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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U902M) for Authority to Establish Its Authorized Cost of Capital for Utility Operations for 2022 and to Reset the Annual Cost of Capital Mechanism.	Application 21-08-014 (Filed August 23, 2021)

PROTEST OF THE UTILITY REFORM NETWORK

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PROTEST OF THE UTILITY REFORM NETWORK

I. Introduction

On August 23, 2021, Southern California Edison Company ("SCE"), San Diego Gas & Electric Company ("SDG&E"), and Pacific Gas and Electric Company ("PG&E") each separately filed an application seeking various forms of relief regarding the authorized Cost of Capital ("COC") for 2022 and thereafter. Pursuant to Rule 2.6 of the California Public Utilities Commission's ("Commission's") Rules of Practice and Procedure, The Utility Reform Network ("TURN") submits this protest to each utility's application.[1]

Although there are minor differences reflecting each utility's specific circumstances at this juncture, the applications have one key element in common – citing the COVID-19 pandemic, each asks the Commission to forgo a revenue requirement reduction that would otherwise occur pursuant to existing regulatory mechanisms. Under the long-established Cost of Capital Mechanism ("CCM"), current economic indicators would trigger a reduction to both the authorized Return on Equity ("ROE") and Long-Term Debt costs for 2022, to the benefit of the utilities' customers. In a period of ever-increasing numbers of utility requests seeking ever-increasing additions to the authorized revenue requirement, the CCM would provide a rare respite from the trend. And the amount of relief would be significant; below, TURN roughly estimates a reduction of $133 million for PG&E, and $160 million for SCE.

Apparently, the utilities determined they would not abide such an outcome, and

[1] There is a pending motion to consolidate these three separate applications. TURN has prepared a single protest addressing the request of each application, and is serving it separately on each of the three service lists.

together developed a highly-coordinated strategy that, if successful, would allow them to avoid such a revenue requirement reduction. The resulting applications are a brazen attempt to restructure existing regulatory mechanisms to no longer balance a range of interests, but rather to better serve the utilities' parochial interests. In filing them, SCE, SDG&E and PG&E have demonstrated that there are no bounds to how far they will go to protect and promote their own interests, even if it requires using the COVID-19 pandemic as cover. The Commission should have no part of it.

TURN's primary recommendation at this time is that the Commission recognize that the utilities' requests present two sets of issues and address them separately. The first set has to do with whether these applications are appropriately before the Commission, which requires the utilities to demonstrate that the COVID-19 pandemic is not only "an extraordinary or catastrophic event," but also an event that "materially impacts their respective cost of capital and/or capital structure" and "affects them differently than the overall financial markets."[2] If the Commission determines that the utilities have not met their burden of demonstrating that these conditions are met, there would be no need for further review or action. The second set of issues are those tied to a more traditional Cost of Capital proceeding, and would only need to be addressed if the Commission were to agree with the utilities on the first set of issues. Therefore, TURN proposes a phased approach to this proceeding, with the first phase devoted to developing an adequate evidentiary and briefing record on the first set of issues, and the second phase available for review of the more traditional Cost of Capital issues, if necessary.

[2] D.08-05-035, p. 16 and Conclusion of Law 6.

II. Summary of *Status Quo* and Changes Sought In Utility Applications

A. Maintaining the *Status Quo* is Likely to Lead to Substantial Revenue Requirement Reductions Effective January 1, 2022.

Under the *status quo*, the CCM first adopted in 2008 and reaffirmed in 2019 would remain in effect for the entirety of the 2020-2022 COC period. The next COC proceeding would be initiated with applications submitted in April 2022, and would set the ROE, Long Term Debt cost, capital structure, and other similar elements for a 2023 test year. For 2022, the previously-authorized ROE and Long Term Debt costs would remain at the levels set in D.19-12-056, unless an automatic adjustment under the CCM is triggered. The CCM includes a 100 basis point "deadband" tied to an index average, and would produce an automatic adjustment if that deadband is exceeded (either higher or lower).[3] Each of the utilities expects that the applicable index average will likely have decreased by more than the 100 basis point deadband as measured from October 1, 2020 through September 30, 2021, thus triggering ROE and Long Term Debt reductions for 2022 under the CCM.[4]

Based on TURN's very high level initial review of the applications, it appears that the utilities may not have included in their presentations the approximate revenue requirement reduction that would result if the *status quo* were maintained and the CCM-derived adjustments were implemented for 2022. TURN's rough estimates indicate that the reductions would be substantial. The minimum ROE reduction that would occur is 50

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[3] For example, SDG&E is subject to the Moody's Baa utility index, which has a benchmark rate of 4.498 percent. With the 100 basis point "deadband," ff the index's 12-month average from October 2020 through September 2021 is less than 3.498 percent, SDG&E's adjustment mechanism would trigger. SDG&E Application, p. 7.

