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09/30/24
04:59 PM
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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Authority to Establish Its Authorized Cost of Capital for Utility Operations for 2023 and to Reset the Cost of Capital Adjustment Mechanism. (U39M.)	Application 22-04-008
And Related Matters.	Application 22-04-009 Application 22-04-011 Application 22-04-012

SOUTHERN CALIFORNIA EDISON COMPANY (U 338 E), PACIFIC GAS AND ELECTRIC COMPANY (U 39 M), SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M), AND SOUTHERN CALIFORNIA GAS COMPANY (U 904 G) OPENING COMMENTS ON PHASE 2 PROPOSED DECISION

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Dated: **September 30, 2024**

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SUBJECT INDEX OF RECOMMENDED CHANGES

Pursuant to Rule 14.3(b) of the California Public Utilities Commission's ("CPUC" or "Commission") Rules of Practice and Procedure, Southern California Edison Company ("SCE") Pacific Gas And Electric Company ("PG&E"), San Diego Gas & Electric Company ("SDG&E"), and Southern California Gas Company ("SoCalGas") (collectively, the "Utilities") provide the following Subject Index of Recommended Changes in support of their Comments on the Proposed Decision.

1) The Utilities recommend that the Costs of Capital (including Returns on Equity (ROEs), costs of debt and preferred equity) for the Utilities not be modified in this Phase 2 Decision because adjustment of the ROE was not an identified issue in Phase 2.
2) The Utilities recommend that the PD be adjusted to maintain the Cost of Capital Mechanism (the "CCM") equity adjustment ratio at 50 percent of the interest rate change above the 100-basis point threshold. The PD errs in comparing inter cycle Return on Equity changes to changes that are required because the conditions for a trigger of the CCM have been met.
3) PG&E recommends that the PD be revised to accept PG&E's Yield Spread Adjustment proposal.

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Pursuant to Rule 14.3 of the Rules of Practice and Procedure of the California Public Utilities Commission ("Commission") and the September 10, 2024, Administrative Law Judge's proposed decision ("PD"), Southern California Edison Company ("SCE"), Pacific Gas and Electric Company ("PG&E"), San Diego Gas & Electric Company ("SDG&E"), and Southern California Gas Company ("SoCalGas") (collectively, the "Utilities"), hereby submit the following comments.[1]

In brief, the PD commits legal and factual error in a number of respects, most notably the imposition of new costs of capital for the Utilities for 2025. By taking that step, the PD has introduced uncertainty and instability, which has concerned investors and makes it incrementally more difficult to raise capital. Throughout this proceeding, it has been well understood that investors value regulatory stability, which is also good for customers. Unfortunately, by taking an unexpected step outside the scope of the proceeding and the record, the PD is harming customers and the Utilities alike.

[1] Pursuant to Commission Rule 1.8(d), counsel for SCE, SDG&E and SoGalGas have authorized PG&E to submit this document on their behalf. The Utilities jointly sponsor the entirety of these comments, except for Section IV on the Yield Spread Adjustment (YSA), which is solely sponsored by PG&E.

I.

SUMMARY

The PD commits legal error by setting newly authorized costs of capital for the Utilities for 2025. Although the Phase 2 Scoping Ruling permitted the consideration of “modifications to the cost of capital mechanism,” that does not allow the further step of setting newly authorized costs of capital for 2025 without that newly adjusted cost of capital (“CCM”) triggering. Instead, the PD goes beyond prospectively changing the CCM by retroactively applying the new ROE adjustment ratio of 20 percent for 2025 to the 2023 CCM triggering event. And the PD goes even further, setting new costs of capital for 2025 by having the Utilities update their costs of debt and preferred equity ratios.

The PD has no authority to do so because setting a new cost of capital for 2025 was not within the scope of Phase 2 and is prejudicial to the Utilities. The only justification for a change such as this would require retroactively modifying the CCM based on the 2023 triggering event, which is impermissible. Because ROE modifications were not identified to be in the scope of Phase 2, the Commission cannot modify the cost of capital for the Utilities at this time. Moreover, the PD engages in impermissible retroactive ratemaking by reaching back to revise the rate effects of a Commission resolution approving October 2023 Advice Letters following the Utilities’ ROEs triggering upwards.

