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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 2026.

Application 25-03-010  
(Filed March 20, 2022)

And Related Matters.

A.25-03-011  
(March 20, 2025)  
A.25-03-012  
(March 20, 2025)  
A.25-03-013  
(March 20, 2025)

**THE PROTECT OUR COMMUNITIES FOUNDATION  
OPENING BRIEF**

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**THE PROTECT OUR COMMUNITIES FOUNDATION  
OPENING BRIEF**

Pursuant to the Scoping Memo issued in this proceeding, The Protect Our Communities Foundation (PCF) hereby timely<sup>1</sup> submits its opening brief.

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<sup>1</sup> A.25-03-010 et seq. Assigned Commissioner’s Ruling Consolidating Four Applications and Scoping Memo and Ruling (July 16, 2025), p. 4.

## I. INTRODUCTION

Although utility commissions throughout the nation have authorized returns on equity (ROEs) that far exceeded the cost of equity for decades,<sup>2</sup> public awareness of the detrimental impact of excessive ROEs on ratepayers has recently become palpable.<sup>3</sup> Across the United States, efforts are underway to course-correct and reign in the unjustifiably high profits experienced by utility company shareholders to the detriment of ratepayers.<sup>4</sup> Here in California, a bipartisan coalition of California Assemblymembers has urged the Commission to reject the Utilities' cost of capital applications,<sup>5</sup> and the Commission itself put the Utilities on notice that the shenanigans of the past would not be blindly accepted in this proceeding and in future cost of capital proceedings.<sup>6</sup>

Despite this, Pacific Gas & Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E), and Southern California Gas Company (SoCalGas) (collectively Utilities) propose that the Commission increase their ROEs even higher, thereby increasing their profits.

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<sup>2</sup> Kainoa Lowman, *Investor Payouts Are Driving Up Your Utility Bill: New evidence, and a roadmap for reform*, in our latest paper, American Economic Liberties Project (January 30, 2025), available at <https://economicpopulist.substack.com/p/investor-payouts-are-driving-up-your>.

<sup>3</sup> Mark Ellis, *I was a California energy strategist. Here's how the state lets PG&E give you a raw deal*, San Francisco Chronicle (February 20, 2025), available at <https://www.sfchronicle.com/opinion/openforum/article/pge-utility-bill-california-20175554.php>; Matt Stoller, *Power Moves: How Electric Utility Monopolists Broke Their Bargain with America Big* by Matt Stoller (February 8, 2025), available at <https://www.thebignewsletter.com/p/power-moves-how-electric-utility>;

<sup>4</sup> Blanca Begert, *The affordability issue California Democrats and Matt Gaetz's dad agree on*, Politico (April 14, 2025), available at <https://www.politico.com/newsletters/california-climate/2025/04/14/the-affordability-issue-california-democrats-and-matt-gaetz-s-dad-agree-on-00290404>.

<sup>5</sup> Letter from Assemblywoman Cottie Petrie-Norris et al. to CPUC President Alice Reynolds, Subject: Urge Rejection of Utility Cost of Capital Applications (March 25, 2025), available at <https://www.politico.com/f/?id=00000195-cfb3-d655-affd-dfb33bdb0000>.

<sup>6</sup> A.22-04-008, Video of October 17, 2024 Commission Meeting, Item 14 Public Agenda 3553 (Commissioner Houck: "...we have more to do as we examine cost of capital in future proceedings...") available at [https://www.adminmonitor.com/ca/cpuc/voting\\_meeting/20241017/](https://www.adminmonitor.com/ca/cpuc/voting_meeting/20241017/); D.24-10-008, p. 29.

SDG&E, SoCalGas, SCE, and PG&E seek authorized ROEs of 11.25%, 11%, 11.75%, and 11.30%, with SDG&E seeking an authorized capital structure with 54% common equity and SoCalGas, SCE, and PG&E seeking an authorized capital structure with 52% common equity. In doing so, however, the Utilities provide no analysis of the overall impact of their proposals on ratepayers and thus fail to provide the Commission with the fundamental information necessary for the Commission to lawfully determine the appropriate rates of return (RORs).<sup>7</sup>

The Utilities request ROEs that dramatically exceed the returns expected by investors, and make no attempt to optimize their capital structures. Authorizing the Utilities' proposed RORs and capital structures would provide windfall profits to utility company shareholders and executives at the expense of ratepayers, exacerbating the perverse incentives for the Utilities to focus on growing their rate bases through nonstop unnecessary capital expenditures instead of providing safe, reliable, and affordable utility service to which California ratepayers are entitled.

The Utilities argue that they should be awarded ROEs based on other utilities' authorized ROEs; instead of on the Utilities' actual costs of capital, which by definition equate to investors' market-based return expectations. The Utilities claim they should be awarded *higher* ROEs because of "above-average risk," claims refuted by their own representations to the investment community as well as representations made about them by their parent company. The Utilities' unfounded and disingenuous claims about their risk must be rejected because the Utilities fail to quantify their risk at all, much less demonstrate the impact of that purported risk on their proposed capital structure and ROEs, as they conceded during cross-examination.

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<sup>7</sup> Pub. Util. Code, §§ 451, 454, 747, 1757; *cf. Fed. Power Comm'n v. Hope Nat. Gas Co.* (1944) 320 U.S. 591, 612 (Federal Power Act provisions "plainly designed to protect the consumer interests against exploitation at the hands of private [utility] [] companies."); *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia* (1923) 262 U.S. 679, 690 (analysis requires "a proper consideration of all relevant facts"),

The Utilities' ROE proposals are based in part on financial models that do not measure the cost of capital at all. The Utilities' erroneous use of the Risk Premium Analysis (RPA) and the Expected Earnings Analysis (EEA) – financial models which are based on book value rather than the market value upon which investors' expectations are necessarily based – simply do not measure the return that investors, who must pay the market price, expect when purchasing utility stocks.

When utilizing the Discounted Cash Flow (DCF) model and the Capital Asset Pricing Model (CAPM), the Utilities incorporate unsound and economically implausible assumptions that invalidate their results. Most significantly, the Utilities' unsupportable, and economically impossible extrapolation in their DCF analysis of analysts' short term growth assumptions into perpetuity (and exceeding gross domestic product (GDP)) – assumptions used in both their proxy-group DCF and CAPM market-risk premium models – render their CAPM and DCF results entirely unsound and unusable.

The Utilities also fail to present any realistic picture of their actual operational needs, and their proposals fail to account for the fact that each year the Utilities have access to billions of dollars in cash provided by ratepayers, which ratepayers provide at zero-cost. The Utilities can and do use this cash on capital expenditures, and therefore lack any need to seek additional funds from debt or equity investors for these expenditures. The Commission should ensure that ratepayers receive credit for these funds as part of its evaluation of the evidence in this proceeding, and ensure that these uncredited funds do not continue to provide a slush fund provided by the Utilities to their parent companies for dividends and other uses.

The only evidence in this record that provides the Commission with the information it needs to make an informed decision about the appropriate returns on debt and equity and capital structure, and the resulting appropriate RORs, consists of the expert testimony of Mark E. Ellis, sponsored by PCF and Sierra Club. Only Mr. Ellis's testimony allows the Commission to understand the impact of its cost of capital decision on ratepayers. Only Mr. Ellis's testimony estimates the true cost of capital: the returns that investors expect in exchange for taking on the risk of providing capital. Only Mr. Ellis's testimony optimizes ROE and capital structure to the benefit of both ratepayers *and* shareholders. Adopting Mr. Ellis's recommendations will save PG&E ratepayers 15.9% -- \$3.3 billion annually, they will save SCE ratepayers 17.5% -- \$2.02 billion annually, they will save SoCalGas ratepayers 11.4% -- \$440 million annually, and they will save SDG&E ratepayers 11.9% -- \$330 million annually.

The Utilities utterly fail to meet their burden to support *any* increase to their authorized ROEs or their proposed capital structures. As detailed below, ROEs over and above investor's market-based expectations – the cost of capital – harms to ratepayers in myriad ways, including:

- the immediate costs of the excess ROE;
- the cost of the incremental taxes owed on that excess ROE;
- the additional costs of unnecessary investment incentivized by excess ROEs (which includes not only the cost of the investment but also the cost of capital on the investment and the associated taxes);
- the surplus shareholder profit from excess ROE on that unnecessary investment; and
- and the associated taxes on that surplus profit.<sup>8</sup>

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<sup>8</sup> SC/PCF-01 (Ellis), p. 23.

The Commission cannot, consistent with its statutory requirements to ensure just and reasonable charges and to minimize ratepayer costs, authorize rates of return for test year 2026 at the current levels, much less increase those levels as the Utilities propose. All the relevant evidence in the record requires a significant decrease to the Commission's current capital authorizations, as shown in Mr. Ellis's testimony and the other evidence submitted by PCF.

As set forth below, none of the Utilities present any evidence that RORs lower than they propose, or capital structures different than they propose, would be invalid from the investor or company perspective. But the Utilities' proposals, which are untethered to investors' market-based return expectations, remain demonstrably invalid from ratepayers' perspective.

**II. THE COMMISSION'S STATUTORY OBLIGATIONS TO PROHIBIT UNJUST, UNREASONABLE, AND UNJUSTIFIED CHARGES REQUIRES THE COMMISSION TO LIMIT AUTHORIZED RETURNS TO THE COST OF CAPITAL AND TO REDUCE RATES TO AS LOW AS POSSIBLE.**

The Commission's statutory mandates, constitutional limitations, and fundamental finance principles all require the Commission to consider ratepayers' interests, and to avoid the compounding costs to ratepayers that result from authorizing ROEs that exceed the Utilities' costs of capital in the market and their operational needs.

**A. The Commission's Statutory Mandates Require the Commission to Consider and Protect Ratepayers' Interests.**

The Commission remains statutorily obliged to prohibit every unjust or unreasonable charge by the Utilities.<sup>9</sup> Nor may the Commission change any practice or rule to result in a new rate without a showing that the new rate is justified.<sup>10</sup>

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<sup>9</sup> Pub. Util. Code, § 451.

