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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE
STATE OF CALIFORNIA

In Attendance: PRESIDENT MARYBEL BATJER
COMMISSIONER LIANE M. RANDOLPH
COMMISSIONER MARTHA GUZMAN ACEVES
COMMISSIONER CLIFFORD RECHTSCHAFFEN
COMMISSIONER GENEVIEVE SHIROMA

ADMINISTRATIVE LAW JUDGE BRIAN STEVENS, presiding

	ORAL ARGUMENT
Application of Southern California Edison Company (U338E) for Authority to Establish Its Authorized Cost of Capital for Utility Operations for 2020 and to Partially Reset the Annual Cost of Capital Adjustment Mechanism.	Application 19-04-014 Application 19-04-015
And Related Matters.	CONSOLIDATED Application 19-04-017 Application 19-04-018

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I N D E X

WITNESSES: PAGE

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DECEMBER 4, 2019 - 2:00 P.M.

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ADMINISTRATIVE LAW JUDGE STEVENS: All right. Let's call to order. We will be on the record. Good afternoon. This is the final Oral Argument for the Consolidated Proceeding Application 19-04-014, et al., which has in scope issues pertaining to the Cost of Capital for test year 2020 for Southern California Edison, Pacific Gas & Electric Company, San Diego Gas & Electric Company, and Southern California Gas Company. A Proposed Decision in this proceeding was served on November 25th, 2019.

I am the Assigned Administrative Law Judge Brian Stevens. I am here today to hear oral argument and to maintain order in the courtroom. With me today is Commission President Batjer, who is also the assigned Commissioner to this proceeding, and also Commissioners Guzman Aceves, Rechtschaffen, Randolph, and Shiroma. I want to thank all the Commissioners for being here today.

Before we begin, I want to let you know, in the event we need to evacuate, there are two exits behind you: One is the door that you came through, and the other is behind you to your left. In either case, after exiting the building, please make your way south across Van Ness Avenue, across McAllister Street, then turn right after passing the Herbst Theater and War Memorial. That will be our assembly point. I will call 911 in the event of an emergency.

A court reporter is transcribing today's Oral Argument and a transcript will be available. As a reminder, for the benefit of our court reporter, please speak clearly and directly into the microphones and please do not talk over one another; please state and spell your name at the beginning of your allotted time.

Please keep your oral argument to issues that are scoped within this proceeding, and speaking of which, I do also want to remind you that this Oral Argument is noticed for Application 19-04-014, et al., and is not intended to address issues in other open proceedings at the Commission, even though some of the topics discussed today may touch upon issues related to those other proceedings. To avoid making ex parte communication in other open ratesetting proceedings, please refrain from discussing topics at issue in those proceedings.

This Oral Argument will begin with 15 minutes of presentation from the applicants and parties aligned with the applicants. Then we will provide 20 minutes for the nonapplicant-aligned intervenors to present. The applicants and the parties aligned to the applications then will have 10 minutes for rebuttal, and the final 10 minutes is reserved for follow-up questions from Commissioners.

I asked the question of the Commissioners if they had any opening remarks. I believe President Batjer would like to start with an opening remark.

PRESIDENT BATJER: Good afternoon. I'm pleased to be here today with the parties, Commission staff, of course, my fellow Commissioners, and with ALJ Stevens.

My staff and I have been intently following these proceedings, and I appreciate the work that has been done. This is my first Oral Argument at the Commission, and I'm very much looking forward to hearing from the parties.

Thank you, Judge.

ALJ STEVENS: Thank you.

Let's begin with the applicants and the aligned parties with the applicants.

Are you prepared?

MR. PAYNE: Yes.

ALJ STEVENS: Please begin. Time starts now.

ARGUMENT

MR. PAYNE: Good afternoon. I'm Kevin Payne, President and CEO of Southern California Edison. My name is spelled K-e-v-i-n, P-a-y-n-e.

I want to thank you and your staffs for the considerable effort that has been put into managing this proceeding and for committing to achieve a decision by the end of the year. I'm here today because of the importance of the decision before you.

The decision you have to make is not just a financial decision; it's critical to SCE's overall ability to accomplish the state's ambitious climate goals. Our final comments will get into greater depth on each of the items I've mentioned, but I want to emphasize the following things today:

First, the Proposed Decision's acceptance of SCE's capital structure is critical to our goal of improving our credit metrics and reducing our overall risk, and we appreciate this positive outcome.

Second, the PD's holding of SCE's

ROE at 10.3 percent, the level that was set in 2017 is concerning. SCE is clearly exposed to greater risk than it was in 2017, as evidenced by among other things lower credit ratings.

While the PD correctly concludes that "SCE's adopted ROE should be set at the upper end of the just and reasonable range," it then places SCE in the middle of this range as shown on page 2 of the handout.

SCE provided extensive justification for an ROE above this range based on California wildfires, electric industry transformation, and regulatory lag.

Despite this, if the Commission ultimately adopts the PD's ROE range of 9.8 to 10.6, it should place SCE at the top of that range at 10.6.

Third, the PD does not accurately assess California's wildfire risk. As shown on page 3, these risks are unparalleled, and for utilities, compounded by inverse condemnation with strict liability and uncertain standards for cost recovery. The PD claims that with the passage of AB 1054 the only remaining risk to utilities is from imprudent management.

While we agree that AB 1054 limits

risk, albeit at significant cost to shareholders, we do not agree that it eliminates all residual risk.

Even after the passage of AB 1054, many details of the regulatory framework have yet to be decided. For example, the CPUC's ongoing safety certification process requires clarification and approval of SCE's Grid Safety and Resiliency settlement is mostly uncontested and yet is still pending approval.

And just as initial implementation of AB 1054's customer contributions to the Wildfire Fund was highly contested, we expect that nearly every aspect of AB 1054 implementation will be challenged, including the new framework for establishing prudency.

