue a significant amount of debt to pay wildfire costs disallowed for recovery in rates (debt not used to fund capital investments does not generate future cash flow). This new development would negatively impact the utility's Funds From Operations (FFO) to Debt ratio, a key metric of financial health.

The Stress Test therefore focuses on maintaining an investment grade credit rating because this metric is a predictable indicator of a utility's ability to access capital markets on reasonable, acceptable terms, which is critical to avoid materially impacting its ability to provide adequate and safe service.[4] Access to capital is critical for the utility to support reasonable and prudent capital investments and ongoing operational needs to provide adequate and safe service. As a utility's credit rating declines, the cost of debt increases and access to debt capital becomes more difficult, with the greatest impact occurring as credit ratings drop below investment grade (i.e. junk status). Thus, when a utility's credit rating falls below investment grade it materially impacts its ability to access capital. If the utility cannot reasonably obtain sufficient amounts of capital from external sources,

4 Section 451.2(b).

it will be forced to reduce spending on activities approved or mandated by the Commission.

In addition to materially impacting a utility's ability to provide safe and adequate service, utility ratings below investment grade have negative impacts that harm ratepayers.[5] Increases to a utility's cost of debt in turn raise the overall cost of capital. A higher cost of capital is ultimately passed onto ratepayers as a higher rate of return earned on the utility's multi-billion-dollar ratebase.[6] Loss of credit may also require posting additional collateral and further increase working capital requirements. The Stress Test model therefore looks at the utility's ability to take on additional debt while maintaining an investment grade credit rating, in order to also minimize financial harm to ratepayers.

The second component of the Stress Test model evaluates excess cash. The Customer Harm Threshold is adjusted upward to include those cash and cash equivalents above a desirable minimum cash level that are not captured by the implied Maximum Incremental Debt Capacity analysis ("Excess Cash").

The third component of the Stress Test model allows the Commission to adjust the Customer Harm Threshold up or down, within limits, to reflect the record developed in its regulatory proceedings ("Regulatory Adjustment"). The Regulatory Adjustment may be warranted in light of other reasonable opportunities available to the utility to access capital or based on the Commission's holistic view of the utility's financial metrics and in recognition of the subjective judgment involved in the rating agencies' credit analysis.

The individual components of the Stress Test model are described in greater detail below.

A. Maximum Incremental Debt Capacity

The Stress Test will use the most updated analytical rating frameworks from the two largest rating agencies, Moody's and S&P. At a high level, both of these analytical frameworks look at the legal and business environment of a utility as well as the utility's financials. The frameworks are similar but have differences. Therefore, to ensure a minimum investment grade issuer-level credit rating prevails under both frameworks,

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[5] Section 451.2(b). *See* D.03-12-035 at 42-43.

[6] The Commission regularly reviews and authorizes cost of capital based on its components (cost of debt, cost of preferred stock, and cost of common equity). Sustained higher costs to the utility to finance long-term debt will be eventually reflected in the authorized cost of capital.

Footnote continued on next page

the proposed framework will assess results from both rating agencies and rely on the framework that yields the most conservative Maximum Incremental Debt Capacity for the underlying utility; further, Moody's as well as S&P's frameworks are publicly accessible.[7] Below is an abbreviated multi-step process for calculating the Maximum Incremental Debt Capacity.

1. Explanation of the Credit Rating Frameworks

The Moody's framework uses a weighted sub-factor framework to arrive at an overall issuer-level credit rating, and S&P uses a comparative matrix to determine its core issuer rating. Under Moody's "Grid-Indicated Rating" framework, each sub-factor is assigned a Moody's credit rating category Aaa through C. The credit rating categories have associated scores which are applied to the sub-factor weightings to determine the utility's overall credit rating. For each level of assessment in the test, from sub-factor to overall credit rating, the same ratings categories are used where Aaa is the highest rating, Baa3 is the minimum investment grade rating, and C is the lowest rating. After it reaches a Grid-Indicated Rating, Moody's may make certain subjective adjustments that can impact the final rating assigned to an issuer. Moody's Grid-Indicated Rating framework is shown below in Table 2:

[7] For Moody's, follow this link https://www.moodys.com/research/Moodys-updates-its-methodology-for-rating-regulated-electric-and-gas--PR_368709 and accept the disclaimer then sign up for a free account so you can access "Moody's Investors Service Regulated Electric and Gas Utilities Rating Methodology." For S&P If you follow this link https://www.standardandpoors.com/en_US/web/guest/ratings/ratings-criteria/-/articles/criteria/corporates/filter/general and register for a free account so you can access "S&P's Corporate Methodology (November 19, 2013)." Also, for S&P If you follow this link https://www.standardandpoors.com/en_US/web/guest/ratings/ratings-criteria/-/articles/criteria/corporates/filter/utilities and be register for a free account so you can access "S&P's Key Credit Factors for the Regulated Utilities Industry (November 19, 2013)."

