

Decision **PROPOSED DECISION OF ALJS MCKINNEY AND HECHT**  
(Mailed 5/10/2017)

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of Southern California Edison Company (U338E) for Authority to Establish Its Authorized Cost of Capital for Utility Operations for 2013 and to Reset the Annual Cost of Capital Adjustment Mechanism.

Application 12-04-015  
(Filed April 20, 2012)

And Related Matters.

Application 12-04-016  
Application 12-04-017  
Application 12-04-018

**DECISION REGARDING  
JOINT PETITION FOR MODIFICATION OF  
DECISIONS 12-12-034 AND 13-03-015**

**Summary**

This decision grants, in part, with certain modifications, the Joint Petition for Modification of Decision (D.) 12-12-034 and D.13-03-015<sup>1</sup> filed on February 7, 2017, by Pacific Gas and Electric Company, San Diego Gas & Electric Company, Southern California Edison Company, Southern California Gas Company, the

<sup>1</sup> D.13-03-015 was modified previously by D.16-02-019. Commission Rule 1.7(a) states: "Separate documents must be used address unrelated subjects or to ask the Commission or the Administrative Law Judge to take essentially different types of action." Seeking modification of both D.12-12-034 and D.13-03-015 in the same joint petition does not conflict with Rule 1.7 since both decisions are so closely interrelated.

Office of Ratepayer Advocates, and The Utility Reform Network (collectively, the Joint Petitioners). We accordingly adopt the modifications to D.12-12-034 and D.13-03-015 requested by the Joint Petitioners, as modified by this decision.

Specifically, we adopt modifications to:

- (a) extend the date for each of the above-referenced utilities' next cost of capital application filing from April 22, 2017, to March 22, 2018 (rather than April 22, 2019, as parties had proposed),
- (b) reduce the authorized return on equity as requested by the parties, as specified in Section 3.1 below,
- (c) reset the authorized costs of long-term debt and preferred stock beginning in test year 2018 for each utility, as requested by the parties, and
- (d) require testimony on specified factual questions to be provided in the utilities' next round of cost of capital filings.

## **1. Background**

The Joint Petitioners (i.e., Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), Southern California Edison Company (SCE), Southern California Gas Company (SoCalGas), Office of Ratepayer Advocates (ORA), and The Utility Reform Network (TURN)) filed the instant Petition for Modification (PFM) on February 7, 2017. No party filed a response. The PFM is thus uncontested.

As noted in Decision (D.) 08-05-035, the major energy utilities' capital structures and return on equity (ROE) were traditionally addressed in their respective general rate case (GRC) applications. However, with the complexity of processing those GRC applications and the Commission's desire to ease a burden of issuing year-end decisions, a rulemaking proceeding, Rulemaking (R.) 87-11-012, was issued on November 13, 1987, to consider changes to the GRC process. That rulemaking resulted in transferring our review of major energy

utilities' capital structure and ROE to separate cost of capital applications from GRC applications, effective January 1, 1990.<sup>2</sup> Subsequently, in all GRC proceedings for the major energy utilities since 1990, the scope of the GRC has excluded the review of the utilities' capital structure and ROE issues.<sup>3</sup>

The PFM seeks a two-year delay in the filing of the utilities' cost of capital applications, along with a modification of the Cost of Capital Mechanism (CCM) that was initially adopted in D.08-05-035 for SCE, SDG&E and PG&E to reduce the frequency of filings of cost of capital applications. Instead of annual filings, D.08-05-035 specified that each of the three utilities would file applications only every three years.<sup>4</sup> In the intervening years, the utilities' costs of capital was to be governed by an adjustment mechanism tied to an interest rate index.

The CCM is based on: (1) the most recently adopted capital structure and costs of long-term debt and preferred stock; (2) an index based on the average 12-month October through September period of Moody's A utility bonds (for utilities rated better than BBB+ and lower than AA-) and Moody's Baa utility bonds (for BBB+ credit-rated utilities or lower); (3) a 100-basis point dead band; and (4) an adjustment ratio of 50%.<sup>5</sup>

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<sup>2</sup> See D.08-05-035 (in Application (A.) 07-05-003 et al.) at page 2.