<sup>10</sup> Pub. Util. Code, § 454.

The requisite justification necessitates consideration of consumer interests: the analysis cannot be limited to investor interests nor may it be divorced from the public interest or ratepayers' actual needs.<sup>11</sup>

The just and reasonable requirement precludes exploitation of consumers,<sup>12</sup> prevents the Commission from acting to protect utility holding (parent) company stock prices,<sup>13</sup> and prohibits the Commission from authorizing “profits such as are realized or anticipated in highly profitable enterprises or speculative ventures.”<sup>14</sup> When investor and customer interests diverge, the investor interest—*not the customer interest*—must yield so that the Commission may ensure that rates are affordable and provide “the lowest possible reasonable rate.”<sup>15</sup> In California, the just and reasonable requirement must be read to effectuate the Legislature’s explicit intent that the Commission “reduce rates for electricity and natural gas to the lowest amount possible.”<sup>16</sup>

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<sup>11</sup> *Fed. Power Comm'n v. Hope Nat. Gas Co.* (1944) 320 U.S. 591, 603; *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia* (1923) 262 U.S. 679, 693 (“The return should be reasonably sufficient to...enable [a utility] to raise the money **necessary for the proper discharge of its public duties.**”)(emphasis added); *City of Los Angeles v. Public Utilities Com.* (1975) 15 Cal.3d 680, 694-695 (“unjustified failure to deliberate constitutes error”); see e.g. D.19-12-056, p. 11 (“...it is the policy of the Commission for the authorization of an IOU’s capital structure to be in the public interest of the ratepayers of California.”); D.08-05-035, p. 8 (“...a provision should be included in the CCM for utilities to file a capital structure adjustment application that addresses ratepayer impacts within that time period.”); D.09-10-016, p. 5 (COL 3: “This decision should be effective today because it is in the interest of...ratepayers.”).

<sup>12</sup> *Fed. Power Comm'n v. Hope Nat. Gas Co.* (1944) 320 U.S. 591, 612.

<sup>13</sup> *Fed. Power Comm'n v. Hope Nat. Gas Co.* (1944) 320 U.S. 591, 601 (“The fixing of prices, like other applications of the police power, may reduce the value of property which is being regulated. But the fact that the value is reduced does not mean that the regulation is invalid.”); Pub. Util. Code, § 706 (“(a) For purposes of this section, “compensation” means any annual salary, bonus, benefits, or other consideration of any value, paid to an officer of an electrical corporation or gas corporation. (b) An electrical corporation or gas corporation shall not recover expenses for compensation from ratepayers. Compensation shall be paid solely by shareholders of the electrical corporation or gas corporation.”).

<sup>14</sup> *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia* (1923) 262 U.S. 679, 692-693.

<sup>15</sup> *Atl. Ref. Co. v. Fed. Power Com.* (1959) 360 U.S. 378, 388 (describing the statutory intent of the just and reasonable standard as ensuring the “lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest.”); *Pa. Water & Power Co. v. Fed. Power Com.* (1952) 343 U.S. 414, 418 & n.5 (stating that a “major purpose” of the just and reasonable standard is to “protect power consumers against excessive prices”).

<sup>16</sup> Pub. Util. Code, § 747.

**B. The Commission Must Consider All Relevant Facts and Use Sound Financial Logic to Ensure Authorized Rates of Return Do Not Exceed the Utilities’ Actual Costs of Capital in the Market.**

The Commission must “endeavor[] to set a utility's rate of return on equity at its cost of equity capital.”<sup>17</sup> By definition, “[t]he cost of capital is the minimum rate of return necessary to attract capital to an investment.”<sup>18</sup> In ascertaining the minimum rate of return necessary to attract capital to an investment, the Commission must proceed in the manner required by law which requires that the Commission engage in an analysis “having its basis in a proper consideration of all relevant facts.”<sup>19</sup> The Commission cannot disregard “facts and circumstances” without providing a “reasoned explanation.”<sup>20</sup> The very “notion of lawfulness requires insistence that the chosen framework not collapse in practice into a standardless exercise of Commission discretion resting on no more than an assertion of ‘expertise.’”<sup>21</sup>

The Commission’s analysis must be in “line with ‘general financial logic.’”<sup>22</sup> The Commission may not “ignore the basic financial principles that otherwise undergird its analysis — at least not without a compelling explanation” and “convincing evidence in support of its facially implausible economic assumptions.”<sup>23</sup> The Commission itself recognizes its decision in this proceeding and future proceedings must be based on “empirically accurate and reasonable assumptions about past, present, and future states of the world.”<sup>24</sup>

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<sup>17</sup> *Tennessee Gas Pipeline Co. v. FERC* (D.C. Cir. 1991) 926 F.2d 1206, 1208, quoting *Federal Power Commission v. Hope Natural Gas Co.* (1944) 320 U.S. 591, 605.

<sup>18</sup> *Tennessee Gas Pipeline Co. v. FERC* (D.C. Cir. 1991) 926 F.2d 1206, 1208, quoting A. Lawrence Kolbe et al., *The Cost of Capital: Estimating the Rate of Return for Public Utilities* 13 (1984).

<sup>19</sup> Pub. Util. Code, § 1757; *Bluefield Water Works & Improvement Co. v. Pub. Serv. Com. of W. Va.* (1923) 262 U.S. 679, 690.

<sup>20</sup> *MISO Transmission Owners v. FERC* (D.C. Cir. 2022) 45 F.4th 248, 264.

<sup>21</sup> *Tennessee Gas Pipeline Co. v. FERC* (D.C. Cir. 1991) 926 F.2d 1206, 1209, quoting *Hope*, 320 U.S. at 602.

<sup>22</sup> *MISO Transmission Owners v. FERC* (D.C. Cir. 2022) 45 F.4th 248, 264.

<sup>23</sup> *MISO Transmission Owners v. FERC* (D.C. Cir. 2022) 45 F.4th 248, 264, citing to *Tennessee Gas Pipeline Co. v. FERC* (D.C. Cir. 1991) 926 F.2d 1206, 1210-11; *id.* at 1213 (Thomas, J., concurring).

<sup>24</sup> D.24-10-008, p. 29.

**C. Although *Hope* and *Bluefield* Considered Whether Rates Were So Low as to Be Considered Confiscatory or Invalid from the Investor and Utility Perspective, the Constitutional Principles Underpinning *Hope* and *Bluefield* Also Preclude Uncompensated Confiscation of Ratepayer Funds.**

*Hope* and *Bluefield* considered the impact of rate orders from the investor and utility company viewpoint. The question in *Bluefield* was whether rates were so low as to render them confiscatory under the Takings Clause of the United States Constitution.<sup>25</sup> The Supreme Court in *Hope* considered whether rates were “unjust and unreasonable from the investor or company viewpoint” and concluded that rates which enable a utility “to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risk assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called ‘fair value’ rate base.”<sup>26</sup>

Here, as set forth below, none of the Utilities present any evidence that RORs lower than they propose, or capital structures different than they propose, would be invalid from the investor or company perspective. Their failure to do so reveals that the flip side of the confiscatory rate coin remains at issue here: RORs that exceed the cost of capital not only violate the Commission’s statutory mandate to prohibit unjust, unreasonable, and unjustified charges, but they also result in uncompensated takings of ratepayers’ money. The Takings Clause of the United States Constitution does not protect only billion-dollar corporations like the Utilities, it also protects individuals.<sup>27</sup>

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<sup>25</sup> *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia* (1923) 262 U.S. 679, 690 (“The question in the case is whether the rates prescribed in the commission’s order are confiscatory and therefore beyond legislative power. Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.”).

<sup>26</sup> *Fed. Power Comm’n v. Hope Nat. Gas Co.* (1944) 320 U.S. 591, 603-05.

<sup>27</sup> U.S. Const., Amend. V (“...nor shall private property be taken for public use, without just compensation.”); *Id.* at Amend. XIV, § 1 (“...No State shall make or enforce any law which shall abridge

The Commission cannot confiscate ratepayer money by authorizing RORs which exceed the cost of capital, any more than it may adopt rates so low as to result in uncompensated takings of the Utilities' businesses. Ratepayers' money is private property that cannot be confiscated without compensation.<sup>28</sup> Forcing ratepayers to pay rates of returns that exceed the cost of capital lacks any nexus or proportionality to the utility service ratepayers receive.<sup>29</sup> Because authorizing rates of returns that exceed the cost of capital lacks a sufficient connection to a legitimate regulatory interest, the excess constitutes an unconstitutional condition imposed on ratepayers forced to pay them in order to receive utility service.<sup>30</sup>

### **III. SHAREHOLDERS AND EXECUTIVES ARE FINANCIALLY INCENTED TO SEEK HIGH PROFITS, PROTECT STOCK PRICES, AND GROW RATE BASE IRRESPECTIVE OF RATEPAYERS' NEEDS.**

As this Commission has recognized, the financial incentives inherent to the Utilities' regulated corporate monopoly structure require the Commission to protect ratepayers against the Utilities' requests in cost of capital decisions.<sup>31</sup>

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the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.”); *Sheetz v. County of El Dorado, California* (2024) 601 U.S. 267, 276-277 (Fourteenth Amendment incorporates the Takings Clause against each State as an undivided whole, without distinction between branches of government).

<sup>28</sup> *Horne v. Dept. of Agriculture* (2015) 576 U.S. 350, 358 (holding that Takings Clause “protects ‘private property’ without any distinction between different types”).

<sup>29</sup> *Koontz v. St. Johns River Water Management Dist.* (2013) 570 U.S. 595, 616 (“monetary exactions are subject to scrutiny under *Nollan* and *Dolan*”).

<sup>30</sup> See e.g. *Sheetz v. County of El Dorado, California* (2024) 601 U.S. 267, 275-276 (conditions that lack a sufficient connect to a legitimate police power interest “amount to ‘an out-and-out plan of extortion”).