Table 2: Moody's Grid-Indicated Rating framework

	Sub-Factor			Weighted Sub-Factor Score
	Rating	Score	Weight	
Regulatory Framework				
Legislative and Judicial Underpinnings of the Regulatory Framework			12.5%	
Consistency and Predictability of Regulation			12.5%	
Ability to Recover Costs and Earn Returns				
Timeliness of Recovery of Operating and Capital Costs			12.5%	
Sufficiency of Rates and Returns			12.5%	
Diversification				
Market Position			5.0%	
Generation and Fuel Diversity	Non-Financial Sub-		5.0%	
Financial Strength				
CFO Pre-WC + Interest / Interest			7.5%	
CFO Pre-WC / Debt			15.0%	
CFO Pre-WC - Dividends / Debt			10.0%	
Debt / Capitalization	Financial Sub-		7.5%	
Aggregate Weighted Total Factor Score				
Grid-Indicated Rating				

S&P determines core ratings through its "Anchor Rating Methodology Grid" framework. Under its anchor rating framework, the utility's business risk ("Business Risk Profile") and financial risk ("Financial Risk Profile") are each evaluated to determine where each factor falls on a 6-point scale. The two risk categories are compared together to determine the utility's anchor credit rating. For S&P, AAA is the highest rating, BBB- is the minimum investment grade rating, and D is the lowest rating. After it assigns a core anchor rating, S&P may also make certain additional modifications that can impact the final rating assigned to an issuer. The S&P Anchor Rating Methodology Grid framework is shown below in Table 3:

Table 3: S&P Anchor Rating Methodology Grid

Non-Financial Factors		Financial Factors: Financial Risk Profile					
		1 (Minimal)	2 (Modest)	3 (Intermediate)	4 (Significant)	5 (Aggressive)	6 (Highly Leveraged)
Business Risk Profile	1 (Excellent)	AAA/AA+	AA	A+/A	A	BBB	*BBB-/BB+*
	2 (Strong)	AA/AA-	A+/A	A-/BBB+	BBB	BB+	BB
	3 (Satisfactory)	A/A-	BBB+	BBB/BBB-	*BBB-/BB+*	BB	B+
	4 (Fair)	BBB/BBB-	BBB-	BB+	BB	BB-	B
	5 (Weak)	BB+	BB+	BB	BB-	B+	B/B-
	6 (Vulnerable)	BB-	BB-	BB-/B+	B+	B	B-

Investment Grade

Partially Investment Grade

2. Stress Test Methodology

Using the credit agencies' analytical frameworks, the Commission follow the process described below to arrive at a utility's Maximum Incremental Debt Capacity. The Maximum Incremental Debt Capacity is an implied value based on the utility meeting the target minimum investment grade credit ratings of Baa3 for Moody's Grid-Indicated Ratings and BBB- S&P's Anchor Ratings.

a) Step One: Most Recent Non-Financial Factor Scores

First, the Stress Test will evaluate the scores given to a utility for its non-financial factors, which reflect up-to-date assessments of the utility's legislative, regulatory, and business environment. The utility will provide in its application the non-financial factor scores given to them in the most recent credit agency reports. The non-financial component for Moody's framework makes up 60% of the total weight of a utility's credit rating, and 50% for the S&P framework. As an example, in S&P's grid framework, a utility with a "Business Risk Profile" that is "Strong" receives a score of two on the Y axis of the grid, as shown in Table 3.