The Utilities further request that the PD be modified to retain the CCM with a 50 percent adjustment ratio. The PD’s change to a 20 percent adjustment ratio ignores the economic conditions under which a trigger occurs and the actual changes to a utility’s Cost of Capital when interest rates either go up or down significantly. The PD’s assertion that a 28-basis point change reflects the largest change in ROE is insufficiently based upon a narrow timeframe during a period of interest rate stability. The 50 percent adjustment remains empirically sound based upon academic and practical evidence. Ironically, by instituting an immediate 40-basis point reduction in 2025, the PD is contradicting its objective of avoiding significant fluctuations in ROE without the context of a comprehensive Cost of Capital review. Considering the PD's own stance that a fully adjudicated proceeding would likely result

in an ROE change of less than 25 basis points, it does not follow why a 40-basis point reduction is appropriate here.

Finally, PG&E recommends that its proposed modifications to its Yield Spread Adjustment be accepted for the reasons discussed below.

II.

THE PROPOSED DECISION COMMITS LEGAL ERROR BY IMPROPERLY CHANGING THE UTILITIES' COST OF CAPITAL FOR 2025

The PD adopts new ROEs for 2025 for each of the Utilities and further directs the Utilities to update their cost of debt and preferred equity for 2025.[2] In so doing, the PD commits legal error by improperly setting new costs of capital for the Utilities for 2025 outside the scope of this proceeding. The Phase 2 Scoping Ruling permitting the consideration of modifications to the cost of capital mechanism did not put the Utilities on notice that any such changes would be applied to that mechanism retroactively to a 2023 trigger event (effective January 1, 2024) to then set new ROEs for 2025 without a CCM trigger.[3] Nor does it provide any justification for the PD setting entirely new costs of capital for 2025 by also having the Utilities update their costs of debt and preferred equity ratios. The PD – by setting new costs of capitals for 2025 without any notice in the Phase 2 Scoping Ruling – is in error and must be revised.

The only justification under the Scoping Ruling for setting new cost of capitals for 2025 would be by improperly, and retroactively, applying a new CCM modification being adopted for the first time in the PD to the CCM triggering event that applied for 2024. To correct these legal errors, the PD should be revised to remove all language changing the Utilities' cost of capital for 2025.

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[2] PD, p. 35, Ordering Paragraphs ("OP")3, and 4.

[3] Administrative Law Judge's Ruling Outlining Phase 2 Issues and Schedule (Oct. 31, 2023) ("Phase 2 Scoping Ruling").

A. Setting a New Cost of Capital for 2025 Was Not in Scope for Phase 2

The PD adopts new ROEs for the Utilities and directs them to update their cost of debt and preferred equity for 2025. In effect, the PD is setting new authorized costs of capital for 2025. There can be no dispute that setting new costs of capital for 2025 was not in scope for Phase 2 of this proceeding, absent a CCM trigger or new application. It was not mentioned in the Phase 2 Scoping Ruling, and no testimony was submitted in Phase 2 regarding the Utilities' cost of debt or preferred equity, let alone technical ROE analysis. Simply put, there is no Phase 2 record evidence that supports the ROEs set forth in Ordering Paragraph 3 of the PD.

Because setting a new cost of capital for 2025 was not a scoped issue for Phase 2, the PD runs afoul of Commission rules and California Supreme Court authority, to the prejudice of the Utilities. The requirements for a formal scoping ruling identifying the issues to be decided are intended to give fair notice to parties to substantively participate and be heard on a matter.[4] It bears emphasizing that if this issue had been within the scope of Phase 2, the Utilities certainly would have put forth testimony and briefing on this very issue and there can be no question that the Utilities are prejudiced by the Commission's decision on this out-of-scope issue. In this regard, the California Supreme Court has made plain that the Commission commits legal and prejudicial error by deciding issues outside the stated scope of the proceeding. For example, in *Golden State Water Co. v. Public Utilities Commission*, the California Supreme Court found that the Commission improperly eliminated the mechanism for water utilities to decouple the amount of water sold from revenues because the issue was not adequately identified as a scoped issue in the proceeding:

> The issue before us does not concern the merits of this decision, but the process that led up to it. The question is whether the Commission gave adequate notice that the elimination of the decoupling mechanism was one of the issues to be considered in the proceeding. We conclude that the

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[4] Public Utilities Code section 1701.1(b)(1) mandates that the "assigned commissioner shall schedule a prehearing conference and shall prepare and issue by order or ruling a scoping memo that describes the issues to be considered…" Pub. Util. Code § 1701.1(b)(1). Rule 7.3 of the Commission's Rules of Practice and Procedure, in turn provides, "The assigned Commissioner shall issue the scoping memo for the proceeding, which shall determine the schedule (with projected submission date) and issues to be addressed."

answer is no. We further conclude that the Commission's failure to give adequate notice requires us to set the order aside.[5]

Here, application of California statutory and case law would compel a similar result for the portion of the PD setting a new cost of capital for 2025: the new costs of capital for 2025 should be set aside.