<sup>3</sup> This exclusion of cost of capital issues thus applies to the scope of the currently pending PG&E GRC Settlement for Test Year 2017 (in A.15-09-001). Accordingly, any adopted changes in the utilities' revenue requirements and related retail rates as a result of changes in the adopted cost of capital pursuant to the instant decision are separate and distinct from any other pending changes in the adopted revenue requirements and associated retail rates that may result from other proceedings, including our disposition of the pending PG&E GRC settlement.

<sup>4</sup> These filing dates were deferred for two years for PG&E and SCE in D.09-10-016 and for SDG&E in D.10-01-017.

<sup>5</sup> D.13-03-015 at 2 (footnote omitted).

In any year in which the CCM operates, if the difference between the current 12-month (October through September) average Moody's utility bond index rate and the related benchmark exceeds 100 basis points, the utility's authorized return on equity and costs of long-term debt and preferred equity are adjusted for the following calendar year.

In D.12-12-034, the Commission adopted the authorized cost of capital for test year 2013 for each of the four major energy utilities, including factors for long-term debt, preferred stock, and common equity. D.13-03-015 expanded the scope of the CCM to include SoCalGas, and required the utilities to file test year 2016 cost-of-capital applications on April 20, 2015 to set the authorized cost of capital for 2016. By letter dated December 24, 2014, the Commission's Executive Director extended that filing date to April 20, 2016, for a 2017 test year. By letter dated November 25, 2015, the Executive Director granted a further extension to April 2017, for a 2018 test year. D.16-02-019 modified D.13-03-015, to confirm the April 20, 2017 filing date and suspend the CCM for 2017. On February 13, 2017, the Executive Director again extended the filing date for cost-of-capital applications to 60 days after the effective date of the Commission's decision on the instant PFM, or April 20, 2017, whichever is later.

Pursuant to the instant PFM, the Joint Petitioners request: (1) reduction of the authorized return on equity (ROE) for each utility for test year 2018 as specified in Section 3.1 below; (2) reset of each utility's authorized cost of long-term debt and cost of preferred stock in 2018; and (3) extension of the next round of cost of capital application filings to April 22, 2019. In all other respects, under the Joint Petitioners' request, D.12-12-034 and D.13-03-015 would remain in effect. The CCM would not operate in 2017 but could operate in 2018 to change the adopted cost of capital effective for 2019.

**2. Rule 16.4(d) of the Commission's Rules of Practice and Procedure (Rules) Requirements**

Rule 16.4(d) requires that a PFM be filed and served within one year of the effective date of the decision at issue unless it could not have been presented during that one year period. D.12-12-034 became effective December 20, 2012 and authorized the respective cost of capital for each energy utility. D.13-03-015 became effective March 21, 2013 and set the date for the next cost of capital application as April 20, 2015.

The Commission's Executive Director and D.16-02-019 extended the application filing date such that the next application was revised to April 20, 2017. The filing extensions are new or changed facts that occurred more than one year after the effective date of D.13-03-015. The PFM proposed to: (a) extend the cost of capital application filing date to April 22, 2019, (b) reduce ROE beginning on January 1, 2018, and (c) reset of the costs of long-term debt and preferred stock beginning on January 1, 2018. The analyses and comparisons supporting these proposed changes are based on data that did not exist within one year of the effective dates of D.12-12-034 and D.13-03-015. Accordingly, we acknowledge that the PFM could not have been filed within one year, and conclude that the PFM has been timely filed.

**3. Adopted Modifications**

We conclude the modifications proposed in the PFM, with certain modifications discussed below, are reasonable, and should be approved and implemented. Accordingly, we grant the PFM, in part, with certain additional modifications, as discussed below.