Credit rating agencies' comments and actions reflect this uncertainty. SCE's credit ratings, as shown on page 4, were downgraded several times. They stabilized after the passage of AB 1054, but they have not been upgraded back to the 2017 levels.

This signals that investors perceive greater risk than when the last cost of capital was established. Our credit ratings remain below the national average for electric utilities.

Relative to industry peers, all of SCE's business, financial, and regulatory risk metrics have declined since the last Cost of Capital proceeding. These metrics, shown on page 5, have not improved since AB 1054 was passed, and since then, California's regulatory environment was downgraded.

Fourth, California's ambitious clean energy goals also create risk for SCE as they will require investment of billions of dollars in new technologies and equipment and in new approaches to planning and operating the grid.

Since 2017, when the current ROE was established, clean energy goals have been accelerated; customer load has migrated to Community Choice Aggregators, and Distributed Energy Resources increasingly provide grid support functions. This, combined with at times unpredictable regulatory processes, creates greater uncertainty and risk for California utilities.

To be clear, we are proud to be a part of California's clean energy leadership, but we must be realistic about the risks investors see in the transformation.

Finally, a related risk is regulatory lag. Page 6 shows this trend for

SCE GRC cases over time compared to other jurisdictions. In recent years, Commission decisions have been delayed, and in the absence of direct guidance, the Commission has increasingly relied on balancing accounts and memorandum accounts.

The PD mistakenly assumes that balancing and memorandum accounts equally mitigate the risk of regulatory lag. Memorandum accounts only avoid retroactive ratemaking risks. They do not otherwise mitigate the risk of cost recovery that is caused by changes in circumstances while cases languish for extended periods of time.

And today I'm particularly concerned about the effect of this regulatory lag, given that SCE currently has hundreds of millions of dollars awaiting recovery in wildfire-related memorandum accounts.

This scale of wildfire risks, industry transformation, and regulatory lag are not faced by average-risk utilities.

Based on the evidence in the record, I respectfully request that SCE ROE should be a minimum of 10.6.

Again, I want to thank each of you and your staffs for devoting so much time and attention to these critical issues. Thank you very much.

ALJ STEVENS: The floor is open.

ARGUMENT

MR. FOLKMANN: My name is Bruce Folkmann, B-r-u-c-e, F-o-l-k-m-a-n-n, and I'm representing San Diego Gas & Electric and Southern California Gas. Thank you, Commissioners, and staff, for your commitment of time and attention today to the Cost of Capital proceeding of SDG&E and SoCalGas. Your thoughtful consideration of these matters is fundamental to the restoration of investors' interest in us.

By way of background, I've been in the power and utilities industries for about 20 years, always in financial and accounting roles, mostly with the Sempra family of companies, but also an independent power developer, NTXU, now known as Oncor, in effect.

A couple of folks here today and I last spoke with you about three years ago in a Cost of Capital proceeding at that time. All the utilities in this proceeding agreed to reduction in return on equity in that supplement, and we did so because we believed that it was appropriate for circumstances at the time. I would like to say that in my view, this PD is largely correct. I would like to address with you a couple tweaks that I believe would be important to improving this decision even more relevant to SDG&E and SoCalGas.

Over the course of this Cost of Capital cycle we anticipate investing great capital dollars at both of these utilities than at any previous time in our company's history. This investment will be needed to support our very important programs, particularly wildfire safety and five-point safety enhancement projects.

To successfully execute these programs at a reasonable cost to ratepayers, it is imperative that the cost of capital be authorized at levels that will attract investors, particularly when they consider our risk profile relative to alternative utility investments in the other 49 states.

I'll call your attention to Slide 2, which depicts the credit rating downgrades that occurred at SDG&E and the negative status assigned to SoCalGas.

These are impacting both of our utilities and the most recent examples has been in the spring when both utilities issued bonds at significantly larger credit premiums than we've paid in the past. The ratepayers in our service territories will pay higher expense throughout the 30-year life of these bonds.

Importantly, this is true for SDG&E and SoCalGas even though we have not experienced a significant wildfire since 2007 and we've actually repeatedly been lauded for our wildfire mitigation efforts.

There are clear indications like this of the capital market perceptions of SDG&E and SoCalGas. These unfavorable developments remain in place today in spite of Assembly Bill 1054 intended to help mitigate wildfire risks.

The scope of this proceeding includes only two issues that impact investor perception and credit quality: Return on equity and capital structure. The tweaks I mentioned earlier are both designed to produce optimal results for ratepayers and all stakeholders in both cases.

The first tweak I'll touch quickly on is return on equity. We do believe that SDG&E and SoCalGas both are at the top of the reasonable range in terms of ROE and authority to set our ROE at those levels: 10.4 percent at SDG&E and 10.3 percent at

SoCalGas.

SoCalGas is also exposed to inverse condemnation, including by contagion risk whereby weakness in SDG&E's credit profile impacts SoCalGas. They are both part of the same family of companies.

Furthermore, SoCalGas is the largest gas distribution utility in the US at a time when efforts to decarbonize the energy supply with greater electrification, for example, directly elevate the risk profile for investors in the gas company.

The second tweak impacting investor perception in credit ratings is capital structure. The record in this proceeding has established the capital structures of both SDG&E and SoCalGas have included approximately 56 percent equity for a number of years. It is important to note that our current ratings incorporate these actual levels without consideration of authorized levels.

As a result, credit metrics that we've achieved have directly benefitted through these credit ratings enhancement measures. Ratepayers and lenders being the primary beneficiary, and the shareholders have not been compensated.

Consistent with our operational history and our expectations going forward, the Commission should authorize 56 percent equity ratios in this decision to support credit quality and investor perception in our current diminished status.

ALJ STEVENS: There are five minutes left. Just be aware.