<sup>31</sup> See e.g. SC/PCF-01 (Ellis), p. 23 (“Utility management’s primary fiduciary obligation is to maximize shareholder value.”); D.24-10-008, p. 30 (“In approving a cost of capital, the Commission has a duty to utility ratepayers to protect them from unreasonable risks, including risks of imprudent management.”). A.22-04-008, Video of October 17, 2024 Commission Meeting, Item 14 Public Agenda 3553 (Commissioner Houck) (“...setting ROEs well above the cost of equity distorts utility profit incentives. So basically, utilities have an extra incentive to acquire additional capital if the allowable rate of return exceeds the cost of capital. The utilities in this proceeding are all decoupled, which means their sole way to increase profits year to year is to add to rate base, and this creates incentives for utilities to expand rate base as much as possible to benefit shareholders. And we know this because increasing profits is the fiduciary duty of the firm's management, and it's our job to ensure that these returns are fair and rates are

These perverse incentives help explain why between 2020 and 2023 publicly owned utilities' rates have gone up 44% *less* than inflation, while investor-owned utility rates went up 49% more than inflation, and SDG&E's rates increased by 78%.<sup>32</sup>

For ratepayers, excess ROEs are the epitome of a vicious cycle.<sup>33</sup> Beyond their direct impact on rates, which also includes the incremental taxes owed on the surplus profit, authorizing ROEs that exceed investors' market-based expectations incentivize the Utilities to unnecessarily expand rate base at customer expense.<sup>34</sup> The more money that the Utilities' shareholders and executives make by spending money on capital projects, the greater their enthusiasm for capital expenditures.<sup>35</sup> To wit, SDG&E's and SoCalGas's parent company announced a company-record five-year 2025-2029 capital plan of approximately \$56 billion, with over 90% of projected capital expenditures focused on regulated utility investments in Texas and California, representing a 16% increase from its prior plan.<sup>36</sup> Sempra freely admits that its "business model is designed to produce recurring cashflows and earnings" which translates into a five-year plan for SDG&E and SoCalGas (collectively, the Companies) to increase annual capital expenditures to close to \$5 billion dollars in 2029 and "significant projected rate base growth" all five years.<sup>37</sup>

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just and reasonable. For example, cumulatively, across the four IOU's, the impact of each basis point of ROE above cost of equity is \$6 million. So we need to be clear in our understanding that while the utilities have ROEs set above their cost of equity, which is strongly supported by their current price to book ratios, they will be strongly incentivized to add as much capital as they can, which increases the difficulty for all of us in dispensing with GRC applications."), available at [https://www.adminmonitor.com/ca/cpuc/voting\\_meeting/20241017/](https://www.adminmonitor.com/ca/cpuc/voting_meeting/20241017/).

<sup>32</sup> SC/PCF-02 (Ellis), p. 2 (pdf p. 3).

<sup>33</sup> SC/PCF-01 (Ellis), p. 23.

<sup>34</sup> SC/PCF-01 (Ellis), p. 23.

<sup>35</sup> SC/PCF-01 (Ellis), p. 24 (quoting a recent analysis that "higher regulated returns incentivize utilities to own more capital: a one percentage point rise in return on equity increases capital assets by 3–4%.")

<sup>36</sup> PCF-02, Slide 5 (pdf p. 6); *id.* at Slide 39 (pdf p. 40) (Sempra California, which constitutes SD&GE and SoCalGas, accounts for 40% of the five year capital plan).

<sup>37</sup> PCF-02, Slides 9, 19, 31 (pdf p. 10, 20, 32).

The Companies' witnesses admitted they had personal financial interests in maintaining or increasing Sempra's stock price.<sup>38</sup> Because setting the ROE equal to the market-based cost of capital could result in a one-time downward adjustment to the Utilities' parent companies' stock prices,<sup>39</sup> it is no surprise that the Utilities fight so hard to increase authorized RORs each cycle. The Commission must nevertheless protect ratepayers – not stock prices.<sup>40</sup> A reduced stock price resulting from a reduced ROE that reflects the cost of capital would not remotely risk the Utilities' continued ability to attract capital, though it may temporarily make an investment in the Utilities *more* attractive to new purchasers of the securities.<sup>41</sup>

To make matters worse, SDG&E and SoCalGas employees are provided with personal incentives to maximize revenues and profits, and to seek shareholder returns and earnings per share well in excess of other utilities and of other more risky business.<sup>42</sup> Compensation is linked directly to Sempra's total return to shareholders relative to the S&P 500 Index and relative to the S&P 500 Utilities Index, and based on the compound annual growth rate of Sempra's earnings per share.<sup>43</sup> Utility executives therefore have powerful professional and personal incentives to maximize ROE.<sup>44</sup>

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<sup>38</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 135 (Bille); *id.* at p. 172-173 (Mekitarian); *id.* at 189 (Mijares); *id.* at 206-207 (Gonzalez).

<sup>39</sup> SC/PCF-01 (Ellis), p. 99-100.

<sup>40</sup> SC/PCF-01 (Ellis), p. 100.

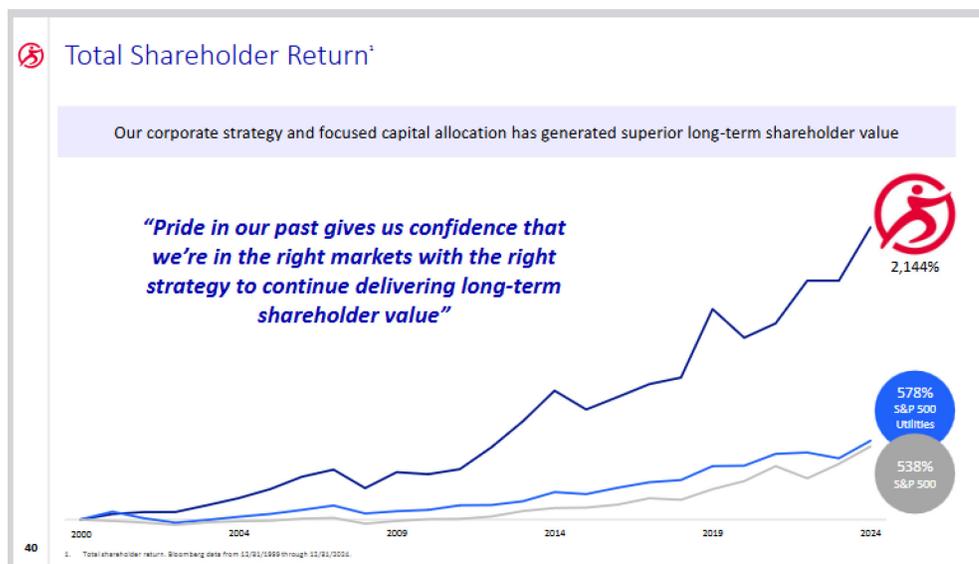
<sup>41</sup> SC/PCF-01 (Ellis), p. 10-14; SC/PCF-08 (Ellis), p. 21 (quoting Kahn explaining that investors respond to higher earnings per share by bidding up the prices of the securities and that “[t]here is no way of giving new purchasers of stock more than the cost of capital”); *see e.g.* A.25-03-010 et seq. Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 189 (Mijares) (conceding a new investor would likely prefer a lower stock price).

<sup>42</sup> PCF-01, p. F-118 (pdf p. 86); *id.* at Exhibits 10.8, 10.9, 10.10, 10.11, 10.64, 10.71 (pdf. p. 98 et seq.); *id.* at p. 120 (pdf p. 25) (index to exhibits showing Exhibits 10.8 through 10.11 apply to SDG&E, and SoCalGas, Exhibit 10.64 applies to SDG&E, and Exhibit 10.71 applies to SoCalGas).

<sup>43</sup> *Ibid.*

<sup>44</sup> SC/PCF-01 (Ellis) p. 23-24.

Moreover, the relationship between ROE and stock market value is not linear, i.e., a 10% increase in ROE, from, say, 10% to 11%, does not result in an increase in the stock price of 10%, but of 13% to 20%.<sup>45</sup> Because of the non-linear relationship between stock market value and ROE, the greater the difference between ROE and the *cost* of equity (COE), the stronger the incentive to inflate investment.<sup>46</sup> With existing market to book (M/B) ratios over 2.0, every dollar of equity invested creates more than two dollars of shareholder value – a powerful incentive to maximize investment.<sup>47</sup> These incentives help explain why, with SDG&E, SoCalGas, and Oncor as its cash cows, Sempra has provided its shareholders with returns exponentially higher than the S&P 500 Index and S&P 500 Utilities Index.<sup>48</sup>



<sup>45</sup> SC/PCF-01 (Ellis), p. 23.

<sup>46</sup> SC/PCF-01 (Ellis), p. 23.

<sup>47</sup> SC/PCF-01 (Ellis), p. 23.

<sup>48</sup> PCF-02, Slide 40 (pdf p. 41). PCF-01, p. F-19, F-25 (showing SDG&E more than doubled, and SoCalGas doubled, their respective dividends to Sempra in 2024 from 2023); PCF-02, Slide 6 (Sempra touting as a major accomplishment its “Record Capital Plan” that involves “Over 90% of new capital plan focused on regulated utility investments”); PCF-02, Slide 30 (“16% increase over prior year five-year capital plan with over 90% focused on regulated utilities”); PCF-02, Slide 39 (showing that Sempra California comprises 40% of Sempra’s entire 2025-2029 capital plan and representing that “[t]hrough disciplined capital allocation, Sempra has successfully simplified its portfolio with a focus on regulated utility investments”); PCF-02, Slide 44 (showing Sempra California consists of SDG&E and SoCalGas, and Sempra Texas consists of Oncor).

ROEs over and above investor’s market-based expectations – the cost of capital -- thus amplify ratepayers harms in myriad ways:

- the immediate costs of the excess ROE;
- the cost of the incremental taxes owed on that excess ROE;
- the additional costs of unnecessary investment incentivized by excess ROEs (which includes not only the cost of the investment but also the cost of capital on the investment and the associated taxes);
- the surplus shareholder profit from excess ROE on that unnecessary investment; and
- and the associated taxes on that surplus profit.<sup>49</sup>

While a lower ROE or equity ratio will tend to increase both the cost of debt (COD) and the cost of equity (COE), it is virtually impossible to reduce ROE, equity ratio, or both so much that any resulting increase in interest costs would outweigh the customer savings from lower utility profits (ROE x E/C x rate base) – especially when the tax gross-up on equity is taken into account.<sup>50</sup>

The Commission’s statutory mandates to prohibit unjust, unreasonable, and unjustified charges requires the Commission to avoid these ratepayer harms by limiting the rate of return to the cost of capital. As Commissioner Houck highlighted late last year, setting an authorized ROE equal to the cost of capital would allow the Commission to comply with *Hope* and all applicable legal requirements.<sup>51</sup>

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<sup>49</sup> SC/PCF-01 (Ellis), p. 23.