The PD attempts to justify adoption of new ROEs for 2025 with a finding that "[m]odifications to the CCM for this cycle are within scope of this proceeding."[6] But the PD's adoption of new ROEs for 2025 goes beyond "modifications to the CCM." This is because the PD applies the newly modified CCM adjustment to the 2023 triggering event, in the absence of a triggering event in 2024 for 2025.[7] The inclusion of "modifications to the CCM" as a scoped issue did not put the Utilities on notice that a newly-adopted CCM modification could be retroactively applied to the 2023 CCM triggering event and thus would change ROEs for 2025.[8]

Even if D.22-12-031 and the Phase 2 Scoping Ruling allows the Commission to modify the CCM for this cost of capital cycle,[9] it does not justify the PD taking the *additional step* of setting a new

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5 *Golden State Water Co v Public Utilities Commission*, (2024) 16 Cal.5th 380, 382. *See also Southern California Edison Co. v. Pub. Utilities Com.,* (2006) 140 Cal. App. 4th 1085, 1105 (annulling a Commission decision where it addressed an issue that was not previously encompassed within the issues to be considered in the proceeding set forth in the scoping memo).

6 PD, p. 33, Finding of Fact 15.

7 The fact that the PD directs the Utilities to update their cost of debt and preferred equity for 2025 (PD, p. 35, OP 4) when the PD does not modify that aspect of the CCM shows that the PD goes beyond "modifications to the CCM."

8 There are additional, practical obstacles to the PD's direction. Ordering Paragraph 4 requires the Utilities to "[w]ithin 30 days of this decision...submit a Tier 2 Advice Letter to reflect the Cost of Capital Mechanism adjustment ratio modification from 50% to 20%, with an effective date of January 1, 2025." For the Utilities, it takes approximately two to four weeks to conduct the necessary testing and system updates to implement a rate change. Accordingly, although the Utilities could submit an advice letter within 30 days of the decision, the Utilities may not be able to reflect these changes in rates as part of their January 1, 2025 consolidated revenue requirement and rate change process.

9 Notably, the Scoping Ruling does not say *when* a modification to the CCM would become effective. The PD justifies changes to the CCM effective January 1, 2025 by quoting ordering paragraph 6 of D.22-12-031 that the CCM shall continue to be in effect through the 2023 Cost of Capital cycle …"unless modified by a subsequent Commission decision." PD at 14 (citing D.22-12-031, p. 54, OP 6). Yet that Decision's equally controlling conclusion of law 24 found that the "CCM should be extended through the 2023 Test Year Cost of Capital Cycle." D.22-12-031, p. 52, Conclusion of Law 24.

cost of capital for the Utilities for 2025. As noted, the only change the PD made to the CCM was to change the CCM's ROE adjustment ratio from 50 percent to 20 percent.[10] As the PD thus finds, it remains the case under D.22-12-031 that there are only "two methods" for the Utilities to adjust their authorized cost of capital in between triannual cost of capital applications:

- A CCM triggering "if there is a difference of 100 basis points between the trailing 12-month October through September average Moody's utility bond index rates and the Utilities' respective benchmarks;" or
- A Utility off-cycle cost of capital application "if an extraordinary or catastrophic event materially impacts the Utilities' respective cost of capital and/or capital structure and affects them differently than the overall markets."[11]

Neither occurred here. The CCM has not triggered – nor could it yet – for 2025. Nor has a Utility brought an off-cycle application. Nowhere does D.22-12-031 provide for the Commission changing the Utilities' cost of capital in this Phase 2 proceeding outside those two pathways.

Yet the PD does exactly that, as it "adopt[s]" new 2025 ROEs for the Utilities.[12] And the PD goes even further. The PD sets entirely new costs of capitals for 2025 by having the Utilities update their cost of debt and preferred equity for 2025.[13] That is, the PD is not just setting new ROE for 2025 based upon applying its modification to the CCM adjustment to the CCM trigger that occurred in 2023. The PD is setting entirely new costs of capital by changing all components – ROE, cost of debt, and preferred equity – for the upcoming year. Nowhere did the Scoping Memo indicate that the Commission would set new costs of capitals for 2025 in the Phase 2 of this proceeding.