**3.1. Reduction in Authorized ROE**

The Joint Petitioners ask the Commission to reduce each of the utilities' authorized ROE for 2018, respectively, by the amounts shown below:

Utility	ROE Authorized per D.12-12-034	ROE Requested by Joint Petitioners	
		2018 Test Year	Total Reduction
PG&E	10.40%	10.25%	0.15%
SCE	10.45%	10.30%	0.15%
SDG&E	10.30%	10.20%	0.10%
SoCalGas	10.10%	10.05%	0.05%

These proposed ROE reductions would reduce utility rates and promote certainty regarding the authorized costs of capital for 2018 and 2019 for PG&E, SCE, SDG&E, and SoCalGas (Collectively, the Joint Utilities). In this manner, both customers and investors would realize benefits. While the parties do not present specific quantitative analysis to derive the proposed basis point reductions, they note broad financial market trends relevant to the proposal. In particular, since the Joint Utilities' costs of capital were last authorized by the Commission in December 2012, the financial markets have remained relatively stable. The proposed reductions in the authorized ROE reflect this trend of market stability. The signatories to the PFM express the belief that the changes in utility cost of capital proposed for 2018-2019 would benefit ratepayers by reducing utility rates and benefit utilities by providing appropriate returns to attract needed capital as well as providing reasonable returns for the two years 2018-2019.

We find merit in the proposal to reduce the authorized ROE by the amounts set forth in the table above for the reasons outlined by the Joint Petitioners. Moreover, we note that the PFM proposal is jointly sponsored not only by the affected public utilities but also by two well-recognized consumer interest groups (i.e., ORA and TURN). The sponsoring parties thus represent the interests both of ratepayers and of utility investors. The fact that these parties all recommend adoption of the same ROE reductions on an uncontested basis provides some indication that the proposed ROE reductions fairly balance the interests at issue here. As discussed in Section 3.3 below, we conclude that the cost of capital, including the ROE, should be subject to a comprehensive review with a new cost of capital becoming effective for 2019. Accordingly, we adopt the proposed ROE reductions, but limit the duration of this ROE adjustment to extend only through 2018.

### **3.2. Long-Term Debt and Preferred Stock Cost Issuance Reset**

Long-term debt and preferred stock costs are based on actual, or embedded, costs. Future interest rates must be anticipated to reflect projected changes in a utility's cost caused by the issuance and retirement of long-term debt and preferred stock during the year.

The Joint Petitioners request to reset each utility's authorized cost of long-term debt for 2018. The reset will reflect actual August 2017 month-end embedded costs and forecasted interest rates for variable long-term debt and new long-term debt expected to be issued in the remainder of 2017 and all of 2018. The revised long-term embedded cost of debt will be provided by each utility via a Tier 2 Advice Letter to be filed by September 29, 2017.

The Joint Petitioners also request a reset of each utility's authorized cost of preferred stock for 2018 if there are any new preferred stock issuances since January 1, 2013 or new preferred stock forecast to be issued in 2017 and 2018. The revised embedded cost of preferred stock, if applicable, will also be provided via a Tier 2 Advice Letter by September 29, 2017.

We find this aspect of the joint proposal to have merit, and accordingly adopt it. In this manner, the authorized cost of debt and preferred stock issuances will be kept up to date, and will more accurately reflect actual costs of capital going forward.

### **3.3. Filing Date Extension for Cost of Capital Applications**

D.16-02-019 modified D.13-03-015 to suspend the CCM for 2017. By letter dated December 24, 2014, the Executive Director extended the filing date for cost of capital applications by one year, to April 20, 2016. By letter dated November 25, 2015, the Executive Director again extended the filing date, so that the next cost of capital applications were due April 20, 2017, for test year 2018. By letter dated February 13, 2017, the Executive Director again extended the filing date for cost of capital applications by 60 days after the effective date of the Commission's decision on the instant PFM, or April 20, 2017, whichever is later. This decision resolves the PFM, and sets a new date for the filing of the next cost of capital applications.