<sup>50</sup> SC/PCF-01 (Ellis), p. 30.

<sup>51</sup> A.22-04-008, Video of October 17, 2024 Commission Meeting, Item 14 Public Agenda 3553 (Commissioner Houck: “Setting an authorized return on equity that’s equal to a utility’s cost of equity would thus satisfy all these Supreme Court decisions by properly balancing shareholder and ratepayer interest.”), available at [https://www.adminmonitor.com/ca/cpuc/voting\\_meeting/20241017/](https://www.adminmonitor.com/ca/cpuc/voting_meeting/20241017/).

**IV. THE UTILITIES' PROPOSALS MUST BE REJECTED BECAUSE THE UTILITIES WHOLLY FAILED TO PROVIDE THE COMMISSION WITH INFORMATION NECESSARY FOR THE COMMISSION TO CONSIDER AND PROTECT RATEPAYERS' INTERESTS.**

The main issue for the Commission to determine in this proceeding involves how to pay for the Utilities' necessary capital investments at the lowest costs to ratepayers. The Utilities, however, are naturally incentivized to focus instead on protecting their credit ratings and stock prices for *shareholders*. The Utilities present no evidence and no analysis of the impact of their proposals – or of any other proposals – on *ratepayers*. Instead, the Utilities make unsupported and unwarranted claims about risk to argue that their ROEs should be based on – and should be higher than – other authorized ROEs, as opposed to investors' market-based expectations which constitute the cost of capital. As set forth below, the Utilities' applications, testimony, and other evidence fail to provide any analysis on the fundamental issue in this proceeding: ascertaining “the minimum rate of return necessary to attract capital to an investment.”<sup>52</sup>

**A. The Utilities Fail to Present Any Evidence of the Impacts of their ROE and Capital Structure Proposals On Ratepayers.**

The Utilities present no evidence that RORs lower than they propose, or capital structures different than they propose, would be invalid from the investor or company perspective. SDG&E and SoCalGas (the Companies) witnesses admit that they did not present any evidence that would suggest their ROEs equal the cost of capital: the minimum return that investors expect to earn from investing in the company.<sup>53</sup>

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<sup>52</sup> *Tennessee Gas Pipeline Co. v. FERC* (D.C. Cir. 1991) 926 F.2d 1206, 1208, quoting A. Lawrence Kolbe et al., *The Cost of Capital: Estimating the Rate of Return for Public Utilities* 13 (1984) (“Recognizing that utility investors must be allowed an opportunity to earn returns sufficient to ‘attract capital,’ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 605 [] (1944), and ‘to compensate [the] investors for the risks assumed,’ *id.*, the Commission endeavors to set a utility's rate of return on equity at its cost of equity capital. ‘The cost of capital is the minimum rate of return necessary to attract capital to an investment.’ A. Lawrence Kolbe et al., *The Cost of Capital: Estimating the Rate of Return for Public Utilities* 13 (1984).”).

<sup>53</sup> SC/PCF-01, p. 10-11.

During the abbreviated evidentiary hearings provided, the Companies' ROE witness, Mr. Nowak, admitted that he did not perform any kind of analysis about the impacts on customers of his ROE recommendations.<sup>54</sup> Mr. Nowak conceded he had not even assessed the factors set forth in *Hope* from the utility company perspective:<sup>55</sup>

Q. Did you assess whether an authorized ROE lower than your recommended ROE would jeopardize either company's financial integrity? . . .

A. . .no, I did not perform that analysis.

Q. Did you consider whether an ROE lower than your recommended ROE would impede either company's ability to raise the capital that it needs for the proper discharge of its public duties?

A. That's not a -- an analysis I performed. . . .

Q. Did you consider whether an ROE lower than your recommended ROEs would leave either company with insufficient operating capital? . . .

A. No, that's not an analysis I performed, and I'm not sure what the relevance would be in determining the appropriate cost of equity.<sup>56</sup>

The Companies also ignored the impacts of their capital structure proposals on ratepayers. Mr. Gonzalez, on behalf of SoCalGas, did not consider impacts to ratepayers when making his capital structure proposal:

Q. . .did you assess impacts to customers based on your...proposed capital structure?

A. No...

Q. Did you quantify the impact on ratepayers of any of the capital structure proposals?

A. No, I did not.<sup>57</sup>

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<sup>54</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 68 (Nowak) (“Q Did you perform any analysis quantifying the cost savings to ratepayers that would accrue if the Commission authorized lower ROEs than you proposed? A I -- I didn't quantify any impacts of the ROE on ratepayers.”); *id.* at p. 72 (Nowak) (“...I didn't measure any impacts as to what that may – what the rate impact may be if its higher or lower.”); *see also id.* at p. 202-203 (Mijares) (Q. Did you consider whether a reduced ROE could result in much lower ratepayer costs? A. No.”)

<sup>55</sup> *Fed. Power Comm'n v. Hope Nat. Gas Co.* (1944) 320 U.S. 591, 605 (“Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called ‘fair value’ rate base.”).

<sup>56</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 73-74 (Nowak).

<sup>57</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 209 (Gonzalez).

Ms. Meketarian, on behalf of SDG&E, also admitted she did not consider impacts of capital structure on ratepayers:

Q. And you didn't consider the impact of your capital structure proposal on customer costs; correct?

A. We included in the application the impact the proposed ROR would have on customer rates. But I did not use that analysis to come up with my recommendation of capital structure.<sup>58</sup>

The witness were aware, however, that capital structure influences the amount of dividends that the Companies pay to Sempra.<sup>59</sup> They had not considered the impacts on ratepayers of their capital structure proposals on those dividends, dividends which doubled for SoCalGas from 2023 to 2024 and *more than doubled* for SDG&E from 2023 to 2024.<sup>60</sup>

**B. The Utilities Failed to Present Any Analysis Optimizing their Capital Structure and ROE Proposals as is Required.**

The Commission authorizes RORs using the weighted average of the COD, ROE, and return on preferred equity (where applicable), where the weights are determined by the capital structure, or the relative amounts of each source. Because of the inter-relationships between ROE, capital structure, and credit quality, and the regulatory requirements that ROE and credit quality be set equal to specific thresholds, ROE and capital structure must be determined jointly, as the Commission has required.<sup>61</sup>

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<sup>58</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 177 (Meketarian).

<sup>59</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 220 (Gonzalez) (“A change to capital structure will influence the amount of dividends we would pay in order for us to maintain that authorized cap structure.”); *id.* at p. 192 (Meketarian).

<sup>60</sup> PCF-01, p. 100 (pdf. p. 21); *id.* at p. F-25 (pdf. p. 46); *id.* at p. F-19 (pdf p. 40); *id.* at p. F-48 (pdf p. 63); PCF-03, p. 16 (pdf p 17).

<sup>61</sup> D.08-05-035, *Decision Establishing a Multi-Year Cost of Capital Mechanism for the Major Energy Utilities* (May 29, 2008), p. 8 (“capital structure and ROE cannot, and should not, be assessed independently”); *id.* at p. 19 (COL 4: "Capital structure and ROE should not be addressed independently.").

These relationships and trade-offs between capital structure and costs of both debt and equity can be quantified and rigorously analyzed to determine the minimum equity ratio and ROE needed to maintain a desired credit rating, and the implications of the trade-off on customer costs.<sup>62</sup> For example, the cash-flow-to-debt ratio (CF/D) and the cost of equity can be calculated at a variety of equity ratio and ROE combinations, and the results of these analyses can be compared to determine the minimum equity ratio and ROE needed to maintain a desired credit rating.<sup>63</sup>

However, because equity generally has a higher cost than debt, a higher equity to total capital ratio increases income for existing shareholders and concomitantly increases costs for customers.<sup>64</sup> Accordingly, shareholders' interests conflict with customers' interests<sup>65</sup> and it is not in shareholders' interests to expose the true impact of different ROEs and equity ratios on customers. The Companies freely admit that they failed to conduct any analysis to optimize their capital structure and ROE proposals.<sup>66</sup>

Q. Did you perform any kind of analysis that would refute Mr. Ellis' testimony that regulators can adjust ROEs and equity ratios to reduce both customer costs and the market-based cost of debt and equity?

A. No....<sup>67</sup>

Q. ...did you consider the impact of ROE on capital structure?

A. No....<sup>68</sup>

Q. ...You do not address the cost reductions to customers that result from reductions to ROE and to the associated taxes that ratepayers pay on top of ROE in your testimony; correct?

A. No, I do not...

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<sup>62</sup> SC/PCF-01 (Ellis), p. 25-34.

<sup>63</sup> SC/PCF-01 (Ellis), p. 27-28.

<sup>64</sup> SC/PCF-01 (Ellis), p. 25.

<sup>65</sup> SC/PCF-01 (Ellis), p. 25.

<sup>66</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 69 (Nowak) ("...I did not make any calculations").

<sup>67</sup> *Id.* at p. 175 (Mekitarian).

<sup>68</sup> *Id.* at p. 177 (Mekitarian).

Q. So you do not address the impact of the relationship between ROE and capital structure on customer costs in your testimony; correct?”

A. Correct, I do not.<sup>69</sup>

Q. Did you consider whether a different capital structure in combination with a reduced ROE could dramatically reduce customer costs in your testimony?

A. ...I know that I didn't....<sup>70</sup>

In short, while the Utilities allude to the possibility that *market* costs of both debt and equity could go up, the Utilities entirely ignore the *customer* savings from a lower ROE and/or equity ratio – savings that entirely offset any possible increases in market costs.<sup>71</sup> In other words, while the Utilities thunder about higher interest rates and their purported effect on consumer costs, they conveniently ignore that the costs reductions for customers obtained from lowering equity amounts completely dwarf any possible increased market costs.