b) Step Two: Minimum Financial Strength

Next, after identifying the current non-financial factor ratings, the Stress Test determines the utility's minimum financial strength to achieve the target rating of minimum investment grade. The minimum financial strength is implied based on the most recent non-financial factor score and the target rating. For example, the utility that had an S&P Business Risk Profile score of Strong in step one, would have an implied Financial Risk Profile of four, or "Significant," on the X axis, because this is the lowest financial strength the utility can have and retain an overall credit rating above BBB-. The categories that the Stress test targets for S&P, which include just investment grade credit ratings in Table 3, are shaded in dark gray.

c) Step Three: Maximum Incremental Debt Capacity

After going through the credit rating agency's analytical framework, the Stress Test then looks at the utility's ability to take on incremental debt. The ratings agencies consider different financial metrics to determine a utility's financial health. However, under both frameworks, once the financial ratios needed to achieve the target rating are identified, the Maximum Incremental Debt Capacity value can be calculated. The Maximum Incremental Debt Capacity value uses the utility's 3-year financial forecast including the current fiscal year (with the standard Moody's and S&P adjustments to financials) to see how much additional debt the company can add while maintaining the identified minimum financial strength ratios. The financial forecast should exclude the impact of any disallowed wildfire costs for which the utility is seeking recovery.

For example, using S&P's financial risk metrics as shown in Table 4 below, the utility that had an implied Financial Risk Profile of Significant in step two, needs a FFO to Debt ratio between 13-23% and a Debt to Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) ratio between 3.5-4.5x.[8] The Commission targets the midpoint of the desired financial ratios, but may, in its sole discretion, select financial ratios that achieve investment grade ratings and minimize rate impacts. Therefore, the Commission would select ratios in tandem with the utility's forecasted financials to calculate the Maximum Incremental Debt Capacity the utility could take on and achieve the target credit rating.

[8] Core ratios based on S&P's Medial Volatility table in its Corporate Methodology. The volatility table referenced may change as S&P's view of a utility's operating environment changes.

Table 4: S&P Financial Risk Metrics						
	Financial Risk Profile					
	1 (Minimal)	2 (Modest)	3 (Intermediate)	4 (Significant)	5 (Aggressive)	6 (Highly Leveraged)
FFO / Debt	>50 %	35% - 50 %	23% - 35%	13% - 23%	9 % - 13%	<9 %
Debt / EBITDA	<1.75x	1.75x-2.50x	2.50x-3.50x	3.50x-4.50x	4 .50x-5.50x	>5.50x

As an example, a hypothetical utility could have $10 B of preexisting debt, an FFO of $2.9 B (FFO/Debt ratio of 29%), and an EBITDA of $4.0 B (Debt/EBITDA of 2.5x). This company would have an Intermediate Financial Risk Profile. Building off the previous example this utility has an FFO of $2.9 B but could move to a FFO/Debt ratio of 18%, the midpoint for the "Significant" range for the Financial Risk Profile, by taking on additional debt.[9] Therefore the utility has an implied debt capacity of $16.1 B ($2.9 B / 18%).[10]

$$[FFO/Debt]\% = \frac{\$\,FFO}{\$\,Debt} \Rightarrow 18\% = \frac{\$\,2.9bn}{\$\,Debt} \Rightarrow \$\,Debt = \frac{\$\,2.9bn}{18\%} \Rightarrow \$16.1bn$$

This hypothetical utility with $10 B in preexisting debt can retain the minimum investment grade rating while taking on $6.1 B of incremental debt. The $6.1 B represents the utility's Maximum Incremental Debt Capacity and is the first component of the Customer Harm Threshold.[11]

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[9] Similarly, if the ratings agencies viewed the non-financial factors more favorably, this would increase a utility's ability increase its Maximum Incremental Debt Capacity further. This would result in higher Ratepayer Harm Threshold, *i.e.* reduce ratepayers Stress Test Costs. All else being the same, this would lower rates as the amount of Stress Test Costs passed on to ratepayers would be smaller.

[10] This example is simplified and does not take into account that debt service costs that would reduce FFO by adding incremental debt. The actual test will account for a utility's incremental interest expense and account for all other adjustments utilized to determine credit ratings.

[11] The implied Maximum Incremental Debt Capacity value from the different financial metrics will likely not match; therefore, a utility should seek to maximize its Maximum Incremental Debt Capacity within the rating agencies' frameworks for purposes of determining the Customer Harm Threshold.