[4] SCE Application, p. 3; SDG&E Application, p. 7; PG&E Application, p. 10.

basis points, since the adjustment is calculated as 50% of the change in the index average. In addition, the costs of Long-Term Debt would be reduced as a result of the update to reflect the latest available information and forecasted interest rates. For PG&E, one can roughly estimate a revenue requirement reduction of approximately $133 million resulting from a 50 basis point reduction to its authorized ROE.[5] [6] For SCE, the revenue requirement reduction would include savings from both the reduced ROE and Long-Term Debt cost reductions, totaling approximately $159 million.[7] TURN was unable to perform a similar calculation for SDG&E, but expects the reduction to be of a similar magnitude (keeping in mind the much smaller scale of SDG&E's utility operations).

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[5] PG&E seeks a 75 basis point increase to its authorized ROE, while retaining its current capital structure and making a relatively small (3 basis point) decrease to its cost of Long-Term Debt, the combined revenue requirement impact of which is an increase of approximately $201 million. PG&E Application, pp. 20-21. $201 million / 75 basis points = $2.67 million per basis point. Thus, a very conservative estimate of the revenue requirement reduction that would result from a 50 basis point reduction is $133 million (50 X $2.67 million).

[6] PG&E updated its cost of Long-Term Debt from 5.16 percent to 4.17 percent, effective July 1, 2020, as part of the implementation of the Commission-approved Plan of Reorganization for the utility's most recent voluntary bankruptcy. As a result, the incremental reduction of Long-Term Debt costs (from 4.17% to 4.14%, or 3 basis points) is very limited as compared to the basis point reductions at issue for SCE (42 basis points) and SDG&E (75 basis points).

[7] SCE seeks a 23 basis point increase to its ROE (from 10.3% to 10.53%). SCE repeatedly claims that its proposal would be "rate neutral," suggesting that the increased cost of the higher ROE would be offset by changes to the cost of Long-Term Debt and preferred equity. SCE states the Long-Term Debt and preferred equity changes would result in a $50 million revenue requirement reduction. (SCE Application, pp. 4 and 13-14.). If the 23 basis point increase to ROE would increase the authorized revenue requirement by approximately $50 million, a 50 basis point decrease to ROE would reasonably be expected to reduce the authorized revenue requirement by approximately $109 million. (50/23 X $50 million). The total revenue requirement impact under the CCM would include both the ROE reduction and the $50 million reduction from Long-Term Debt and preferred stock costs, or $159 million.

B. The Utility-Proposed Changes Would At Best Result In A Lost Opportunity For Substantial Revenue Requirement Changes and, for PG&E, Actually Increase The 2022 Revenue Requirement By Approximately $260 Million.

When the Commission adopted the CCM in D.08-05-035, it provided that a utility could file a cost of capital application outside of the CCM process "upon an extraordinary or catastrophic event that materially impacts [its] respective cost of capital and/or capital structure and affects them differently than the overall financial markets."[8] The utilities' applications here rely upon this provision, and assert that the COVID-19 pandemic and associated economic impacts meet the requirements of having materially impacted each utility's cost of capital, and having affected them differently than the overall financial markets.

Should the Commission determine that the current circumstances meet the "material impact" and "affects utilities differently" conditions set in D.08-05-035, the utilities' applications seek numerous changes to the authorized Rate of Return and associated financial components. TURN summarizes some of the key changes below:

- Each utility seeks an increase to its currently-authorized ROE.
  - SCE – 10.53%, up from 10.3%
  - SDG&E – 10.55%, up from 10.2%
  - PG&E – 11.0%, up from 10.25%

- Each utility seeks to update its embedded cost of Long-Term Debt to reflect current lower rates.
  - SCE – 4.32%, down from 4.74%
  - SDG&E – 3.84%, down from 4.59%
  - PG&E – 4.14%, down from 4.17%

- SDG&E seeks a change to its authorized capital structure (including an increase in its common equity component from 52% to 54%).