The instant PFM seeks to extend that suspension for one year. As proposed, at year-end 2018, the Commission would reset the cost of capital for 2019 if the CCM is triggered. Benchmark interest rates would remain unchanged from D.13-03-015, unless reset as a result of the CCM trigger from the October 2017 to September 2018 index.

The Joint Petitioners argue that deferring the Joint Utilities' next cost of capital applications by two years to 2019 would alleviate administrative costs and burdens on Commission staff, and would avoid the litigation costs and burden for parties that participate in the cost of capital proceedings. The Commission would avoid the workload and costs associated with conducting evidentiary hearings, which have typically been held in the energy utility cost of capital proceedings.

While we recognize the benefits of alleviating cost and resource burdens from a two-year deferral, we must weigh such benefits against the offsetting regulatory risks from potentially waiting too long before comprehensively reviewing the authorized cost of capital. Granting the requested extension would result in a gap of approximately seven years since the last comprehensive litigation of a cost of capital proceeding.

While we appreciate parties' observation that financial markets have remained relatively stable over recent years, we are not persuaded that such relative stability provides sufficient basis to defer a review for two more years. The longer the deferral period, the more the risk increases that the authorized rate of return, or capital structure, does not accurately reflect the current financial market conditions facing each utility. Given the countervailing considerations at issue, we conclude that a deferral of no more than one year is appropriate. Accordingly, we conclude that good cause exists to grant the requested deferral of the Joint Utilities' next cost of capital application filing date, only in part. Thus, we shall grant a deferral only for one year, with the next round of comprehensive cost of capital applications to be due March 22, 2018, (which is 13 months earlier than the Joint Petitioners requested). We set the filing date in March, rather than April, in order to provide parties and the Commission with an

additional month to complete the proceeding prior to January 1, 2019. In addition, this proceeding will remain open to provide a possible venue in which to consider the modification of PG&E's Cost of Capital based on the report issued consistent I.15-08-019 Ordering Paragraph 4, on the extent to which PG&E's organization and governance promote a safety culture.

#### **4. Required Testimony for Test Year 2019 Cost of Capital Applications**

Given the extension of the deadline for cost of capital applications by eleven months in this decision, in combination with the previous extensions, there will be an anticipated gap of approximately six years between the most recent and next litigated cost of capital applications. Thus, in view of the significant passage of time since the last round of litigated applications, we believe that a more in-depth review of cost of capital issues is warranted. Given that concern, we require that, in addition to the typical evidentiary showing that is normally required, each of the Joint Utilities address the following questions in prepared testimony accompanying their next round of applications. We anticipate that the resulting testimony will better inform the Commission's consideration of cost of capital in light of developments in the intervening years. These questions are:

1. How does the utility's level of business risk compare to other utilities nationally and to other California utilities? Include separate comparisons for vertically integrated and non-vertically integrated utilities. How has this level changed since the test year 2013 cost of capital application?
2. How does the utility's level of financial risk compare to other utilities nationally and to other California utilities? Include separate comparisons for vertically integrated and non-vertically integrated utilities. How has this level changed since the test year 2013 cost of capital application?

3. How does the utility's level of regulatory risk compare to other utilities nationally and to other California utilities? Include separate comparisons for vertically integrated and non-vertically integrated utilities. How has this level changed since the test year 2013 cost of capital application?
4. How has the utility's recorded capital structure changed since the 2013 cost of capital application? How has the recorded capital structure compared to authorized capital structure over this time period?
5. How does the utility's current capital structure compare to other utilities nationally and to other California utilities? Include separate comparisons for vertically integrated and non-vertically integrated utilities.
6. How does the utility's authorized ROE compare to the authorized ROE of other utilities nationally and to other California utilities? Include separate comparisons for vertically integrated and non-vertically integrated utilities.
7. What, if any, regulatory, tax, policy, legal, technological, or accounting changes since the test year 2013 cost of capital applications have occurred that impact the level of risk facing the utility? Provide a qualitative discussion of the impacts of these changes, and support that discussion with quantitative analysis and data to the extent practicable. Please include changes in any relevant jurisdiction.
8. Are there additional types of information or comparisons that should inform the Commission's consideration of cost of capital? This could include comparisons to non-utility benchmarks for level of business risk, level of financial risk, level of regulatory risk or capital structure. It could also include market expectations of returns on investment. If so, please include this information and/or comparisons.