B. Excess Cash

The Excess Cash component ensures that any excess cash available to a utility is used to satisfy disallowed wildfire costs. This is intended to include both cash in excess of that needed for ordinary operations (to the extent not accounted for or double-counted in the Maximum Incremental Debt Capacity component) and proceeds from asset sales which would prevent customer harm.

Under this second component of the Stress Test, a utility's application should provide an analysis of what levels of minimum cash are reasonably necessary to operate the business in ordinary course relative to its existing cash balances. An analysis of Excess Cash must be demonstrated as part of a financial forecast or through other materials submitted to support the application of the Stress Test. Minimum cash should include optimal cash balances necessary to operate in the ordinary course, consistent with historic industry and company norms for monthly cash balances. Moreover, a utility may provide a fact specific explanation of why any deviations might be needed, i.e. debt maturity events or pension funding deadline.

The Excess Cash component shall also consider prudent alternatives available to the utility to monetize non-core assets as determined to be in the best interest of ratepayers. Through this component of the Stress Test, the utility shall provide a detailed analysis and explanation of the potential opportunities to effectuate ratepayer mitigating non-core asset sales. The analysis of ratepayer mitigating non-core asset sales will consider the market environment implications of forced sales of assets and the implications of such asset sales on the Customer Harm Threshold as well as the utility's access to capital on acceptable terms.

Finally, the Excess Cash component will also consider and increase the Customer Harm Threshold to reflect the aggregate value of dividends paid by the utility to shareholders within the one year prior to the utility's filing of an application to recover Stress Test costs.

C. Regulatory Adjustment

The third step of determining the Customer Harm Threshold enables the Commission to adjust the Customer Harm Threshold up or down by a maximum of 20% of the subtotal of the first two components. Regulatory Adjustments may be warranted and in the public interest because the credit rating agencies' analyses, while formulaic, involve subjective judgments and adjustments. The Commission's aim in applying the Regulatory

Adjustment is to ensure the applicant utility can maintain or reach an investment grade credit rating while minimizing rate impacts as much as possible.

The third component allows the Commission to apply its unique expertise in ratemaking for California utilities based on the record developed in the proceeding to recover wildfire costs. This element will ensure that the utility considers other business opportunities that could be leveraged by the corporation to pay wildfire liabilities before filing an application, but also maintains predictable outcomes by constraining the total amount of the adjustment.

Under the proposed Regulatory Adjustment component, a utility applying for the Stress Test must describe how the utility exhausted every reasonable opportunity at the utility's disposal to satisfy disallowed wildfire costs, or to otherwise access capital on reasonable terms. This could include, for example, asset sales (both used and useful as well as non-revenue generating assets where the value of the asset is not clearly defined at the time of the Stress Test), financial policy enhancements adjustments to dividend policies, assessment of equity flows to or from the parent corporation, and reducing or deferring discretionary spending. The utility must also present its assessment of whether it could feasibly raise additional equity capital based on observed equity market transactions.

If the utility identifies sources it can reasonably access that are ratepayer neutral over time and will enable the utility to reach or maintain target minimum credit ratings, then it must identify those amounts within its proposed Customer Harm Threshold. If the utility does not deem any of these options reasonable, the request for Stress Test Cost recovery should nevertheless include a detailed description of its analysis and the basis for the utility's conclusion that each potential opportunity is not reasonable.

As a hypothetical example, after assessing the first two components (Maximum Incremental Debt Capacity and Excess Cash), the Commission arrives at a Customer Harm Threshold of $1 billion dollars. The Commission could use its regulatory expertise to increase the Customer Harm Threshold by 20% to $1.2 billion, for example if the record supports finding shareholders can absorb additional wildfire liabilities or the utility has other reasonable means to access capital. Likewise, the Commission could decide to reduce the Customer Harm Threshold by 20% to $800 million, if it finds such adjustment is necessary to avoid harming ratepayers or materially impacting the utility's ability to provide adequate and safe service.

If a utility is already at the minimum credit rating that is investment grade, or if it has fallen below investment grade, the first two components of the Stress Test model may yield a Customer Harm Threshold that is very low or even zero. In this case, the Commission may still authorize Stress Test Costs if the utility can demonstrate a path back to investment grade (as discussed below) and may apply a Regulatory Adjustment to arrive at the final Customer Harm Threshold. To ensure the Commission retains the ability to apply a meaningful Regulatory Adjustment in this scenario, the minimum Regulatory Adjustment of the Customer Harm Threshold will be up or down a minimum of 5% of the disallowed 2017 catastrophic wildfire liability considered by the Stress Test. In sum, maximum Regulatory Adjustment is the greater of up or down 20% of the Customer Harm Threshold or 5% of the disallowed wildfire liability.