To the contrary, in approving the Utilities' advice letters (AL) implementing the adjusted ROEs resulting from the 2023 CCM trigger, first the Energy Division and then the Commission itself affirmed

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[10] PD, p. 34, COL 4.

[11] PD, pp. 17-18.

[12] PD, p. 28.

[13] PD p. 29, 35 at OP 4.

that the CCM as adopted in D.22-12-031 applied to the 2023 triggering event.[14] In so doing, the Energy Division rejected the joint protest to the advice letters that specifically requested suspension of the rate adjustments for 2024 and 2025 resulting from the 2023 triggering event on the ground that modifications to the CCM were at issue in Phase 2 of this proceeding,[15] concluding that the relief requested "is not pending before the Commission in a formal proceeding."[16] The Energy Division's determination was subsequently affirmed by the Commission itself in Resolution E-5306[17]—confirming that retroactively amending the CCM that applied to the 2023 triggering event to change the Utilities' previously adjusted ROEs was not in scope for Phase 2. By disregarding the scoping of issues and the Commission's past determinations on this issue, the PD has created legal error.

B. Retroactive Application of a New CCM Modification Was Neither Noticed Nor in Scope for Phase 2 and Constitutes Impermissible Retroactive Ratemaking

In addition, the PD goes beyond prospective modification of the CCM (which was the scoped issue), by effectively retroactively applying the new ROE adjustment ratio to the CCM triggering event that occurred in 2023 and recalculating the previously adjusted ROEs.

The PD thus runs afoul of retroactive ratemaking. The prohibition against retroactive ratemaking rests upon the principle that ratemaking is "legislative in character and looks to the future" and is thus

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[14] Energy Division disposition letter on ALs 4813-G/7046-E; 5120-E; 4300-E/3239-G; 6207-G, (Dec. 22, 2023) (Energy Division Disposition), Attachment 1, p. 8, available at: <https://www.pge.com/tariffs/assets/pdf/adviceletter/GAS_4813-G.pdf> (accessed Sept. 27, 2024); Resolution E-5306 (issued July 16, 2024).

[15] Energy Division Disposition, Attachment 1, pp. 4-5.

[16] *Id.,* p. 9. In addressing this argument, the Energy Division commented that the Phase 2 scoping ruling "only identifies 'Modifications to the Cost of Capital Mechanism' as an issue to be resolved in the proceeding while citing back to language in D.22-12-031." *Id.* The Energy Division Disposition, and subsequent Commission resolution, further noted that parties protesting the Utilities' advice letters had in fact supported continuation of the CCM for the 2023 COC cycle in Phase 1. *See* Energy Division Disposition, Attachment 1, at 8 ("D.22-12-031 notes that parties to the proceeding, some of whom are now members of the Joint Protestants, 'generally supported the continuation of the cost of capital mechanism as a buffer against market volatility.'"); Resolution E-5306, p. 11 (noting that parties such as EPUC, IS, and TURN "voiced support for continuing the CCM").

[17] Resolution E-5306, p. 12.

fundamentally prospective.[18] As a result, the Commission precedent dictates that rate adjustments must be prospective and forward-looking.[19] The PD could have, but does not, limit application of the new CCM adjustment ratio to prospective application based on operation of the mechanism after January 1, 2025. Instead, the PD retroactively applies the new CCM adjustment ratio to triggering events that occurred in the past and have been implemented in rates.

Thus, the PD improperly revises the CCM adjustments to the ROE resulting from the 2023 triggering event, despite the Commission previously affirming that CCM trigger as properly implemented in rates for 2024 and mandated by D.22-12-031.[20] Tellingly, the party that put forward the CCM modification adopted in the PD—Cal Advocates—did not suggest that its proposed change to the mechanism would result in a change to the cost of capital for 2025 in the absence of another CCM trigger. Rather, Cal Advocates' testimony stated that its modification was intended to moderate "*future* equity related changes" relative to the operation of the CCM, i.e., to apply prospectively to future triggers of the CCM.[21] Thus, neither Cal Advocates nor any other party presented testimony or suggested that the Utilities' ROEs should be recalculated for 2025 to reflect retroactive application of the modified mechanism to the CCM triggering event that occurred in 2023.[22]

As other jurisdictions have noted, retrospective alterations to a prior rate order's treatment of past events constitutes impermissible retroactive ratemaking. For example, in *Citizens Utilities Co. of Illinois v. Illinois Commerce Commission*, (1988) 124 Ill.2d 195, the Illinois Supreme Court rejected the

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[18] *See Pacific Telephone and Telegraph Co. v. Public Utilities Com.*, (1965) 62 Cal.2d 634, 650; *see also* Pub. Util. Code § 728 (stating that the Commission "shall determine and fix, by order, the just, reasonable, or sufficient rates…to be thereafter observed and in force.").