Both SDG&E and SoCalGas relied heavily on statements made by credit ratings agencies and credit ratings agencies' methodologies, but instead of providing a meaningful analysis they cherry pick statements by credit ratings agencies to use as a bogeyman. For example, the Companies highlight debt ratio benchmarks in their testimony, but admitted during cross-examination that their debt ratio benchmarks consist of only 7.5% of the “financial strength” factor, a factor that itself is only 40% of the “preliminary outcome,” an outcome which is then adjusted based on myriad other factors.<sup>72</sup> SDG&E and SoCalGas overemphasize and cherry-pick statements by credit ratings agencies in a manner that does not survive scrutiny when considered in the context of the document as a whole.

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<sup>69</sup> *Id.* at p. 208 (Gonzalez).

<sup>70</sup> *Id.* at p. 203 (Mijares).

<sup>71</sup> SC/PCF-01 (Ellis), p. 30 (“...it is virtually impossible to reduce ROE, equity ratio, or both so much that any resulting increase in interest costs would outweigh the customer savings from lower utility profits (ROE x E/C x rate base) – especially when the tax gross-up on equity is taken into account.”).

<sup>72</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 178-179 (Mekitarian testify that the debt ratio benchmarks in Table 2 consist of only 7.5% of the financial strength factor, which is only 40% of the “preliminary outcome”); *id.* at p. 210-211 (Gonzalez testifying same regarding is Table 4); PCF-03, p. 2.

Although credit ratings agencies rely on the accuracy of audited financial statements<sup>73</sup> and “focus more on a utility’s cash flow than on its reported net income,”<sup>74</sup> the witnesses did not consider or utilize Utilities’ cash flow statements in preparing their testimony.<sup>75</sup> And although ratings agencies consider total capitalization, which includes deferred taxes,<sup>76</sup> the Utilities failed to consider deferred taxes in their testimony.<sup>77</sup> Thus, the Utilities’ arguments about what credit agencies might do if the Commission dares not accede to the Utilities’ demands lacks credibility and should not be given any weight.

### **C. The Utilities Fail to Consider the Impact of Ratepayer-Provided Cash Flows and Fundamentally Fail to Establish Their Operational Needs for Additional Outside Investment.**

The Commission is required to set a rate of return sufficient to enable the Utilities to attract the capital necessary for the Utilities to provide safe and reliable service.<sup>78</sup> The Utilities’ rationale for their extraordinary ROR requests is their need to raise funds “by issuing debt or selling equity” in order “to invest in the wires, poles, pipelines and substations needed to deliver clean, safe, and reliable electricity and/or natural gas to customers.”<sup>79</sup>

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<sup>73</sup> PCF-03, p. 19 (pdf p. 20) (Moody’s: “We rely on the accuracy of audited financial statements to assign and monitor ratings in this sector.”).

<sup>74</sup> PCF-03, p. 13 (pdf p. 14).

<sup>75</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 186 (Mekitarian) (Q Did you utilize the cash flows statement? A I specifically did not utilize the audited financial statements for 2024 to specifically inform my testimony. I may have used components of it, but I didn't use the 10-K audited financial statements.”); *id.* at p. 212 (Gonzalez testifying he did not rely on cash flow statements); *id.* at p. 213 (Gonzalez testifying that a positive number for deferred taxes on cash flow statement means that we have that much more funds available to utilize in the operations).

<sup>76</sup> PCF-03, p. 14.

<sup>77</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 180-183 (Mekitarian) (“I did not specifically...consider deferred income taxes when I was preparing my testimony....”).

<sup>78</sup> *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia* (1923) 262 U.S. 679, 693 (“The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary **for the proper discharge of its public duties.**”) (emphasis added).

<sup>79</sup> *See e.g.* SDG&E Application, p. 3.

SDG&E and SoCalGas witnesses admitted on cross-examination that ratepayers pay a rate of return that includes the cost of debt, the return on equity, plus taxes on the return on equity.<sup>80</sup> But the Utilities’ applications and testimony fail to account for the fact that they have capital in their possession which requires neither issuing debt nor selling equity: the large sums of money ratepayers provide each year in the form of deferred taxes and depreciation and amortization, all of which the Utilities can – and do – use and invest at zero-cost.

Consideration of ratepayers’ interests requires the Commission to consider depreciation and deferred taxes when determining the appropriate capital structure and costs of equity and debt. The Utilities’ disclosures required by federal securities laws confirm that deferred taxes and depreciation and amortization comprise available cash for the Utilities in a given year.<sup>81</sup> In 2024, cash available from ratepayers in the form of depreciation and amortization constituted \$1.223 billion for SD&GE and \$910 million for SoCalGas.<sup>82</sup> In 2024, cash available from ratepayers in the form of deferred income taxes and investment tax credits constituted \$169 million for SD&GE and \$28 million for SoCalGas.<sup>83</sup> Thus, in 2024 alone, ratepayers provided the Utilities with zero-cost capital in an amount exceeding half (55%) of SDG&E’s and 42% of SoCalGas’s *total* expenditures for their respective investments in property, plant, and equipment.<sup>84</sup>

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<sup>80</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 67 (Nowak) (“Q: ...Do you agree that ratepayers pay a rate of return that includes the cost of debt, the return on equity, plus taxes on the return on equity? . . . A: Yeah, the rates would be developed with an assumed tax rate, as well.”); *id.* at 207 (Gonzalez).

<sup>81</sup> PCF-01, p. F-19 (pdf p. 40; F-25 (pdf p. 46).

<sup>82</sup> PCF-01, p. F-19 (pdf p. 40; F-25 (pdf p. 46).

<sup>83</sup> PCF-01, p. F-19 (pdf p. 40; F-25 (pdf p. 46).

<sup>84</sup> PCF-01, p. F-19 (pdf p. 40) (showing for SDG&E \$2,522,000,000 in expenditures for property, plant and equipment; and \$1,392,000,000 provided by ratepayers in the form of depreciation and amortization (\$1,223,000,000) and deferred income taxes and investment tax credits (\$169,000,000)); *id.* at p. F-26 (pdf p. 46) (showing for SoCalGas \$2,231,000,000 in expenditures for property, plant and equipment; and \$938,000,000 provided by ratepayers in the form of depreciation and amortization (\$910,000,000) and deferred income taxes and investment tax credits (\$28,000,000)).

The ratepayer-provided cash that the Utilities already have access to – at zero cost (no interest payments and no return payments) – impacts the Utilities’ actual operational needs. Ratepayer-provided, internally-generated cashflows fund virtually all utility capital investment.<sup>85</sup> The Commission must ensure that ratepayers are being credited for the zero-cost capital that they provide to the Utilities, and not authorize windfall payments for shareholders and executives by authorizing RORs and capital structures untethered to the Utilities’ operational needs.

While the Utilities would tell the Commission that depreciation is deducted from rate base and does not provide a basis for additional utility earnings, what they fail to address is that the “need” for a utility to “attract” capital is impacted by a utility’s cash flows. The greater the consistent cash flow, the less need, if any, to go to the market to seek capital, with interest and return payments, to fund the capital improvements necessary to provide safe and reliable utility service.

The Utilities’ capital structure proposals do not credit customers for the cash customers provide to the Utilities at zero cost. The cash that ratepayers reliably provide each and every month necessarily impacts the Utilities’ operational reality and the extent of any need to attract capital from investors in the form of equity or debt. This lack of inclusion of billions of dollars of ratepayer capital float undercounts ratepayers’ significant contribution to the Utilities’ actual cash on hand that reduces the Utilities’ need to obtain all their capital in the market, all of which lowers any risks the Utilities could arguably face. Without considering the issues in this proceeding from the ratepayer perspective and in the context of the Utilities’ cash flow financial statements, the Commission cannot meet its statutory obligation to ensure that Utility investments are made at the lowest possible cost to ratepayers.

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<sup>85</sup> PCF-01, p. F-19 (pdf p. 40), F-25 (pdf p. 46).

**V. SDG&E’S AND SOCALGAS’S CLAIMS ABOUT RISK ARE UNSUPPORTED AND UNSUBSTANTIATED, CONTRADICT REPRESENTATIONS TO THE INVESTMENT COMMUNITY, AND DO NOT COMPORT WITH FUNDAMENTAL FINANCE PRINCIPLES.**

The Utilities make claims about risk which lack any basis in law or fact and which fail to provide the Commission with any basis for authorizing the ROEs that the Utilities seek.

**A. SDG&E and SoCalGas Failed to Provide Competent Evidence About the Risks they Assert, Much Less Quantify the Impact of Such Risks.**

The Utilities argue for above-average ROEs and above-average equity ratios based on their claimed “above-average” risk, without quantifying risk at all, much less the effect of risk on their ROEs or capital structure.<sup>86</sup> The witness admitted in cross-examination that they did not quantify any risks to shareholders or the effect of those claimed risks on their proposed ROEs.<sup>87</sup>

In fact, cross-examination revealed that the witnesses had no qualifications or basis for making the assertions that they made regarding risk.<sup>88</sup> For example, SDG&E witnesses were not qualified to testify about the risk to shareholders resulting from Public Utilities Code 451.1, nor could they confirm that they even read the code section to prepare their testimony.<sup>89</sup>

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<sup>86</sup> SDG&E Application, p. 9; Exhibit SDG&E-03 (Nowak), p. JCN-39-57; SCG Application, p. 7-9; SCG-03 (Nowak), p. JCN-37-45; A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 154 (Bille unaware that national average ROEs exceeded investors’ return expectations.)

<sup>87</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 99-100 (Nowak admitting no evidence of any “quantitative analysis” of risk); *id.* at p. 100-101 (Nowak) (Q “...you don’t quantify that risk or I effect on ROE in your testimony in this proceeding?” . . . A “...I don’t have a specific quantification.”); *id.* at p. 140 (Bille) (“Q So when you’re talking about the risk, have you quantified what the risk is to shareholders? A I have not quantified that. Q Have you qualified what the risk is to ratepayers? A. No I have not.”).