MR. FOLKMANN: It is important to note that any actual reduction in equity ratio weakens credit quality and that is because that or preferred stock increase, which are lower instruments relative to credit quality.

Referencing Slide 6, I would like to note that preferred stock has declined in the marketplace for operating utilities. This is demonstrated in some of SDG&E's materials as well as the market ratios that reflect not only a diminishing market appetite for preferred stock, but an increased appetite for equity.

We do not recommend issuing preferred stock at this time. We believe that PD, which contemplated maintaining our preferred stock levels at 2.75 percent ratio and a 2.4 percent ratio for the two utilities respectively may not have contemplated this circumstance appropriately.

We think it is appropriate, however, that in Edison's and PG&E's case their preferred stock equity levels were actually decreased, and we support that effort. We think the market circumstances warrant using the instruments other than preferred equity.

The preliminary decision, however, encourages, perhaps, preferred equity, and as I said, we do not recommend it at this time.

In closing, we strongly believe that SDG&E/SoCalGas should have an equity ratio of 56 percent. However, at a minimum, we believe it is unreasonable to return to the preferred stock markets as a source of capital for operating utilities.

Accordingly, the 2.75 percent preferred stock at SDG&E could be allocated to equity as common stock for a total of 54.75, and Southern California Gas could be allocated a ratio of 2 percent from preferred to equity for an equity layer of 54 percent.

We believe this outcome is clearly preferable to authorizing preferred equity that doesn't exist and isn't forecasted by any party to exist.

I would call your attention to Slide 7, and equity ratios are shown in the exhibits in the record, and we believe these levels of 54.75 and 54 percent are reasonable in these 20 of 47 pending rate cases. Thank you for your attention.

ALJ STEVENS: Please, proceed.

ARGUMENT

MR. BEH: Thank you. Good afternoon. My name is James Beh, B-e-h.

I'm appearing today on behalf of the Institutional Equity Investors, and I appreciate the opportunity to be here today.

The record in this proceeding contains substantial evidence concerning unique financial business and regulatory risk facing PG&E and other California utilities.

The Proposed Decision, however, appears, to the extent that it fails to address this critical evidence detailing the significant risks facing the California IOUs, risks that merit an ROE above the levels recommended in the Proposed Decision.]

ALJ STEVENS: A little closer to the mic, please.

MR. BEH: Thank you. Among the many witnesses addressing these matters, the Institutional Equity Investors sponsored the testimony of Dr. Richard Hern of NERA Economic Consulting.

What is particularly compelling and

noteworthy about Dr. Hern's analysis, is that it is based on actual market data, which demonstrate clearly the risk premium in the debt and equity markets for the California IOUs. I would like this afternoon to highlight just three aspects of Dr. Hern's analysis, which should be taken into account in the final decision in this proceeding.

First, the California IOUs face significant risks. Prior to 2017, the California IOUs debt and equity securities generally tracked the performance --

ALJ STEVENS: One minute.

MR. BEH: -- of IOUs outside of California. However, beginning in the fall of 2017, investors saw greater risk in investing in California utilities relative to utilities in other states as is illustrated by the clear market separation of the IOUs from the non-California peer group as shown in the chart on page 1 of our handout.

The timing of this divergence corresponds to the significant wildfires in 2017 and to the 2017 decision denying SDG&E's application for cost recovery followed by the 2007 wildfires.

Two, these additional risks must be reflected in the utility ROE. Dr. Hern utilizes three financial models to incorporate these risks into a just and reasonable ROE: A discounted cash flow analysis, an option pricing analysis, and a debt spread analysis.

His analysis shows a risk premium range of 3.6 to 5.9 percent. When combined with an analysis of base ROE, these data support an ROE of 15.2 percent, which is midpoint of his range.

ALJ STEVENS: We're at 15 minutes, so if you could please complete your remarks. And also be aware that there will be 10 minutes for rebuttal after the next group goes.

MR. BEH: Okay. Would it be possible for us to take additional time now at the expense of rebuttal time later?

ALJ STEVENS: Yes.

MR. BEH: Thank you.

These calculations are shown in page two of the handout. While the specific result is -- the 15.2 is certainly reasonable and within the range, the more important point is that an ROE adopted in this proceeding must reflect the significant asymmetric risk facing the California IOUs rather than a specific position within that range.

These risks need to be addressed. They're plainly evident in the market data, and this is something unfortunately the proposed decision just doesn't do.

Finally, the third point is that the market data showed that AB 1054 has stabilized the situation but has not fully mitigated the risks facing the IOUs. This is present in both debt and equity markets as shown in the tables on page three of our handout.

The keyword here is "stabilize." The data show that the market continues to price the material risk premium into the IOUs debt and equity securities. And these data are consistent with the findings of the major credit rating agencies, which downgraded the California IOUs in 2018 and 2019 --

ALJ STEVENS: Mr. Beh, I apologize. Let's go off the record.

(Off the record.)

ALJ STEVENS: We are on the record.

We're going to continue to give 1 minute and 30 seconds to the final representative for the applicant beginning now.

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ARGUMENT

MR. WELLS: Good afternoon, President Batjer, Commissioners, Judge Stevens.

Thank you for the opportunity to speak today. I'm Jason Wells, the executive vice president and CFO of PG&E Corporation. My name is J-a-s-o-n, W-e-l-l-s.

We appreciate all the work the Commission and its staff have done to get a timely decision of cost of capital proceeding. This is a critical factor in our ability to attract capital to invest in our energy infrastructure.

I want to acknowledge up front we understand there is much we need to do to better serve our customers. And we are making continual progress to make our system safer, more reliable, and more resilient to the effects of climate change and to support California's clean energy bills.

Now through 2022, PG&E plans to invest $28 billion in energy infrastructure. To put that into context, the total investment in our gas and electric systems is about $40 billion today. To attract that capital, California must offer investors a fair return for the risks they bear comparable to opportunities they have nationally and internationally.