[19] *See, e.g.*, D.92-03-094 (Mar. 31, 1992) at 6 ("It is a well established tenet of the Commission that ratemaking is done on a prospective basis…This practice is consistent with the rule against retroactive ratemaking."); D.08-02-036 (Feb. 28, 2008) at 44 (same).

[20] *See* Energy Division Disposition; Resolution E-5306.

[21] CA-02, p. 1 ("The reduction in the equity adjustment would serve to dampen *future* equity related changes relative to the current CCM.") (emphasis added).

[22] While certain parties argued that CCM modifications should become effective in 2025, and EPUC/IS continued to argue the CCM should be suspended for the 2023 COC cycle in spite of D.22-12-031, no party presented testimony proposing that the adjusted ROEs resulting from the 2023 CCM triggering event should be re-calculated for 2025 to reflect proposed CCM modifications.

Commerce Commission's proposal to reduce Citizens' rate base with solely prospective effect based on past tax benefits that had resulted in a long-running discrepancy between paid taxes and tax expense used for ratemaking purposes.[23] The Illinois Supreme Court held that the Commission's proposed action was impermissible retroactive ratemaking because it rested upon the Commission's decision to now treat differently past events that had a valid preceding ratemaking treatment.[24] The Illinois Supreme Court noted that this is especially problematic where the Commission has issued past rate orders with full information and absent any misconduct or lack of disclosure by affected utilities.[25] Here, as in that case, the Commission seeks to make a retroactive adjustment to a past event and its resulting rate impact in order to implement a new rate treatment based on that same event.

Seemingly in recognition of the retroactive ratemaking problem implicated by the PD's backward-looking approach, the PD does not purport to make any change with respect to 2024.[26] Limiting the impact of the PD to 2025 rates, however, does not solve the problem because there is no legal or factual basis to set new rates for 2025 other than the PD's retroactive application of the new CCM modification to events that occurred in the past.[27] Prospective application of a change does not immunize a fundamentally retrospective action from the prohibition on retroactive ratemaking.[28] By

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[23] 124 Ill.2d at 200-02.

[24] *Id.* at 210-11 ("Just as there is no recovery of reparations for rates charged under a Commission order later held to be invalid, there can be no retroactive adjustment in this case simply because the Commission has now decided to treat the tax benefits differently."); *see also* Illinois Commerce Commission Dkt. Nos. 83-0537 & 84-0555, 1989 WL 1647085 (identifying the key retroactive ratemaking distinction from *Citizens Utilities Co.* to be that, in *Citizens Utilities Co.*, "the Commission was attempting to correct an error made in a past rate order.").

[25] *Citizens United Co.*, *supra*, 124 Ill.2d at 213 ("There has been no suggestion, however, that Citizens obscured the true bases of the earlier ratemaking decisions, or otherwise misled the Commission in making those determinations.").

[26] Alternatively, the PD relies on a fiction that the CCM is triggering in 2024 such that it would support the adoption of a new cost of capital for 2025, which has no support in the evidentiary record.

[27] *See, e.g.*, *Citizens United Co.*, *supra*, 124 Ill.2d at 214 ("The Commission's order here will not be saved simply because a more thoroughgoing violation of the rule against retroactive ratemaking is imaginable.").

[28] Illinois Commerce Commission Dkt. No. 89-0120, 1990 WL 10554476 (rejecting the argument that no retroactive ratemaking was implicated where the change was "instituted currently and implemented prospectively" because "it is the arbitrary deferral and amortization which violates the prohibition"); *id.* ("The fact remains that Staff's proposed deferral and amortization is an attempt to revisit a past event for the

Continued on the next page

applying its modified adjustment ratio to rates *already adjusted* by the CCM effective January 1, 2024, the PD alters the already approved basis for the Utilities' current rates in violation of the retroactive ratemaking doctrine.[29]

In the absence of a new CCM trigger, the Commission must reject the PD's change to the Utilities' cost of capital for 2025. In sum, the most that the Commission could do in this Phase 2 proceeding under the scoping ruling is alter the CCM that applies as of January 1, 2025. But without a new CCM trigger (or a Utility off-cycle application) the Commission lacks any legal basis to change the Utilities' cost of capital for 2025. The PD cannot avoid the notice and retroactive ratemaking problems by applying the new adjustments to the 2023 triggering event without a legal basis to set new cost of capitals for 2025.