<sup>88</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 97-98 (Nowak admitting that he had no context to assess whether SoCalGas could plan ahead to address natural gas use reductions); *id.* at p. 135 (Bille admitting she has no legal training).

<sup>89</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 101-102 (Nowak); *id.* at p. 141 (Bille) (“Q Ms. Bille, have you read Public Utilities Code Section 451.1. A Not recently, no. Q Did you read it in preparation of your testimony in this proceeding? A I did not.”).

Mr. Nowak mistakenly assumes risk even when shareholders recover the costs necessary to operate from ratepayers.<sup>90</sup> Ms. Bille did not even understand that the enactment of AB 1054 (in 2019) made it much more difficult for the Commission to deny recovery from ratepayers,<sup>91</sup> but she nevertheless disagrees with this Commission’s own finding that AB 1054 eliminated unmitigated wildfire risks that would warrant higher ROEs.<sup>92</sup> Ms. Bille’s testimony about inverse condemnation damages was based exclusively on unreliable and erroneous hearsay by an unknown person with unknown qualifications.<sup>93</sup>

Moreover, SoCalGas witnesses revealed that their claims about risk are not risks at all. For example, SoCalGas argues about “environmental risk,” but admits in its audited financial statements that it recovers the costs to comply with environmental laws and regulates in customer rates.<sup>94</sup> SoCalGas argues that climate action taken by local governments constitutes a “risk” to SoCalGas, but SoCalGas’s failure to plan for reduced natural gas use in the future comprises a risk of its own making.

Instead of planning ahead to reduce natural gas use, SoCalGas proposes to increase its rate base with speculative ventures.<sup>95</sup> SoCalGas’s business decision to engage in speculative ventures and corresponding refusal to adapt and plan for reduced natural gas use does not constitute a legal basis for its proposed ROE.

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<sup>90</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 102-104 (Nowak).

<sup>91</sup> *Id.* at p. 144 (Bille).

<sup>92</sup> *Id.* at p. 147-148 (Bille) (“...I don’t necessarily concur...I would not necessarily agree...”); D.19-12-056 (Finding of Fact No. 29: “With the adoption of AB 1054, there are no remaining significant unmitigated risks that warrant investor compensation through a higher ROE.”).

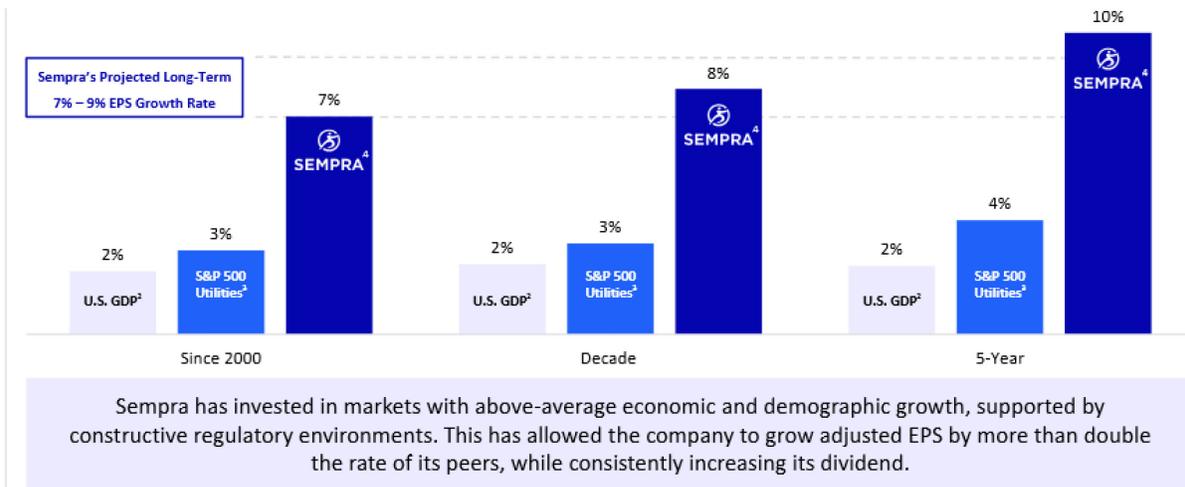
<sup>93</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 146-147 (Bille) (testifying she had no idea who wrote the statement upon which her testimony about inverse condemnation was based).

<sup>94</sup> PCF-01, p. F-136 (pdf p. 91).

<sup>95</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 196-197 (Mijares testifying about SoCalGas expanding its business into hydrogen and refusing to state that SoCalGas considers reducing natural gas use when it makes its business decisions).

**B. SDG&E’s and SoCalGas’s Claims About Risk Conflict With Their Parent Company’s Representations to the Investment Community.**

The Utilities’ unsupported claims of above-average risk conflict with the Utilities’ own parent company’s representations to the investment community. Sempra, the parent company for SDG&E and SoCalGas, recently reported that by focusing over 90% of its new capital plan on SDG&E, SoCalGas, and Oncor,<sup>96</sup> it has “invested in markets with above-average economic and demographic growth, supported by constructive regulatory environments.”<sup>97</sup>



The support of constructive regulatory environments in what Sempra describes as the “some of North America’s most attractive markets”<sup>98</sup> has “allowed the company to grow adjusted EPS by more than double the rate of its peers, while consistently increasing its dividend.”<sup>99</sup>

<sup>96</sup> PCF-02, Slide 6 (Sempra touting as a major accomplishment its “Record Capital Plan” that involves “Over 90% of new capital plan focused on regulated utility investments”); PCF-02, Slide 30 (“16% increase over prior year five-year capital plan with over 90% focused on regulated utilities”); PCF-02, Slide 39 (showing that Sempra California comprises 40% of Sempra’s entire 2025-2029 capital plan and representing that “[t]hrough disciplined capital allocation, Sempra has successfully simplified its portfolio with a focus on regulated utility investments”); PCF-02, Slide 44 (showing Sempra California consists of SDG&E and SoCalGas, and Sempra Texas consists of Oncor).

<sup>97</sup> PCF-02, Slide 37.

<sup>98</sup> PCF-02, Slide 38.

<sup>99</sup> PCF-02, Slide 37.

Sempra touts its “Significant Projected Rate Base Growth” for SDG&E, SoCalGas, and Oncor,<sup>100</sup> with a \$22.4 billion capital plan for SDG&E and SoCalGas.<sup>101</sup> Sempra informs its investors that its California and Texas markets are “the right markets...to continue delivering long-term shareholder value,” and presented a graphic detailing that its investments have generated for shareholders a return around four times above the S&P 500 and the S&P 500 Utilities Index.<sup>102</sup> Sempra freely admits that its regulated utility-focused “business model is designed to produce recurring cashflows and earnings with visibility to long-term growth, while reducing commodity and environmental risks,” and involving higher risk for *consumers*.<sup>103</sup>

### **C. SDG&E’s and SoCalGas’s Claims About Risk Violate Fundamental Finance Principles.**

The Commission would be required to reject the companies’ claims about risk even if SDG&E and SoCalGas had not failed to provide any competent evidence of risk. In arguing for returns higher than their industry peers, SDG&E asserts that it “faces *unique* and significant wildfire and wildfire liability risk,”<sup>104</sup> and SoCalGas asserts that it “faces *unique* risks as a gas-only utility operating in California and in today’s economic and regulatory climate.”<sup>105</sup> Their testimony similarly frames the issue in terms of “factors *specific*” to SDG&E’s and SCG’s risk profiles that he considered in developing his ROE recommendations.<sup>106</sup> Yet as The Brattle Group (the consultancy providing both SCE’s and PG&E’s testimony) explains, a fundamental principle of finance, the Nobel Prize-winning Modern Portfolio Theory, instructs that firms are only rewarded for their systematic, non-diversifiable risk, not their unique, firm-specific risks:

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<sup>100</sup> PCF-02, Slide 31

<sup>101</sup> PCF-02, Slide 30; PCF-02, Slide 46.

<sup>102</sup> PCF-02, Slide 40.

<sup>103</sup> PCF-02, Slide 9.

<sup>104</sup> SDG&E Application, p. 9 (emphasis added).

<sup>105</sup> SCG Application, p. 8 (emphasis added).

<sup>106</sup> SDG&E-03 (Nowak), p. JCN-38 (emphasis added); SCG-03 (Nowak), p. JCN-37 (emphasis added).

Finance theory explicitly distinguishes the type of risk that affects the cost of capital from risks that do not. The cost of capital is a function of the first: the systematic risk of the assets owned by the company. Another portion of the total risk is the unique risk, which can be eliminated through diversification and so does not affect the cost of capital. This distinction between diversifiable and non-diversifiable risk is based upon modern portfolio theory, which demonstrated that a portion of an investment's total risk can be eliminated or be "diversified away" when the investment is included in a well-designed portfolio of investments. Only the remaining nondiversifiable risk affects the cost of capital, and its amount is typically measured by its beta.

The portion of the risk that can be eliminated does not affect the cost of capital because capital markets do not reward investors for risks that can be avoided. Nonetheless, diversifiable risk should not be ignored by investors or policy makers. The price investors are willing to pay for an investment depends upon both types of risk. *Unique events, good or bad, will affect a company's stock price, but they do not affect its cost of capital.*<sup>107</sup>

Modern Portfolio Theory thus long ago established that the cost of equity reflects *only* systematic risks, not risks unique to individual firms like those described in the Utilities' applications and testimony. While unique events can be expected to affect stock price, *they do not affect the cost of capital.* The Commission must reject arguments that the Utilities should be awarded more generous returns because of unquantified, unsubstantiated, and immaterial claims about risk.

## **VI. THE UTILITIES USE FINANCIAL MODELS AND ASSUMPTIONS THAT DO NOT REFLECT REALITY AND CONTRADICT SOUND FINANCIAL LOGIC.**

Although the Commission placed the Utilities on notice in D.24-10-008 that they would be required "to file applications with empirically accurate and reasonable assumptions about past, present, and future states of the world,"<sup>108</sup> the Utilities' use empirically inaccurate and unrealistic assumptions about the world that do not reflect reality, and therefore the Utilities' analysis must be rejected.<sup>109</sup>

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<sup>107</sup> SC/PCF-01 (Ellis), p. 101-102.