- PG&E seeks a 159 basis point premium over the three-month commercial paper

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[8] D.08-05-035, p. 16 and Conclusion of Law 6.

rate for short-term financing associated with its balancing and memorandum accounts.

- PG&E and SCE propose, as an alternative, a suspension of the CCM so there would be no adjustment to the authorized ROE for 2022. Under this alternative, the utilities would file an application in April 2022 (as regularly-scheduled) for purposes of setting the cost of capital for a 2023 test year.

III. Grounds For Protest And Issues To Be Considered

A. Should the Commission Permit The Utilities To Evade Operation Of The Cost of Capital Mechanism?

The first issues the Commission will need to consider and address in this proceeding is the utilities have established that the COVID-19 pandemic both "materially impacts their respective cost of capital" and "affects them differently than the overall financial markets" such that the revenue requirement reductions that would otherwise occur under the CCM would be scuttled in favor of earlier-than-expected consideration of ROE increases sought by the utilities. TURN's initial high-level review suggests this will be a complex, evidence-driven determination, requiring the Commission to address a number of factors such as attempting to differentiate the impact that the COVID-19 pandemic has had on California's regulated utilities from the general impacts the pandemic has had on the economy. Furthermore, and perhaps more controversial, is the differentiation of the impact of the COVID-19 pandemic from the host of other factors that likely impact a regulated utility's cost of capital at any given time. Once TURN has this proceeding fully staffed and can more closely review the utilities' showings on this point, we expect discovery and further analysis will identify more specific issues associated with those showings.

As a policy matter, the Commission will also need to consider whether it wishes to permit the utilities to rely on the COVID-19 pandemic to serve as the reason for

suspending a ratemaking mechanism that would otherwise deliver to utility customers meaningful revenue requirement decreases in 2022. To date, the Commission has recognized the adverse impacts the pandemic has had and continues to have on California households and the economy at large, and has taken numerous actions to mitigate at least some of those impacts. These efforts are consistent with the shared sacrifice and hardship that all elements of society are called upon to bear during such an unexpected and extraordinary event. With these applications, SCE, SDG&E and PG&E demonstrate a collective belief that the regulated utilities should be spared any direct sacrifice or hardship, and instead be provided even higher revenues as an offset to what they purport to be specific pandemic-caused impacts. TURN submits that the Commission response most consistent with its pandemic-related efforts to date would be to reject the utilities' positions out of hand, and instead permit the expected revenue requirement reduction under the CCM to take effect.

B. If the Commission Chooses to Consider The Utilities' Proposals for a New 2022 Cost of Capital, Are The Proposals Reasonable?

If the Commission determines that the conditions underlying the utilities' applications meet the "material impact" and "affects the utilities differently" criteria identified in D.08-05-035, it will effectively initiate a Cost of Capital proceeding similar to those conducted in the past. The Commission should reasonably expect that there will be widely varying views of how the current and forecasted conditions should impact the authorized Return on Equity, cost of Long-Term Debt, capital structure, and the host of other issues that are typically disputed in such a proceeding. In addition, there will be novel issues such as PG&E's proposal for a 159 basis point premium to the three-month commercial paper rate applicable to its balancing and memorandum accounts, which raises

questions regarding the merits of the proposal, and whether it should be treated as a cost with sufficient nexus to PG&E's most recent voluntary bankruptcy and therefore not recovered from customers.

C. The Commission Needs To Know What It Is Being Asked To Give Up, And Should Direct Each Utility To Supplement Its Showing With A Calculation of the Revenue Requirement Reductions That Would Occur Under the *Status Quo*.

Each utility's application clearly anticipates that the Cost of Capital Mechanism would produce a reduced revenue requirement for 2022. As noted earlier, TURN's initial review of the applications did not find a calculation of the amount of the estimated reduction from any of the utilities. TURN is reasonably confident that its rough estimates for SCE and PG&E presented in the preceding section are sufficiently accurate for at least discussion purposes. However, it would be helpful to have the utility-calculated figures available early in the process in order to ensure all parties have a common understanding of the full amount at stake under the utilities' proposals. Therefore, the utilities should each be directed to either identify where its application or accompanying prepared testimony presents the calculation of the 2022 revenue requirement reduction that would occur under the CCM, or supplement its showing with that calculation as soon as practicable.