## **5. Comment on Proposed Decision**

The proposed decision of Administrative Law Judges (ALJs) McKinney and Hecht 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.<sup>6</sup> Comments were filed on \_\_\_\_\_ and reply comments were filed on \_\_\_\_\_.

## **6. Assignment of Proceeding**

Michael Picker is the assigned Commissioner and Jeanne McKinney and Jessica T. Hecht are the assigned ALJs in this proceeding.<sup>7</sup>

### **Findings of Fact**

1. The Petition for modification filed on February 7, 2017 proposed changes to D.12-12-034 and D.13-03-015 to result in:

- (1) a reduction of the authorized ROE for each of the respective utilities, noted as follows:

Utility	Authorized ROE per D.12-12-034	Revised ROE	
		2018 Test Year	Total Reduction
PG&E	10.40%	10.25%	0.15%
SCE	10.45%	10.30%	0.15%
SDG&E	10.30%	10.20%	0.10%
SoCalGas	10.10%	10.05%	0.05%

- (2) a reset of each utility's authorized cost of long-term debt and cost of preferred stock in 2018; and

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<sup>6</sup> A previous version of the proposed decision in this matter was withdrawn from the Commission's April 27, 2017 agenda, and is superseded by the instant proposed decision.

<sup>7</sup> By notice of the Chief ALJ dated April 17, 2017, this proceeding was reassigned from ALJ Kevin Dudney to ALJ Jeanne McKinney. By notice of the Chief ALJ dated April 28, 2017, ALJ Jessica Hecht was co-assigned to this proceeding.

- (3) an extension of the next cost of capital application filing date to April 22, 2019.
2. No party contests the changes proposed in the instant Petition for Modification.
3. Since the PFM is jointly sponsored both by the affected public utilities and also by two well-recognized consumer interest groups (i.e., ORA and TURN), it reflects the interests both of ratepayers and of utility investors.
4. The requested reductions in authorized return on equity reflect financial market stability since 2012, and will benefit ratepayers by reducing utility rates for 2018.
5. A long deferral period between formal cost of capital proceedings results in an increased risk that the authorized rate of return, or capital structure, does not accurately reflect the current financial market conditions facing each utility.
6. The last litigated cost of capital proceeding concluded more than four years ago. The Joint Petitioners' request would result in a seven year gap between Commission proceedings setting cost of capital.
7. It is reasonable to extend the date for filing of cost of capital applications by no more than one year.
8. It is reasonable to require each of the Joint Utilities to address specified questions in their test year 2019 cost of capital applications as discussed in Section 4 of this decision.
9. The requested modifications to D.12-12-034 and D.13-03-015 are reasonable in light of the whole record, except that the filing date extension should be limited to one year or less.

**Conclusion of Law**

1. The PFM satisfies the procedural requirements of Rule 16.4.

2. The proposed changes to D.12-12-034 and D.13-03-015 should be approved and implemented, in part, with the modifications, set forth in Appendix A and Appendix B of this order.

**O R D E R**

**IT IS ORDERED** that:

1. The Petition for Modification of Decision (D.) 12-12-034 and D.13-03-015, as filed on February 7, 2017, by Pacific Gas and Electric Company, San Diego Gas & Electric Company, Southern California Edison Company, Southern California Gas Company, Office of Ratepayer Advocates, and The Utility Reform Network, is granted as modified by this decision.

2. Decision (D.) 12-12-034 and D.13-03-015 are hereby modified as set forth in Appendix A and Appendix B of this decision.

3. Each of Pacific Gas and Electric Company, San Diego Gas & Electric Company, Southern California Edison Company, and Southern California Gas Company shall present prepared testimony accompanying their test year 2019 cost of capital applications addressing the questions listed in Section 4 of this decision.