III.

THE CCM ADJUSTMENT SHOULD BE RETAINED AT 50 PERCENT

A. The 20 Percent Adjustment is Arbitrary and Unsupported

The PD's alteration of the CCM's equity adjustment ratio from 50 percent to 20 percent is unsupported by the record evidence and should be rejected. The PD primarily approves the move to 20 percent because it would "moderate the ROE adjustments" under the mechanism. The PD further asserts that a 20 percent adjustment is less likely to be controversial than a 50 percent adjustment.[30]

But the PD does not offer a compelling or reasoned basis to adopt an arbitrary change to the CCM's adjustment ratio. The 50 percent adjustment ratio is the most commonly used adjustment factor

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purpose of influencing forward-looking rates when no relationship exists between the past event and the future operation of the utility.").

[29] *See, e.g.*, *The Ponderosa Tel. Co. v. Public Util. Com.*, (2011) 197 Cal.App.4th 48, 63-64 (rejecting "rollback of general rates already approved by the Commission" as "precisely the type of action prohibited by the retroactive ratemaking doctrine."); *Pacific Telephone and Telegraph Co. v. Public Util. Com.*, (1965) 62 Cal.2d 634, 650 (noting that "plain and unambiguous language" requires Commission rate determinations to be prospective.); *see also BullsEye Telecom, Inc. v. Public Util. Com.*, (2021) 66 Cal.App.5th 301, 332 n.32 (describing retroactive ratemaking as "improper adjustments to rates established in prior proceedings").

[30] PD, p. 24.

among regulators that rely on an adjustment mechanism in between full proceedings.[31] Moreover, the 50 percent adjustment ratio is supported by studies that have found that a 100-basis point change in the risk-free rate correlates to an approximately 50-basis point change in the average ROE.[32]

Instead, the PD relies only on the fact that a lower percentage would reduce the CCM's impact. Even if true, that assertion does not change the financial underpinnings that supported the 50 percent adjustment ratio when adopted. Nor does the PD have any evidence that its proposal will achieve the intended outcome of reducing controversy around the CCM.[33] The PD's proposal would therefore result in an arbitrary and unsupported adjustment ratio and should not be adopted.

B. The PDs Reference to Average Changes In-Between Cost of Capital Cycles is Misplaced

The PD indicates that authorized ROEs for electric and gas utilities seldom change by even 28 basis points over a three-year period compared to the 50 bps minimum change pursuant to the CCM.[34] However, comparing this data point to what happens when the CCM triggers is inapt. Evaluating year-over-year changes to allowed ROEs is misleading because it does not evaluate the historic relationship between ROE and bond yields.

From 2010 to 2022, the yield on Baa utility bonds fell gradually from 5.96 percent in 2010 to 3.36 percent in 2021.[35] The year-over-year change in Baa utility bond yields ranged from -80 bps (2019 to 2020) to 29 bps (2017 to 2018). In 2022, by contrast, bond yields increased substantially by 168 bps to 5.04 percent.[36] Unlike the relatively stable interest rate environment from 2010 to 2021, in recent years there has been a steep increase in interest rates to fight inflation, which has impacted the Utilities'

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[31] JIOU-02, p. 9, line 6 to p. 11, line 20.

[32] *See* IOU-02, p. 8, line 17 to p. 9, line 3, fns. 28 and 29 (citing a 2006 study by Dr. Roger A. Morin that found that the risk premium decreases by 52 basis points when the risk-free rate increases by 100 basis points, resulting in a change in the average ROE of 48 basis points, and a 2021 study by Dr. Morin showing that the risk premium changes by approximately 46 percent of the change in interest rates).

[33] PD, p. 24.

[34] PD, p. 26.

[35] JIOU-02, p. 6, lines 5-7.

[36] *Id.*, lines 7-9.

Costs of Capital. References to the comparative stability of ROEs during that period are thus irrelevant at best and ignore the fundamental reasons that the CCM is in place—to change ROEs when there has been a substantial change in the market in between cost of capital cycles.