No other state faces the combined risks of climate change, wildfires, inverse condemnation, and decarbonizing the natural gas system. And no other state has seen such an overall decline in the financial health of its utility as experienced here in California. We remain committed to helping California reduce the risk of wildfires and to achieve its clean energy goals. And our proposal of 12 percent return on equity does just that.

We believe the PD does not adequately recognize these risks, and we ask you to consider that as part of your deliberation. Thank you for your time and consideration.

ALJ STEVENS: Thank you. That concludes the first portion of this. We will move to the intervening parties that are not in line with the applicants.

You'll have 20 minutes, and then we will follow with 7 and-a-half minutes for rebuttal from the applicants.

Let's go off the record.

(Off the record.)

ALJ STEVENS: On the record.

We will now move to the interveners

who are not aligned with the applicants. There are 20 minutes allotted for this.

Are you prepared? Please begin. The 20-minute starts now.

ARGUMENT

MS. KAHL: Hello, Commissioners, ALJ Stevens. I'm Evelyn Kahl, and I'm here on behalf of the Energy Producers and Users Coalition and Indicated Shippers.

I wanted to start by commending ALJ Stevens for a very well reasoned decision. There's not a lot to find fault with reading through it. I think our problem is that the reasoning in the decision doesn't really match necessarily with the values that have been chosen.

The decision gives the impression that we're maintaining the status quo. There's no new wildfire risk to mitigate. There's a finding that there's no other unique California risks to mitigate, and we're maintaining the percentage ROE. So it gives the impression that we're just maintaining the status quo.

Yet, the matter of the fact of the decision is to give shareholders a raise, which is something I don't think that the Commission should be inclined to do at this point.

The disconnect occurs in the choice of values in the modelling ranges, and I'll let Mr. Hawiger address that shortly. But I did want to add three other observations.

First of all, Treasury Bond Yields, which are the risk free rate, have declined 120 basis points since your last decision in 2012. So maintaining the utilities' ROE at the status quo while the risk free rate is declining suggests that you're adding risk premium to compensate shareholders for risk.

Likewise -- and you have a slide you can look at later up there -- but the spread between the California ROEs and the average ROEs for other utilities across the country have increased by 25 basis points since your last decision. So, again, it suggests that you're giving them something. Increased compensation for risk that's not identified in this decision.

And finally, you're compensating Edison shareholders for another $36 million based on the change in their capital structure. You know, so all told this adds up to an additional $40 million for each PG&E and Edison on the ROE basis point differential. And that will grow as the ratebase grows as well.

So the signal appears to be surface status quo, but it is not the status quo. And this decision will send the message that the Commission is interested in giving shareholders a raise, not in protecting ratepayers. And as you know, ratepayers are facing a lot of increases and will continue to face increases for the wildfire mitigation plans and other costs.

This is not the time to send the message that we want to increase shareholder compensation for a risk that is unidentified by the decision. We will provide comments and response to the utilities in our comments on the PD.

Thank you.

ALJ STEVENS: Please continue.

ARGUMENT

MR. HAWIGER: Thank you, Judge Stevens.

Good afternoon, President Batjer, and honorable Commissioners. I am Marcel Hawiger, a staff attorney with The Utility Reform Network.

I recommend that you revise the PD to reduce the authorized equity returns below 10 percent consistent with the data and the risk profile of the California utilities.

The PD authorizes equity returns that are exactly the same as current returns, which are almost the same as those authorized in 2013 at the last cost of capital proceeding.

As you can see from page 1 of the TURN handout, national authorized equity returns have trended steadily downward since 2013. Now, the PD considers all the relevant data and relies on informed judgment. And that is entirely appropriate. However, the just and reasonable ROE ranges adopted by the PD cannot be squared with the facts.

For example, please take a look at page 2 of the TURN handout, which provides illustrative data for Edison. The PD adopts a reasonableness range of 9.8 to 10.6 percent for the ROE. But if you look at the three columns of the modelling results all taken from the PD labeled "CAPM," "RPM," and "DCF," you'll see that only one result, Edison's risk premium result, exceeds 9.8 percent. Every other result is lower than the supposed low end of the reasonableness range. And Edison's high-risk premium result was due to the use of an unsupportably high-risk rate.

If you look at page 3 of the handout, it explains that Edison's risk-free rate was made on the assumption made back in early 2019 that interest rates would continue to rise. That assumption has proven to be false since the fed has reversed course in 2019 and has now cut the funds rate three times.

Page 4 of the handout illustrates that Edison's risk-free rate of 4.1 percent is about 1 to 2 percentage points higher than the rates assumed by the other experts in this case who submitted testimony in August of 2019. And a similar outcome is true for the ranges established in the PD for both PG&E and SDG&E.

Now, the utilities also continue to push for -- to argue that there is a wildfire risk in California as Edison did. AB 1054 eliminated the utility financial risk absent management negligence. And the legislation adopted more lenient prudence and burden of proof standards for evaluating the reasonableness of management actions.

As illustrated by from a couple of quotes on page 5 of the TURN handout, the utilities and bond analysts allege there is an implementation risk based on the notion that this Commission cannot properly apply the new standards for a reasonableness review.

I don't think that this Commission can conduct appropriate reasonableness reviews whether under the current management standard or the more lenient standards adopted by AB 1054. I best recommend you use the actual data and modelling results to lower the authorized ROEs to a more reasonable level below 10 percent.

Thank you very much.

ALJ STEVENS: The 20 minutes is yours to use.

MR. HAWIGER: And I would just note that Public Advocates conceded its time to TURN, so I had an minute extra.

ARGUMENT

MS. KELLY: Hello, your Honor. Hello, Commissioners. My name is Elizabeth Kelly, E-l-i-z-a-b-e-t-h, Kelly, K-e-l-l-y.