<sup>108</sup> D.24-10-008, p. 29.

<sup>109</sup> *Bluefield Water Works & Improvement Co. v. Pub. Serv. Com. of W. Va.* (1923) 262 U.S. 679, 690 (decision must be based on "a proper consideration of all relevant facts"); *MISO Transmission Owners v. FERC* (D.C. Cir. 2022) 45 F.4th 248, 264 (decision must align "with 'general financial logic'").

**A. The Utilities continue to use financial models that do not measure the Utilities' costs of capital: the RPA and EEA.**

All four Utilities use the risk premium analysis (RPA), and SDG&E and SoCalGas also use the expected earnings analysis (EEA).<sup>110</sup> The RPA and EEA are based on returns calculated from accounting book values, as opposed to the market values upon which investors base their expectations, and therefore do not even purport to measure the *cost* of equity, which must be based on market values. The very definition of cost of equity is the return investors expect on their investment.<sup>111</sup> The cost of equity and investors' expected return are synonymous:

The cost of capital is the price charged by investors for bearing the risk that the company's future cash flows may differ from what they anticipate when they make the investment. The cost of capital to a company equals the minimum return that investors expect to earn from investing in the company. That is why the terms *expected return to investors* and *cost of capital* are essentially the same. The cost of capital is also called the discount rate, because you discount future cash flows at this rate when calculating the present value of an investment, to reflect what you will have to pay investors.<sup>112</sup>

The definition has been quoted by the courts: “[t]he cost of capital is the minimum rate of return necessary to attract capital to an investment”<sup>113</sup> and is well understood to be “the minimum acceptable rate of return on capital investment.”<sup>114</sup> Because investors invest by purchasing stock, which they can only do by paying the market price, the cost of capital remains a market-based concept.<sup>115</sup>

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<sup>110</sup> SC/PCF-01 (Ellis), p. 4.

<sup>111</sup> SC/PCF-01 (Ellis), p. 8-9.

<sup>112</sup> SC/PCF-01 (Ellis), p. 10, quoting SC/PCF-05 Tim Koller, Marc Goedhart, David Wessels, *Valuation: Measuring and Managing the Value of Companies*, 5<sup>th</sup> ed. (John Wiley & Sons, Inc.: 2010), p. 35 (emphasis in original).

<sup>113</sup> *Tennessee Gas Pipeline Co. v. FERC* (D.C. Cir. 1991) 926 F.2d 1206, 1208, quoting A. Lawrence Kolbe et al., *The Cost of Capital: Estimating the Rate of Return for Public Utilities*, p. 13 (1984); SC/PCF-03, pdf p. 5.

<sup>114</sup> SC/PCF-08 (Ellis), p. 3.

<sup>115</sup> SC/PCF-08 (Ellis), p. 21, quoting Alfred E. Kahn, *The Economics of Regulation*, The MIT Press (The MIT Press: 1970). p. 50, 52, 52 fn. 79 (“The cost of capital, which is what a utility company must match if it is to attract funds, is what investors could obtain by buying the *securities* of other companies in the

Neither the RPA nor the EEA estimate investors' market-based expectations, and thus neither estimates the cost of equity.<sup>116</sup> The RPA and the EEM cannot be utilized in a proceeding geared toward ascertaining the cost of equity, because models based on book values remain divorced from investors' expectations about investors' returns, which are necessarily based on market price.<sup>117</sup>

Accordingly, when Mr. Nowak was asked whether he agreed with legendary economist Alfred Kahn that “[t]he cost of capital, which is what a utility company must match if it is to attract funds, is what investors could obtain by buying the securities of other companies in the open market – not what the companies themselves earn on a dollar of additional investment,”<sup>118</sup> Mr. Nowak evaded the question. He admitted to agreeing with only the first part of the statement, that the cost of capital is “what a utility must match to attract funds,”<sup>119</sup> but he refused to testify that he agreed with the second part of Mr. Kahn’s statement, that the cost of capital “is what investors could obtain by buying the securities of other companies in the open market – not

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open market – not what the companies themselves earn on a dollar of additional investment) (emphasis in original).

<sup>116</sup> Exhibit SC/PCF-3, A. Lawrence Kolbe, James A. Read, George R. Hall, *The Cost of Capital Estimating the Rate of Return for Public Utilities* (The MIT Press: 1984), p. 24-27.

<sup>117</sup> *MISO Transmission Owners v. FERC* (D.C. Cir. 2022) 45 F.4th 248, 264 (“investors don’t use [the Risk Premium Analysis] model”); *Ass’n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 569-A (May 21, 2020) 171 FERC ¶ 61,154 (hereafter “FERC Opinion No. 569-A”), p. 62201 (“the returns estimated by the Expected Earnings model are divorced from the returns required by investors, because investors cannot purchase a company’s stock at its book value”); *Entergy Ark., Inc.* (May 20, 2021) Opinion No. 575, 175 FERC ¶ 61,136 at p. 61780 (“the Expected Earnings model is not a market-based model and relying on it does not satisfy the requirements of *Hope*”); *Ass’n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 569 (November 21, 2019) 169 FERC ¶ 61,129 (hereafter “FERC Opinion No. 569”), p. 61767-8; *Ass’n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.* (October 24, 2024) 189 FERC ¶ 61,036 (hereafter “FERC Order on Remand”), para. 23-24; *Generic Determination of Rate of Return on Common Equity for Public Utilities* (February 5, 1988) 53 FR 3342-01, (1988 WL 276401) (hereafter “FERC Generic Determination of ROR”), p. 3347.

<sup>118</sup> SC/PCF-08, p. 21, ll. 9-12; A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 90.

<sup>119</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p. 91.

what the companies themselves earn on a dollar of additional investment.”<sup>120</sup> Mr. Nowak’s use of book value models required Mr. Nowak to feign ignorance of the fundamental economic principle that the cost of capital – by definition – involves investors expected returns based on “what investors could obtain by buying the securities of other companies in the open market” and requires rejection of his results.

In Opinion No. 569, the Federal Energy Regulatory Commission (FERC) concluded that the results of the RPA “def[y] general financial logic”<sup>121</sup> and rejected its use to estimate the cost of equity because the RPA is not market based, relies on past authorized returns to set new ones, and does not drive investor behavior:

[T]he Risk Premium model is likely to provide a less accurate current cost of equity estimate than the DCF model or CAPM because it relies on previous ROE determinations, whose resulting ROE may not necessarily be directly determined by a market-based method, whereas the DCF and CAPM methods apply a market-based method to primary data.

...

[C]ircularity is particularly direct and acute with the Risk Premium model because it directly relies on past Commission ROE decisions. ... As a result, we share the concerns expressed by various parties that the circularity inherent in the Risk Premium model’s use of prior ROE determinations would largely continue previously-approved ROEs and reflect past circumstances that influenced the previous ROE decisions.

...

Additionally, the record contains insufficient evidence to conclude that investors rely on risk premium analyses utilizing historic Commission ROE determinations or settlement approvals to determine the cost of capital and make investment decisions. Investors certainly observe regulatory ROEs and how changes in authorized ROE levels could affect utility earnings, but such considerations differ from the type of analyses employed by the [utilities] looking back at past decisions to determine the current cost of capital. We recognize that academic literature discusses this methodology, but the record indicates the greater prevalence of other methods.<sup>122</sup>

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<sup>120</sup> SC/PCF-08, p. 21; SC/PCF-07 (excerpts of *The Economics of Regulation: Principles and Institutions* by Alfred E. Kahn), p. 52 (pdf. p. 8).

<sup>121</sup> FERC Opinion No. 569, p. 61796.

<sup>122</sup> FERC Opinion No. 569, p. 61796.

The United States Court of Appeals for the District of Columbia Circuit vacated FERC's subsequent attempt, in Opinion No. 569-A, to reinstate the RPA, because the analysis in Opinion No 569-A was not in "line with 'general financial logic,'" the model does not "offer[] meaningful insight into investor behavior," and involves "'particularly direct and acute' circularity problems."<sup>123</sup> Upon remand from the Court of Appeals, FERC reinstated Opinion No. 569 and rejected the RPA as a method for determining ROE:

Upon review of the record and the court's findings, we conclude, as we previously recognized in Opinion No. 569, that the record fails to support the inclusion of the Risk Premium model in the Commission's ROE methodology, either for determining the justness and reasonableness of existing base ROEs under the first prong of section 206 of the FPA or for determining new just and reasonable base ROEs under the second prong of section 206 of the FPA. Specifically, we find that the record does not contain any evidence suggesting that investors use the Risk Premium model adopted in Opinion No. 569-A. We also find that the record does not contain any evidence that would resolve the circularity concerns inherent in the Risk Premium model adopted in Opinion No. 569-A. Accordingly, we reverse the portions of Opinion Nos. 569-A and 569-B that include the Risk Premium model in the Commission's ROE methodology, while maintaining the other modifications to the Commission's ROE methodology set forth in Opinion No. 569, as modified by Opinion Nos. 569-A and 569-B.<sup>124</sup>

Here, too, the record fails to support the inclusion of the Risk Premium model in the Commission's ROE methodology because: the record does not contain any evidence suggesting that investors use the RPA or any evidence that would resolve the circularity concerns inherent in the RPA.<sup>125</sup> To the contrary, the record demonstrates that investors cannot invest at book value, they can only invest at the market price; and establishes that market to book ratios and other evidence reveal that authorized ROEs nationwide far exceed investor's market-based return expectations.<sup>126</sup> Thus, the recommendations that utilize the RPA or EEA must be rejected.

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<sup>123</sup> *MISO Transmission Owners v. FERC* (D.C. Cir. 2022) 45 F.4th 248, 263-264.

<sup>124</sup> FERC Order On Remand, p. 61,036, paragraph 23 (footnotes omitted).