However, the Stress Test is designed to ensure utilities maintain access to necessary capital on acceptable terms. If a utility has already been downgraded to a junk credit rating, the Stress Test may not be the right tool to prevent ratepayer harm and may not be sufficient to prevent material impacts to the utility's ability to provide adequate and safe service.

Therefore, for a for a utility that is currently below investment grade ratings, there is a pre-condition that it must demonstrate an ability (pathway) to achieving an investment grade credit rating to access the Stress Test. A demonstrated ability to achieve a minimum investment grade credit rating could include, for example, the allowance of wildfire related liabilities for recoveries in rates, equity issuances, asset sales, or other forms of capital infusions. Such a pathway should mitigate ratepayer harm relative to other options available to the utility.

IV. Tax Adjustments

The Stress Test application should consider and adjust for any tax consequences of relief sought under the Stress Test, including but not limited to the impacts of the utility taking Net Operating Losses (NOLs) on its Maximum Incremental Debt Capacity or other ability to access cash to satisfy wildfire liabilities. The Commission will maintain discretion to fashion appropriate treatment to address and preserve for ratepayers (without duplication) any tax benefits associated with losses from events that give rise to the Stress Test application. For example, if a utility already has a surplus of Net Operating Losses (NOLs), then NOLs from the wildfire losses would not increase cashflows by decreasing tax liability. In such a scenario, the benefit of NOLs should be accounted for through a balancing account. If a utility does not have a surplus of NOLs, then the benefit of wildfire loses would increase FFO by reducing tax liability. The total impact of NOLs would be reflected in the Maximum Incremental Debt Capacity because of their positive impact on FFO. If the benefits of NOLs are partially captured with the Maximum

Incremental Debt Capacity (through increased FFO) and some might occur later in time, then that residual benefit should be captured through a balancing account.

V. Ratepayer Protection Measures

As part of a Stress Test application, a utility must include Ratepayer Protection Measures to mitigate harm to ratepayers. The Commission has proposed one option for a utility to propose in its application for a Ratepayer Protection Measure and the utility may elect to submit its own form of Ratepayer Protection Measures. Meaningful Ratepayer Protection Measures are a necessary condition of authorizing a utility to recover Stress Test Costs, in order to address fairness concerns and mitigate ratepayer harm. These measures are intended to provide ratepayers with an opportunity to participate in a utility's financial upside as the utility's long-term financial health improves—which is expected as a result of the Commission shifting otherwise disallowed costs from the utility onto ratepayers pursuant to SB 901 (2018). They are also intended as a safeguard to encourage utilities to maximize the share of disallowed costs they absorb and ensure utilities view the Stress Test as a financing mechanism of last resort.

Accordingly, the Commission will condition the authorization to recover Stress Test Costs on the inclusion of meaningful measures or mechanisms to ensure the utility's shareholders do not obtain a windfall of all future upside as the utility recovers financial health without returning some benefits to ratepayers.

A. Ratepayer Protection Option 1: Provide Equity Upside to Ratepayers

Under this concept for a Ratepayer Protection Measure, a portion of future increases in the utility's equity value will accrue to the benefit of ratepayers. Ratepayers will receive equity warrants as a condition of the Commission's authorization to recover Stress Test Costs. These warrants allow ratepayers to participate in a portion of increases in a utility's equity value post-Stress Test; in other words, if the utility's stock price increases post-Stress Test, ratepayers receive some of that increase. These warrants should be held in a special purpose fund or trust to offset the rate impacts of allocated Stress Test Costs as the utility's condition improves.