First, you know, we want to thank the Commission for the PD acknowledging that the Commission has really de-risked the climate policies of California for shareholders. And also the legislature and the Commission have also de-risks wildfires for the utilities.

But one thing I want to touch on is EDF's main proposal in this proceeding. So in this proceeding, EDF proposed what the scoping memo calls a "blended ROE." So that issue was not addressed except for one short paragraph in the PD. Now, that's a legal error.

But more concerning is that there's a significant tactical and strategic error that goes along with it. So first I'll explain briefly what this is.

First, what we're simply saying is that you should evaluate the risks of gas operations and electric operations differently, because the risk they face are different. And then you take a weighted average of those ROEs to determine ROE for the utility as a whole. So that's blended ROE.

So what has EDF shown in this proceeding? First, we have demonstrated that electric risks are different from gas risks, which is obviously apparent to you all as commissioners. You see it every day.

We have demonstrated that decisionmaking within utilities is different. So PG&E gas operations have different decisionmaking than PG&E electric operations.

As for SDG&E, their gas operational decisions are in fact made by SoCalGas. There's no solid line reporting over to SDG&E

for those gas operations.

And we have also shown that the Commission has favorably considered this concept before in 1994. In that decision in '94, 94-11-076, says:

> Unbundling cost of capital is economically sound, will send correct price signals to energy markets, and will mitigate to cross subsidies.

It continues:

> Unbundling the cost of capital is appropriate where services and rates are unbundled and where there is adequate evidentiary support for unbundled cost.

So in 1994, there wasn't an unbundling of rates, but there is that unbundling now. So we are just harkening back to that moment where the Commission has already addressed the value of differentiating these risks.

So let's get back to what we're looking at here, which is the overall return on equity in this proceeding. And I like to think about things IN terms of chess; right. And this decision is a single piece on the board.

And I think it's helpful to take a look -- and I won't get into any ex parte issues -- but you have to take a look at the chess board as a whole. And the decisions that the Commission has made since the last cost of capital proceeding and also what the market looks like.

So a lot has changed. The Commission has implemented a risk-based framework in the general rate cases. The legislature and the Commission have addressed wildfire risks head on and incredibly promptly. So kudos to the Commission on that. And the Commission has continued to de-risk California's climate initiatives specifically for shareholders. Those costs are really passed to ratepayers.

But here the PD is choosing not to move the chess piece. So the ROEs aren't changing. They're maintaining a status quo. There's no differentiation of electric operational risk and gas operational risk. And so this status quo doesn't just provide a false sense of security, this is where you find a tactical and strategic error.

So tactically we've already heard that the ROEs are too high. Maybe even 100 basis points too high. And those are going to be borne by customers for the next three years.

The decision is also sending the wrong signals to investors by lumping together the very different gas operational risks and the electrical operational risks. But the strategic reasons are more important.

So when the next cost of capital applications are before you, first of all you're going to have to address this particularly high premium to shareholders and bring it back to normal levels. And that's going to be a tough pill to swallow at that time. You're also not going to even have the optionality of considering different gas and electric ROEs in that case.

So if the PD isn't modified, the Commission isn't going to have the right tools to address the climate realities, grim realities, and financial realities of California three years from now.

So you need to think several steps ahead. So we ask the Commission to adopt a blended ROE now. And if it doesn't, we ask that it direct SDG&E and PG&E to identify electric ROE and gas ROE separately in their next cost of capital decision.

Thank you.

ARGUMENT

MR. DELMONTE: Madam President, Commissioners, ALJ Stevens. My name is Tom Delmonte, D-e-l-m-o-n-t-e.

Today I have three points. First, our final recommendation for PG&E's ROE was 8.58 not the 7.11 percent stated in the PD.

Second, the PD's proposed PG&E ROE of 10.25 percent is too high because it is inconsistent with the large reductions in cost of capital for utilities seen over the last decade. This is seen first on the graph I provided on the back of my handout showing that declining risk rate, which is the key starting point for the CAPM and other ROE models.

The risk free rate has on average declined over 2 percentage points in the last decade compared to the decade before. That fall is caused by a decline in the expected growth rates of the economy. And the growth rate variable dominates the results for DCF models.

The second graph shows the real annual growth rate of the U.S. economy -- or it shows that the real annual growth rate in the U.S. economy fell almost 2 percentage points from pre-recession levels. Hence, all methods and relevant data showed utility costs of capital have fallen about 2 percentage points.

In 2012 it was reasonable to assume that cost of capital would return to their previously high levels as the Commission did in its last ROE decision. However, over the last decade, most economists have concluded that the low new normal is here to stay.

Thus, the ROE adopted in this decision should not be what it was in 2000 -- or decided in 2012, but instead 2 percentage points lower approximately. This conclusion is reinforced by the party's proposed PG&E ROEs shown in the table provided.

And finally, the PD's Hope and Bluefield analysis of the alleged new risks factors claimed by PG&E leaves no basis for choosing the high end of a determined just and reasonable ROE range.]

This, combined with the new normal factors previously discussed, constitutionally demands a much lower ROE than proposed in the PD, namely, 8.58 for PG&E. Thank you very much.

ARGUMENT

MR. BOSWORTH: Good afternoon, Judge Stevens, Commissioners. My name is Thomas

Bosworth. I'm a senior deputy county counsel with the County of San Diego.

The county agrees with the decision to the extent that it concludes a risk adder should not be considered, but not solely because risks of all kind are included in the rates. The county's concern is that a risk adder of any type under any name that imposes liability on ratepayers for possible future losses that may never be incurred without regard to the conduct of the utility is unjust and unreasonable and contrary to law. The passage of AB 1054 did not change this basic requirement, and reinforced that utilities must act prudently to be entitled to reimbursement by ratepayers --

ALJ STEVENS: Five minutes.