C. A 50 Percent Adjustment Factor Most Accurately Reflects the Change in Cost of Capital

Using a 50 percent adjustment ratio from the change in the utility bond rating most accurately reflects a utility's actual cost of capital. This approach aligns with the statistical analyses indicating that the authorized ROE changes by approximately half of the change in bond yields, as observed in historical data. The 50 percent adjustment is consistent with regulatory practices and has proven to effectively balance the need for accurate cost of capital estimations.[37]

Moreover, this ratio has been a long-standing practice endorsed by both the CPUC and other regulatory jurisdictions, ensuring that the cost of equity remains fair and reflective of market conditions. Changing to a 20 percent adjustment mechanism would inadequately reflect the true Cost of Capital and would result in either overcompensating the utility (and overcharging the customer) upon a reduction or giving a utility an authorized ROE that is below its actual Cost of Capital upon an upward trigger. Nor does the PD have any evidence for its contention that a 20 percent adjustment will be less controversial or reduce regulatory burden.

IV.

PG&E'S YIELD SPREAD ADJUSTMENT PROPOSAL SHOULD BE GRANTED [*SPONSORED BY PG&E ONLY*]

Despite rightly concluding that PG&E currently lacks access to Commercial Paper and thus is not able to recover actual short-term financing costs, the PD wrongly concludes that it is fair to only compensate PG&E at the Commercial Paper rate for costs carried in balancing and memorandum accounts. The PD also rightly notes two prior instances where utilities were granted relief similar to the

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[37] JIOU-2, p. 7.

YSA relief sought here, but then denies PG&E such relief. This inconsistent logic and treatment constitute factual and legal error.

The PD defends its denial of PG&E's YSA proposal by viewing the issue "holistically"[38] The PD explains it has considered the YSA request "in light of [i] EPUC/IS' analysis, [ii] PG&E's financial condition, and [iii] PG&E's capital structure under the capital structure waiver approved in 'D.20-05-053[.]'"[39] The first and third of these factors both relate to PG&E's capital structure waiver. Below, PG&E first addresses PG&E's financial condition and then addresses capital structure.

A. PG&E's Financial Condition Supports the YSA.

No party contested the fact that PG&E is not able to recover its true short-term cost of debt and the PD correctly concludes that PG&E cannot access debt at the Commercial Paper rate.[40] Thus, it is undisputed that PG&E is suffering financial harm in carrying costs in our memorandum accounts, which only compensate PG&E at the Commercial Paper rate even though PG&E must incur higher cost short-term debt..

The record is clear that PG&E's revenue is accordingly too low to recover its undisputed costs. This is a violation of cost-of-service ratemaking. By denying PG&E the ability to recover undisputed costs, the PD effects a revenue requirement reduction that is inconsistent with law and principles of fairness. Accordingly, PG&E's financial condition warrants approval of the YSA, just like the Commission has done in the past for SDG&E and SCE.

B. Capital Structure is Not Related to the YSA Proposal and Thus Not a Basis to Reject the Proposal.

EPUC/IS' analysis wrongly claims that the YSA is unfair because customers are paying higher rates than necessary relative to PG&E's actual capital structure. As PG&E has consistently pointed out –

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[38] PD, p. 12.

[39] PD, p. 13.

[40] PD, pp. 9-10.

and the PD does not dispute – EPUC/IS' calculations have nothing to do with the cost of short-term debt. Utilities' regulated capital structures are based on *long-term* capital and do not relate to *short-term* borrowing costs.

EPUC/IS' argument boils down to this: because EPUC/IS argues that PG&E is over-collecting due to its capital structure waiver, EPUC/IS seeks to effect an under-collection here. By accepting this "holistic" way of thinking, the PD is not only false on the facts, but also flawed procedurally.

It is not correct to say that PG&E is over-collecting from customers due to the capital structure waiver. PG&E's waiver was granted by the Commission in D.20-05-053 without any adjustment to PG&E's revenue requirement and PG&E has been collecting the revenue PG&E is authorized to collect. The Commission should not deny legitimate collections in one docket for a misperceived over-collection from another docket on another issue. Unrelated issues should remain just that: unrelated. Should the Commission entertain such arguments as EPUC/IS makes here, the orderly conduct of proceedings will be jeopardized. Litigation of unrelated issues could become fair game and the due process protections associated with scoping and notice will be at risk.

To prevent these unfortunate outcomes -- and consistent with precedent and cost-of-service ratemaking -- PG&E's YSA proposal should be adopted.