While the utility filing an application to recover Stress Test Costs may propose alternative treatment for ratepayer warrants, presumptively such warrants would be held by the utility for the benefit of ratepayers subject to administration by a board of trustees. Proposals for how a trust would administer ratepayer warrants should be included in the utility's Stress Test application. Further, under a warrants proposal for ratepayer protections, the utility should presumptively increase the percentage of ratepayers' benefit from the utility's equity value from the time of the application's filing by 1% for every $500 million-dollar block of securitized wildfire liability, capped at 15%, as illustrated in Table five below:

Table 5: Ratepayer Share of Future Equity Increases															
Share of upside (%)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%	13%	14%	15%
Maximum Liability ($ Billion)	$0.5	$1.0	$1.5	$2.0	$2.5	$3.0	$3.5	$4.0	$4.5	$5.0	$5.5	$6.0	$6.5	$7.0	∞

B. Ratepayer Protection Option 2: Proposals by Applicant/Intervenors

Under this concept, a utility applying for the Stress Test may indicate its own Ratepayer Protection Measures that offer equivalent or greater protections to ratepayer when compared to the equity warrants concept. The utility should provide adequate detail on the implementation of the suggested Ratepayer Protection Measures and how they will be used to mitigate harm. The Ratepayer Protection Measures will be subject to comments from other parties in the proceeding. The analysis of Ratepayer Protection Measures will take into consideration the implications of such Ratepayer Protection Measures on a utility's ability to obtain capital and the impact such a proposal could have on the cost of capital, access to capital for other California utilities, and ability to maintain or achieve an investment grade credit rating.

VI. Process For Seeking Stress Test Costs

A utility seeking to recover costs and expenses resulting from a 2017 catastrophic wildfire by the Stress Test methodology may request application of the Stress Test, either as a second phase within an existing application to recover 2017 catastrophic wildfire costs or by filing a new application with the Commission requesting an allocation to ratepayers of wildfire costs the Commission has disallowed.

This phasing of process is necessary because the amount of disallowed wildfire costs must be known in order to determine the Customer Harm Threshold. Further, phasing of the prudency review before the § 451.2(b) cost allocation determination will conserve administrative and judicial resources. If the Commission finds that all 2017 wildfire costs were prudently incurred, then there is no need to conduct a Stress Test analysis under § 451.2(b), because prudent costs are recovered from ratepayers. If the Commission finds only some of the costs were prudently incurred, then there may be a need to apply the Stress Test framework. This sequencing will also ensure the wildfire liabilities the utility seeks are reasonably quantified and in excess of insurance proceeds (although they may include contingent costs and expenses).

A request to recover Stress Test Costs that provides the detailed information discussed throughout the proposal will allow for a rapid determination of the Customer Harm Threshold. In order to provide the necessary record to support the Commission ultimately finding that catastrophic wildfire costs should be allocated to ratepayers, the utility's request should include at least the following information:

- Identify total costs sought under the utility's proposed application of the Stress Test model's three components, including detailed review of maximum debt capacity based on the latest credit ratings methodologies. The utility should include a range of maximum debt capacity based on the low and high end of the rating agencies' financial criteria and indicate the midpoint of such ranges
- Financial metrics for the two prior fiscal years, current fiscal year and two additional fiscal years, including financial and credit metrics as adjusted by both Moody's and S&P and excluding the impact of disallowed wildfire liabilities for which the utility is applying for cost recovery under the Stress Test, and any other catastrophic wildfire costs that are pending review by the Commission at the time the utility requests application of the Stress Test.
- Detailed analysis of minimum cash required for operations, including historical and forward-looking support.
- Detailed analysis of asset sale opportunities including anticipated impact on ratepayers.
- Detailed analysis of alternatives available to minimize the cost borne by ratepayers and the proposed treatment of each under the Regulatory Adjustment component of the Stress Test model.
- If the utility has one or more credit ratings that are below investment grade at the time of filing, a showing of how recovery of Stress Test

Costs will allow the utility to regain a stable minimum investment grade credit rating and a pathway for improved financial health over time. Such an application should include detailed analysis of how the proposed path to investment grade mitigates ratepayer harm relative to other alternatives available to the utility.

- Specify whether the utility requests a waiver from the Commission of the authorized capital structure in connection with an allocation of Stress Test Costs.

The Stress Test should be easily quantifiable within a reasonable range, and thus will promote predictability of cost recovery outcomes.

The measurement date of a utility's financial health for the purposes of determining the Customer Harm Threshold is presumed to be the date the request is filed. The utility's financial status could materially change during the course of the cost recovery proceeding, however, and the adopted schedule for the proceeding should address and incorporate useful opportunities for updating the assessment of the utility's financial health before the record is submitted for decision.