MR. BOSWORTH: I'm sorry. What did you say?

ALJ STEVENS: "Five minutes."

MR. BOSWORTH: Okay -- for wildfire losses.

More importantly, by continuing to require shareholders rather than ratepayers to carry the risk of imprudent conduct, the Commission will properly balance shareholder and ratepayer responsibilities. We urge the Commission to adopt the proposed decision in as much as it rejected the use of risk adders, but would ask for a more definitive rejection of that concept based on applicable law so that we don't have to keep fighting this same battle in future proceedings. Thank you.

ARGUMENT

MR. LOPEZ: Good afternoon, Commissioners and ALJ Stevens. Edward Lopez, L-o-p-e-z, on behalf of the Utility Consumers Action Network and Protect Our Communities. Thank you for the opportunity to present a few key points today for your consideration. UCAN/POC will, of course, include and elaborate on these and other points in our comments to propose this issue.

To begin with, simply clarifying the record, in the PD, we are not included as filing a reply brief. UCAN/POC did file, as easily seen in the docket card. We did intervene at all stages of this proceeding.

The most significant issue from the vantage point, we believe, of SDG&E ratepayers is that the chosen ROE keep the California utilities too far above the national average for utility profits. The PD itself notes that the utility's ROEs are well above the average of 2018 ROE of 9.6 percent.

In fact, the PDs ROE are, on average, 60 basis of point -- points above what other utilities nationally received in 2018. In comparison, in the 2012 cost of capital proceeding, the last such proceeding, and in which the Commission gave a really thorough discussion of the evidence in that record, that decision set the ROEs within the reasonable range based on the comparison with the national sample of utility ROEs. Essentially, the Commission performed a reality check in 2012. That was an appropriate reality check on the Commission's conclusions in 2012. UCAN/POC recommends that the Commission perform that reality check again, and revise the PD to bring the California utilities in line with the average national utility ROE, as our experts and testimony detailed in the record.

Per UCAN/POC projections, for example, adopting either our proposed ROE, or even at the low end of the just and reasonable range as set forth in the PD would result in real world dollars in millions not being paid by SDG&E customers to Sempra, SDG&E's sole shareholder. As we estimate, if our RO -- ROE figure of 9.15 percent were to be adopted with the PD's capital structure, this would mean about 35 million annually would not go into Sempra's pockets, or if just the -- or if the just and reasonable range low figure of 9.6 percent -- 9.60 percent was selected, the difference would be about $20 million less per year. That is in real world dollars. That is millions less being paid by ratepayers to utility shareholders. A reality check by this Commission now could result in a very real world difference for California ratepayers.

Now, UCAN/POC does support the PD ruling that SDG&E shall maintain its current authorized capital structure that includes 52 percent common equity, as proposed by UCAN/POC. If SDG&E's proposed capital structure were to be adopted, 56 percent equity, that would result in approximately 11.6 million more being paid annually by SDG&E's customers to Sempra, SDG&E's shareholder. We, of course, believe that SDG&E's ratepayers --

ALJ STEVENS: One minute remaining.

MR. LOPEZ: -- should not overpay.

As mentioned at the onset, all information underlying these points will be detailed in our comments that we will file on behalf of UCAN/POC and on behalf of SDG&E's

ratepayers. We thank the ALJ and the Commission for the opportunity to participate. Thank you.

ALJ STEVENS: You have 40 seconds. Any final remarks?

MR. HAWIGER: May we save it for rebuttal, surrebuttal? No.

ALJ STEVENS: All right. That concludes the portion of the presentation from the intervenors not aligned with the applicants. I will ask the applicants and the intervenors aligned with the applicants to return for seven and a half minutes of rebuttal.

Off the record.

(Off the record.)

ALJ STEVENS: We will be on the record. The applicants and the intervenors aligned with the applicants have seven and a half minutes. That time will begin now.

REBUTTAL ARGUMENT

MR. FOLKMANN: I'll start. Again, Bruce Folkmann, spelled my name earlier. Appreciate the comments and consideration of -- of all the commissioners and staff here today in response to all these remarks. I want to mention a couple of things.

I think one key with regard to the

issues discussed today is the most important matter really is investor perception and their confidence in the health of the utility. The dollars we invest come entirely from the capital markets, and so it's most critical to consider their perspective. I think their perspective with regard to reasonable operations in the face of AB 1054 and how it will be applied is that it's clearly a constructive step. We certainly have that view at San Diego Gas & Electric. However, in the 2007 wildfire case, as a reminder, we obviously did experience significant liability damages, and the amounts that exceeded our insurance recovery were ultimately fully recovered in the FERC jurisdiction 100 percent, and zero percent recovered in the California Public Utilities Commission jurisdiction. That cast into doubt the regulatory framework around the application of what a reasonable operator was, and is the only evidence we have today with regard to how these matters might be handled at the Commission. Investors recognize the credit supportive nature of the intent of AB 1054, but it's not yet demonstrated, and so I think that raises doubt in their mind, and it's appropriate that they have a reasonable return to take on that risk. There are alternatives. If they choose to invest in a North American utility, there are 49 other states. And when they look at our utilities in the State of California, they must accept this risk.

I wanted to address one other matter that I think is helpful in consideration here. You heard today in some of the -- the comments from the other side of this debate some references to 2012, interest rate changes in the intervening period, changes in ROEs across the United States. I would just like to point out that we did have a settlement, and with all interested parties, three years ago. It was ultimately approved by -- by the Commission. And I also want to add one more up-to-date data point, which is we at San Diego Gas & Electric have recently filed a settlement in the Federal -- Federal Energy Regulatory Commission in our FERC jurisdiction. The CPUC was an active party in that settlement, and is supporting the settlement. It's an all-party settlement. Everyone involved in the proceeding supports it. It agreed to a 55 basis point, .55 percent, increase in ROE. I believe all the factors you've heard today were taken into consideration in reaching that settlement, and I think it's relevant in this proceeding. Thank you.