4. Application (A.) 12-04-015, A.12-04-016, A.12-04-017, and A.12-04-018 shall remain open.

This order is effective today.

Dated \_\_\_\_\_, 2017, at San Francisco, California.

**Appendix A****Text Changes to Decision 12-12-034**

The following modifications to Decision 12-12-034 are hereby adopted, and implemented as follows:

- a. In D.12-12-034, add Ordering Paragraph 8 to page 54.

Southern California Edison Company's (SCE's) Return on Equity for 2018 is 10.30%. SCE's embedded costs of Long-Term Debt and the costs of any Preferred Stock issued since January 3, 2013, shall be submitted by Tier 2 Advice Letter by September 29, 2017.

- b. In D.12-12-034, add Ordering Paragraph 9 to page 54.

San Diego Gas & Electric Company's Return on Equity for 2018 is 10.20%. San Diego Gas & Electric Company's embedded cost of Long-Term Debt and the costs of any Preferred Stock issued since January 3, 2013, shall be submitted by Tier 2 Advice Letter by September 29, 2017.

- c. In D.12-12-034, add Ordering Paragraph 10 to page 54.

Southern California Gas Company's Return on Equity for 2018 is 10.05%. Southern California Gas Company's embedded cost of Long-Term Debt and the cost of any Preferred Stock issued since January 3, 2013, shall be submitted by Tier 2 Advice Letter by September 29, 2017.

- d. In D.12-12-034, add Ordering Paragraph 11 to page 54.

Pacific Gas and Electric Company's Return on Equity for 2018 is 10.25%. Pacific Gas and Electric Company's authorized cost of Long-Term Debt and the cost of any Preferred Stock issued since January 3, 2013, shall be submitted by Tier 2 Advice Letter by September 29, 2017.

- e. In D.12-12-034, add Ordering Paragraph 12 to page 54.

On January 1, 2018, Southern California Edison Company, San Diego Gas & Electric Company, Southern California Gas Company, and Pacific Gas and Electric Company shall each reset their authorized cost of long-term debt to reflect actual August 2017 month-end embedded costs and forecasted interest rates for variable long-term debt and new long-term debt scheduled to be issued in the remainder of 2017 and all of 2018.

- f. In D.12-12-034, add Ordering Paragraph 13 to page 54.

On January 1, 2018, Southern California Edison Company, San Diego Gas & Electric Company, Southern California Gas Company, and Pacific Gas and Electric Company shall each reset their authorized cost of preferred stock for new issuances since January 3, 2013 and new preferred stock to be issued in the remainder of 2017 and all of 2018.

- g. In D.12-12-034, add Ordering Paragraph 14 to page 54:

On January 1, 2018, Southern California Edison Company, San Diego Gas & Electric Company, Southern California Gas Company, and Pacific Gas and Electric Company shall each reset their authorized return on equity to the amounts adopted in Ordering Paragraphs 8 through 11, respectively.

- h. In D.12-12-034, add Ordering Paragraph 15 to page 54:

Southern California Edison Company, San Diego Gas & Electric Company, Southern California Gas Company, and Pacific Gas and Electric Company shall each consolidate the respective revenue requirement changes being authorized in this decision with revenue changes from any other relevant applications through the Tier 2 advice letter filing to be filed by September 29, 2017, and to become effective January 1, 2018.

**(End of Appendix A)**

**Appendix B**

**Text Changes to Decision 13-03-015**

The following modifications to Decision 13-03-015 are hereby adopted, and implemented as follows:

In D.13-03-015, change Ordering Paragraph 4 on page 10 (as previously modified by D.16-02-019) as shown (with deletions struck through and additions underlined):

Southern California Edison Company, San Diego Gas & Electric Company, Southern California Gas Company, and Pacific Gas and Electric Company shall each file their next cost of capital application ~~on~~ by March 22, 2018, for a test year ~~2018~~ 2019.

**(End of Appendix B)**