V.
CONCLUSION

The PD recognizes the Commission's obligation under *Hope* and *Bluefield* to "set the return on equity (ROE) at a level of return commensurate with market returns on investments having corresponding risks and adequate to enable a utility to attract investors to finance the replacement and expansion of a utility's facilities to fulfill its public utility service obligation."[41] Yet the PD improperly sets new authorized cost of capitals for the Utilities for 2025 without any basis for doing so in the Scoping Ruling by retroactively applying a prospective change in the CCM to a CCM trigger that

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[41] PD, p. 30; D.22-12-031, p. 15.

occurred in 2023. That portion of the PD should be revised. Further, based on the evidence in the record, the CCM adjustment ratio should be maintained at 50 percent.

Respectfully submitted,

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September 30, 2024

Appendix A

Proposed Modifications to Findings of Fact, Conclusions of Law, and Ordering Paragraphs

Proposed Modifications to Findings, Conclusions of Law, and Ordering Paragraphs

Pursuant to Commission Rule 14.3(c), the Utilities' recommended revisions to the Proposed Decision's Findings of Fact and Conclusions of Law are set forth below. The Utilities have also provided recommended revisions to the Ordering Paragraphs.

Recommended additions are marked with double-underlining. Recommended deletions are marked with strike-through.

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Findings of Fact

6. Whether PG&E is sufficiently compensated through the 5-year capital structure waiver authorized in D.20-05-053 is not relevant to ~~cover its~~ short-term debt costs.

~~8. A 50-basis point modification in an electric or gas utility's authorized ROE results in a significant increase or decrease in the utility's revenue requirement.~~

~~9. The minimum ROE adjustment that may result from a triggered CCM is 50 basis points due to the 50% adjustment ratio and 100-basis point deadband set in D.08-05-035 for PG&E, SCE, and SDG&E and D.13-03-015 for SoCalGas.~~

~~10. Because the minimum ROE adjustment in the current design of the CCM, upon its triggering, is 50 basis points, the CCM being triggered is likely to be controversial in each instance.~~

~~11. There is a structural asymmetry in the implementation of the CCM that is biased towards shareholders at the expense of ratepayers.~~

~~12. A linear regression analysis of utility authorized ROEs against Baa utility bond rates shows that a 100-basis point change in Baa utility bond rates correlates with an approximate 21-basis point change in utility authorized ROE over the period 2009-2023.~~

~~13. An adjustment factor of less than 50%, and closer to 20%, is more empirically accurate regarding the relationship between Baa utility bond yields and utility authorized ROEs.~~

~~14. A 100 basis points change in utility bond yields correlates with a 20 basis points change in authorized ROEs.~~

15. Even if m~~M~~odifications to the CCM for this cycle are within scope of this proceeding, none are justified.

~~16. A CCM adjustment ratio of 20% would better align the CCM with the empirical evidence of the relationship between Baa utility bond rates and utility authorized ROEs.~~

Conclusions of Law

2. It is reasonable to approve ~~deny~~ PG&E's YSA request.

~~3. PG&E may request the YSA again in a future proceeding after the 5-year capital structure waiver expires, if it still lacks access to Commercial Paper.~~

4. The CCM adjustment ratio should not be modified from the current 50% to 20%.

5. The proposed modification of the CCM adjustment ratio from 50% to 20% should be denied. ~~effective January 1, 2025 and should be applied to the ROEs adopted in D.22-12-031.~~

6. ~~The Commission should adopt the following ROEs, effective January 1, 2025: (a) 10.28% for PG&E; (b) 10.33% for SCE; (c) 10.23% for SDG&E; and (d) 10.08% for SoCalGas.~~

O R D E R

IT IS ORDERED that:

2. Within 60 days of this decision, Pacific Gas and Electric Company (PG&E) shall file a Tier 1 Advice Letter to implement ~~eliminate~~ the Yield Spread Adjustment ~~Memorandum Account~~.

3. ~~The following 2025 Return on Equity (ROE) levels are approved, effective January 1, 2025: (a) Pacific Gas and Electric Company 10.28% ROE, (b) Southern California Edison Company 10.33% ROE, (c) San Diego Gas and Electric Company 10.23% ROE, and (d) Southern California Gas Company 10.08% ROE.~~

4. ~~Within 30 days of this decision, Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southern California Gas Company (together, Utilities) shall each submit a Tier 2 Advice Letter to reflect the Cost of Capital Mechanism adjustment ratio modification from 50% to 20%, with an effective date of January 1, 2025. Such Tier 2 Advice Letters shall include a table with updated 2025 rates of return and list the estimated 2025 revenue requirement impact of the change. The Utilities shall update the cost of debt and preferred equity for 2025, if applicable, in the Tier 2 Advice Letters.~~

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