COMMISSIONER RECHTSCHAFFEN: Let me ask you a question. You said in your opening remarks that the risks The Gas Company faces are different because of decarbonization. Can you respond to EDF's argument for a blended rate because of the different nature of the risks that electric and gas operations face?

MR. FOLKMANN: Sure. They're a distinguished company, certainly. Our capital, our investment that comes from the capital markets, has only one -- I think I believe they're talking about San Diego Gas & Electric, in particular, when they -- when they speak to distinguishing or blended rates of return. Investors can only invest in San Diego Gas & Electric as a whole. They're not able to choose one investment over another. And so, in that way, it's combined, and our peer utilities that we consider are generally combined for the same reason. I would also note that even in the preliminary decision before the Commission today, the high end of the range is only ten point -- ten basis point, .1 percent, ROE different from electric versus gas. So I think these are conceptual matters that don't make a material difference, candidly.

REBUTTAL ARGUMENT

MR. PAYNE: I'd like to comment on a couple of issues, as well.

One is Mr. Hawiger, on his Exhibits 3 and 4, made some statements about the impact of interest rates and how recent reductions in interest rates should -- in his mind, should have an impact on -- on ROE. I'd just like to remind everybody that as -- in developing a forward-looking ROE, the important thing is a forecast of interest rates, and there -- it has a relatively marginal impact on the -- on the development of an ROE. But, the most important thing is to be looking at what the forecast is, and -- and all the credible third-party forecasts still would show increasing interest rates over time. So the idea that the ROE should be reduced based on recent reductions in interest rates, we think, is incorrect.

Secondly, as a -- as a minor point, on page 2 of TURN's handout, they also seem to indicate that the PD incorrectly assigns an ROE to SCE that is bigger than SCE's own model range, and I believe there is an incorrect reference in the PD that should be referencing more pages of SCE-2, the Exhibit SCE-2. And when you look at all the data that we submitted, you will see that it does justify the full range that the PD points to.

And then just finally, in response to the EPUC witness, you know, for all the reasons I said in my prepared remarks, I think it is clear that California utilities face risks that are significantly beyond average risk utilities. And I won't go back over those again, but I would just point you back to the -- to the items that we mentioned in our prepared remarks and suggest that a national average ROE is not appropriate for a California utility.

COMMISSIONER GUZMAN ACEVES: Can you clarify that point? So are you making the point that you acknowledge that the national average is lower, but that you have a separate set of category --

MR. PAYNE: Yeah.

COMMISSIONER GUZMAN ACEVES: -- or company types that you're comparing yourself to?

MR. PAYNE: Basic -- basically, what I'm arguing is -- is that a just and reasonable range such as the one that the PD identifies is the first step, but then evaluating where within that just and reasonable range any given utility should lie is -- is what's important here. And what I'm arguing is that the risks that California utilities face, for all the reasons that I said earlier, should push us to the very top end of that just and reasonable range because we face far more risks than an average risk utility.

COMMISSIONER GUZMAN ACEVES: Plus, you say --

ALJ STEVENS: One minute.

COMMISSIONER GUZMAN ACEVES: You're also acknowledging -- sorry. I'll offer time.

You're also acknowledging that you are 25 points above the national spread?

MR. PAYNE: Yes. We're -- what -- yes. But, what I'm -- what I'm -- yes. I'm arguing that we should be at the top end of the just and reasonable range that was identified in the PD.

ALJ STEVENS: You have 45 seconds left.

REBUTTAL ARGUMENT

MR. BEH: Thank you. Just two points in response to the argument that -- that there's no meaningful risk differential between the California utilities and utilities outside of the state.

I think, first, the market data clearly show that there was a significant divergence in 2017, and also the market data show that that diversion continues today. Clearly, investors are pricing the risk premium into the California marketplace that is very indicative of the additional risks faced by the California utilities. Thank you.

ALJ STEVENS: That's time.

COMMISSIONER GUZMAN ACEVES: I have some follow-up questions, Mr. Beh. You're --

ALJ STEVENS: Commissioner, may I just really quickly mention time?

COMMISSIONER GUZMAN ACEVES: Yeah.

ALJ STEVENS: I'll just note that we now have ten minutes for commissioner questions. If the other parties could also be ready, perhaps near the front of the room, to respond, I'll start the ten minutes now.

And Commissioner, you can continue.

COMMISSIONER GUZMAN ACEVES: Thank you.

Your chart does not show SDG&E or SoCalGas. Is there a reason you did not include them in the cost comparisons?

MR. BEH: Oh, I'm sorry. Which chart

are you referring to?

COMMISSIONER GUZMAN ACEVES: I'm looking at all the charts. I don't see SDG&E or SoCalGas.

MR. BEH: Oh, yes. Dr. Hern explained in his testimony he didn't believe that -- that SDG&E and Sempra were as indicative of the risk factors because SDG&E is a smaller percentage relative of its parent corporation than is the case with PG&E or SCE. So there are all these other factors that might influence movement in stock prices for Sempra that make it different and make the analysis based on -- on its stock price movement somewhat different than for the other two.

COMMISSIONER GUZMAN ACEVES: Does that mean that SDG&E and Sempra are lower risk than the other utilities?

MR. BEH: No. No, Commissioner. It's just that trying -- because Dr. Hern's analysis was based on market data, stock price movements, option prices, that sort of thing, and he felt that the signal that was being sent by movements in their price wasn't as closely correlated to the factors he was trying to analyze as would be the case for the others.

ALJ STEVENS: Commissioner Shiroma?

COMMISSIONER SHIROMA: Thank you. This is for San Diego Gas & Electric. Sorry. Your tent is --

MR. FOLKMANN: Oh, I apologize.