D. The Applications Reflect A Level of Coordination Among The Utilities That The Commission May Find Concerning.

The present applications reflect a level of cooperation and coordination among SCE, SDG&E and PG&E that may merit further inquiry from the Commission. After all, the three utilities each filed an application seeking relief from the CCM with arguments that are substantially similar, and presented those applications on the same day. There was

no Commission order or ruling directing or compelling these applications; instead, they reflect a joint determination that each utility would exercise its discretion to seek the same relief in the same manner at the same time.

TURN understands that different standards for anti-competitive behavior apply to regulated monopolies such as California's major energy utilities. Still, there must be some limit to activities of this sort, particularly where the activities give every appearance of the three companies jointly developing and deploying a strategy to avoid a reduction in authorized revenues for 2022 and instead seek an increase to the ROE that would be in effect for a three-year period. As a first step, the Commission should direct each utility to present supplemental testimony explaining and justifying its reliance on this clearly-coordinated process that resulted in simultaneous applications seeking largely similar (if not identical) relief.

IV. Procedural Approach, Schedule, and Need for Evidentiary Hearings

The Commission should adopt a phased approach to this proceeding. Such an approach is consistent with the nature of the questions presented by the utilities' applications. The initial issue the Commission must address is whether the utilities have adequately demonstrated that the current conditions meet the two-prong standard set forth in D.08-05-035: (1) has COVID-19 materially impacted each utility's cost of capital and, if so, (2) has it affected the utility differently than the overall financial market? TURN proposes that the first phase of the proceeding be devoted to answering these questions and making any other determinations necessary to deciding whether the CCM should remain in force through the end of 2022, or be terminated or suspended for the 2020-2022 COC cycle, as the utilities request. Should the Commission determine that the CCM should

remain in force, there would be no need for further action in the proceeding, and any changes required due to the operation of the CCM would go into effect as of January 1, 2022.

The second phase of the proceeding would only be necessary if the Commission agrees with the utilities that the current economic conditions satisfy the two-prong standard of D.08-05-035, and therefore the new applications should be considered on their merits. The follow-on phase would be akin to cost of capital proceedings of the past, with consideration of the range of issues relevant to setting an appropriate ROE, Long-Term Debt cost, capital structure, and other elements of each utility's cost of capital.

This phased approach would have the benefit of reducing to a more manageable level the near-term burden these utility applications will impose on intervenors and the Commission. Until the utilities filed these applications, other interested parties and the Commission itself could reasonably expect to see cost of capital applications arrive as scheduled in April of 2022, and could plan accordingly. In August of this year, TURN already had fully committed its staff and external resources to coverage of existing and known upcoming proceedings through the end of 2021. As an experienced participant in Commission proceedings, TURN fully understands that circumstances can and will change unexpectedly and in ways that require a realignment of resources and priorities. However, here the utilities seek to effectively accelerate by eight months a major proceeding, <u>and</u> to broaden the scope of issues to include determination of whether the D.08-05-035 requirements are met, an approach that would cause unreasonable strain on TURN and likely on other similarly-situated parties as well. If the Commission is going to consider the utilities' extraordinary request, it should do so in a manner consistent with balancing

the interests of all parties involved in that process, including intervenors and the agency itself. TURN's phasing proposal is a reasonable and more balanced approach.

TURN does not have a fully-developed Phase 1 schedule to propose at this time. TURN would, at a minimum, need to consult with other similarly-situated intervenors for this purpose, and expects to have an opportunity to do so during the period between service of protests or responses and the prehearing conference. TURN anticipates that intervenor testimony limited to the Phase 1 issues would likely need to be scheduled for no earlier than December 2021, in order to provide sufficient time for the non-utility parties to obtain the services of outside consultants if necessary, and to engage in discovery and prepare testimony on the novel issues regarding the COVID pandemic and its purported impact on the California utilities' cost of capital. In addition, TURN expects evidentiary hearings will be required on disputed factual issues regarding Phase 1 issues.

Should there be a Phase 2 under TURN's proposed approach, the Commission should reasonably expect that evidentiary hearings will be needed, as was the case with past Cost of Capital proceedings.

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Respectfully submitted,

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