COMMISSIONER SHIROMA: There you go. Thank you.

MR. FOLKMANN: Sure.

COMMISSIONER SHIROMA: So on page 51 in the PD under the conclusions of law on number four, the capital structures proposed by San Diego Gas & Electric and SoCalGas should not be adopted because they do not sufficiently balance ratepayer interests with the intention to maintain an investment grade rating and attract capital.

You've spoken pretty strongly about Wall Street and investors and the -- what's considered the impression investors may have and so forth. It says here that -- under conclusions of law, that what you propose doesn't sufficiently balance ratepayer interests, anyway.

Do you want to speak to that at all?

MR. FOLKMANN: Thank you for the invitation. We obviously will be -- we will comment on this issue, as well.

It is -- it's clear, and I hope it's been helpful to you today, that the preferred equity market is less favorable. It's out of favor for investors. So we think there's an implication in the PD that encourages us to potentially utilize those instruments. We don't -- we have no forecasted instruments as of today. There is zero preferred stock at San Diego Gas & Electric, and only 22 million remaining at SoCalGas, and that's been true since prior to 2013, and it's largely driven in part by this trend around preferred capital.

We believe that our operating history utilizing equity at the clear expense of shareholders is the clearest demonstration that we can offer, that we think that's the best way to structure capital for the utilities. That's been in place for a number of years at both. And so, as I said, we -- we believe 56 percent is appropriate. However, if the Commission finds that just simply unreasonable, we are encouraging the perspective that the existing preferred stock layer, 2.75 percent at San Diego Gas & Electric and 2.4 -- two -- two percent of 2.4 at SoCalGas, should be converted to equity. If we were to manage our businesses at an actual capital structure that reflects that, it would, in fact, weaken our credit metrics, because we've been operating these businesses with greater equity. However, it's what we're offering today, candidly, as -- as a sort of compromise if the feeling is that 56 percent is just untenable.]

ALJ STEVENS: Any other questions from Commissioners?

COMMISSIONER GUZMAN ACEVES: Which settlement were you referring to?

MR. FOLKMANN: San Diego Gas & Electric's currently filed -- it was filed in October, I believe, just this fall, in our TO-5 or 6 - forgive me - proceeding. It's pending now at the FERC. It's not even been approved, but it has support of all parties.

Does that answer your question?

PRESIDENT BATJER: I thought you mentioned one current, the one you mentioned now, recently, but I thought you mentioned an earlier FERC settlement.

MR. FOLKMANN: I've only mentioned one FERC settlement, and that's the one pending now. I also mentioned the CPUC settlement about three years ago about Cost of Capital.

COMMISSIONER GUZMAN ACEVES: The FERC settlement is TL-20 or --

ALJ STEVENS: Off the record.

(Off the record.)

ALJ STEVENS: On the record.

MR. FOLKMANN: Sorry. It's Transmission Order 5 -- was our Transmission Order 19-1553 now pending at FERC.

ALJ STEVENS: Order.

MR. FOLKMANN: We can get you the clear reference. We are happy to clarify that.

ALJ STEVENS: Any other questions from the Commissioners at this time?

(No response.)

ALJ STEVENS: I'll take a moment myself just to follow-up on Commissioner Guzman Aceves' question.

Is it true that preferred equity would in the eyes of a credit agency count somewhat towards that requirement you mentioned for the level of equity which you have in your company based on its analysis of your leverage whether or not you're creditworthy?

MR. FOLKMANN: Sure. If I understand your question -- and thank you for the question. Preferred equity has become a very highly-tailored market, and it's typically used by holding companies for very specific reasons.

I think your question speaks to, what's the level of equity credit, if you will, that might be attributed to preferred equity. I mean, equity is the most valuable credit dollar; debt is the least, and we are always trying to balance these two things. Preferred stock sits in the middle.

As we've discussed it here today among operating utilities, preferred equity typically is judged to be approximately 50 percent debt and 50 percent equity; so if you shift a dollar from equity to preferred stock, you lose about 50 percent of the credit if you will. It diminishes your credit quality.

ALJ STEVENS: So if you had a 50 percent common equity authorization and a 12 percent preferred equity authorization, would that be the equivalent of having 56 percent common equity authorization?

MR. FOLKMANN: I think that's a little bit of a speculative -- 12 percent is a very high level, perhaps the highest of any operating utility I've heard of.

As a reminder, you know, using Southern California Edison examples, this preliminary decision reduces from nine to five. I think that's the right direction.

Directionally, I believe, your answer is conceptually correct. There could be implications for that high level of preferred stock that might require deeper analysis, candidly, but that's a very high level.

ALJ STEVENS: Setting aside those other implications though, would the ratepayer impact of a 50 common equity and a 12 percent preferred equity authorization, would it be a lower impact on ratepayers relative to a 56 percent common equity authorization?

MR. FOLKMANN: Candidly, Judge, I would have -- I would have to get back to you on that. My concern in actually pursuing a capital structure of that nature would be the preferred equity market we're speaking of across the nation, all operating utilities combined is only $13 billion in size.

You're talking about a very significant amount on quite a thin market. I think there's a lot of implic- -- there's just too many implications. I'm not sure what the price would be, but there could be a lot to evaluate. Sorry.

ALJ STEVENS: Any final questions?

(No response.)

ALJ STEVENS: Okay. Hearing none.

That concludes that portion of the Oral Argument and that concludes the Oral

Argument in totality. Thank you all for your participation today. We appreciate it. This oral argument is adjourned. Off the record.]

(Whereupon, at the hour of 3:05 p.m., the Commission then adjourned.)

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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE

STATE OF CALIFORNIA

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EXECUTED THIS DECEMBER 11, 2019.

JASON A. STACEY
CSR NO. 14092

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Rebekah L. DeRosa

REBEKAH L. DE ROSA
CSR NO. 8708

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