<sup>125</sup> SC/PCF-01 (Ellis), p. 15-22; SC/PCF-08 (Ellis), p. 2-4, 20-21.

<sup>126</sup> SC/PCF-01 (Ellis), p. 8-13; *id.* at p. 18-20.

**B. The Utilities Utilize Various Unrealistic and Implausible Inputs to the CAPM and DCF Models, But their Economically Impossible Long-Term Growth Assumptions Constitute the Most Significant Factor that Inflates their COE Estimates.**

Although the Utilities utilize a number of empirically invalid and unrealistic assumptions in their DCF and CAPM analyses,<sup>127</sup> the most significant error that artificially inflates their COE estimates remains their use of unrealistic and economically implausible long-term perpetuity growth assumptions. The Utilities' CAPM and DCF analyses assume analysts' earnings-per-share growth rate forecasts are valid into perpetuity, when in fact analysts' forecasts are only valid for a few years.<sup>128</sup> The Utilities' perpetuity growth rate assumptions are economically infeasible in the real world and therefore cannot form the basis for estimating the cost of equity.<sup>129</sup>

The absurdity of the Utilities' perpetual growth assumptions, which artificially inflate their COE estimates, surpass long term GDP, which is mathematically impossible and untethered to any economic reality.<sup>130</sup> Although the March 2025 Congressional Budget Office long-term nominal GDP forecast growth rate is only 4%,<sup>131</sup> Mr. Nowak's average perpetuity growth rates for his SDG&E and SCG proxy groups are 6.4% and 6.5%, respectively.<sup>132</sup> His "conservative" perpetuity growth rate for the S&P 500 Index is 10.0%,<sup>133</sup> more than double expected long-term GDP growth.<sup>134</sup> It is mathematically and economically impossible for any individual stock or industry to grow faster than GDP into perpetuity.<sup>135</sup>

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<sup>127</sup> SC/PCF-01 (Ellis), p. 40, 66 ("The DCF is a model of future expected dividends of the individual utilities into perpetuity, and the CAPM is a model of risk relative to the market.")

<sup>128</sup> SC/PCF-01 (Ellis) at 41:21-42:3.

<sup>129</sup> SC/PCF-01, p. 41-46; SC/PCF-08, p. 5.

<sup>130</sup> SC/PCF-01, p. 41-42.

<sup>131</sup> SC/PCF-01, p. 43.

<sup>132</sup> Exhibit SDG&E-03 (Nowak), p. JCN-4; Exhibit SCG-03, p. JCN-4.

<sup>133</sup> SDG&E Exhibit JCN-5 and SCG Exhibit JCN-5.

<sup>134</sup> SC/PCF-01.

<sup>135</sup> SC/PCF-08, p. 7-9.

Whether forecasting future dividends for the utilities in the DCF, or forecasting future dividends for the market as a whole in the CAPM, utilizing analysts' short-term earnings-per-share growth forecasts as if they were forecasts for all of time renders the Utilities' DCF and CAPM results unusable.<sup>136</sup>

**C. The Utilities' and Other Parties' Cost of Equity Estimates Exceed the Return Expectations of the World's Largest and Most Sophisticated Investors for the More-Risky Market as a Whole.**

Nearly all the other Parties' cost of equity ("COE") estimates for the Utilities are *substantially higher* than the consensus return expectation for the more-risky market as a whole among dozens of the world's largest and most sophisticated investors.<sup>137</sup> That means that all other parties presume that the California Utilities, as regulated monopolies with guaranteed cost recovery, should pay higher returns than much riskier companies that do not enjoy guaranteed cost recovery from their customers and regulators that ensure that those companies make a profit.

None of the Utilities or Parties acknowledge, much less provide any justification for, the disparity between their COE estimates and the overall market consensus about the cost of capital for the stock market overall.<sup>138</sup> For example, although capital market assumption reports (CMAs) are well-known among finance professionals and are readily available, the Utilities' and Parties' experts omit any mention of their existence. The wide divergence between the market consensus view of the cost of capital and the COE proposals submitted to this Commission provide another data point demonstrating that the Utilities' and Parties' high COEs involve faulty methodologies or facially implausible assumptions.<sup>139</sup>

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<sup>136</sup> SC/PCF-08 (Ellis), p. 6.

<sup>137</sup> SC/PCF-08 (Ellis), p. 1.

<sup>138</sup> SC/PCF-08 (Ellis), p. 4.

<sup>139</sup> SC/PCF-08 (Ellis), p. 4.

Neither the Utilities nor the Parties provide any evidence to suggest that they possess some unique insight into the market that has eluded *every single* institutional market investor, including well-known firms like BlackRock, J.P. Morgan, Morningstar, and Vanguard.<sup>140</sup> The Utilities' and the Parties' witnesses do not provide any rationale for the Commission to determine that their COE results are reasonable, given that all their results far exceed independent benchmarks and conflict with the world's foremost experts.<sup>141</sup> The Commission should not give any weight to the analysis of witnesses testifying in this proceeding that deviate so sharply from that of highly-regarded and well-resourced institutions with demonstrated market experience and expertise.<sup>142</sup>

**VII. THE COMMISSION SHOULD ADOPT THE RECOMMENDATIONS IN MR. ELLIS' EXPERT TESTIMONY, THE ONLY TESTIMONY THAT CONSIDERS IMPACTS ON RATEPAYERS, OPTIMIZES ROE AND CAPITAL STRUCTURE, AND RELIES UPON EMPIRICALLY ACCURATE INFORMATION AND SOUND FINANCIAL LOGIC.**

The Commission will determine in this proceeding whether ratepayers will be required to shoulder unnecessary, additional cost burdens on top of their current extraordinary rates. The testimony presented by the Sierra Club and PCF constitutes the only testimony that allows the Commission to answer the fundamental question at issue in this case: how to pay for the Utilities' necessary capital investments at the lowest costs to the ratepayers. The Commission remains legally bound to consider fully the alternatives presented by PCF and the Sierra Club regarding the appropriate ROR, ROE, cost of debt, and capital structures necessary to protect the public interest.<sup>143</sup>

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<sup>140</sup> SC/PCF-08 (Ellis), p. 4.

<sup>141</sup> SC/PCF-08 (Ellis), p. 4.

<sup>142</sup> SC/PCF-08 (Ellis), p. 2-4.

<sup>143</sup> *United States Steel Corp. v. Public Utilities Com.* (1981) 29 Cal.3d 603, 608 (“The commission must consider alternatives presented and factors warranting adoption of those alternatives.”); *City & County of*

Mr. Ellis recommends a win-win for investors and customers.<sup>144</sup> He demonstrates how regulators can adjust ROEs and equity ratios to reduce *both* customer costs and the market-based costs of debt and equity.<sup>145</sup> Mr. Ellis performs a quantitative analysis that optimizes the relationships between ROE and capital structure, and demonstrates how changes in capital structure and ROE affect the market-based costs of debt and equity.<sup>146</sup> The Utilities did not meaningfully rebut Mr. Ellis’s analysis or recommendations.<sup>147</sup>

Unlike the testimony submitted by the Utilities<sup>148</sup> and the testimony jointly submitted by the Energy Producers & Users Coalition (EPUC), Indicated Shippers (IS), and The Utility Reform Network (TURN),<sup>149</sup> Mr. Ellis does not use financial models that are not market-based to estimate the cost of capital, which by definition consists of the investors’ expected returns based on the cost they pay in the market.<sup>150</sup>

Unlike the Utilities and all the other parties, Mr. Ellis’s results fall within the range that the world’s most sophisticated investors estimate, on average, as the cost of capital for the market as a whole.<sup>151</sup>

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*San Francisco v. Public Utilities Com.* (1971) 6 Cal. 3d 119, 130 (“For failure to consider lawful alternatives in calculation of federal income tax expense, the decision of the commission must be annulled.”).

<sup>144</sup> SC/PCF-01 (Ellis), p. 31.

<sup>145</sup> SC/PCF-01 (Ellis), p. 31.

<sup>146</sup> SC/PCF-01, p. 25-34, 88-99.

<sup>147</sup> A.25-03-010 et seq., Transcript of September 4, 2025 Evidentiary Hearing (September 11, 2025), p 175 (Mekitarian) (“Q. Did you perform any kind of analysis that would refute Mr. Ellis’ testimony that regulators can adjust ROEs and equity ratios to reduce both customer costs and the market-based cost of debt and equity? A. No....); *id.* at p. 169 (Bille) (admitting that statements in testimony about Mr. Ellis’s ROEs being higher than the cost of debt were false: “Q That number 6.15 percent, is higher than SDG&E’s updated average cos of debt estimate; correct? A It would be correct to say that this is higher than our embedded cost of debt...”).

<sup>148</sup> SC/PCF-01 (Ellis), p. 34-39;

<sup>149</sup> SC/PCF-08 (Ellis), p. 20-21.

<sup>150</sup> SC/PCF-01 (Ellis), p. 7 (Figure 2); *id.* at p. 10-11

<sup>151</sup> SC/PCF-01 (Ellis), p. 15-18; SC/PCF-08 (Ellis), p. 2-4.

Unlike the Utilities and other parties, Mr. Ellis does not assume mathematically impossible and empirically unrealistic long-term growth assumptions.<sup>152</sup> Instead, Mr. Ellis uses long-term growth rates consistent with fundamental economic principles and long-term trends over the last nearly 100 years to reach economically valid, empirically supported, reasonable and reliable results.<sup>153</sup>

Most importantly, Mr. Ellis provides the only quantitative analysis from the ratepayer perspective, the Commission’s reason for existence that the Commission remains duty-bound to protect.<sup>154</sup> Mr. Ellis’s DCF and CAPM results, his recommended ROR, ROE, COD, and capital structure, and the ratepayer savings that will result from adopting Mr. Ellis’s recommendations, are reproduced below.<sup>155</sup>

	SDG&E	SoCalGas	PG&E	SCE
<b>Cost of Equity</b>				
DCF	7.0	6.98	6.99	6.90
CAPM	5.38	5.55	5.42	5.42
Average	6.19	6.27	6.20	6.16
<b>Rate of Return</b>				
Rate of Return	5.42	5.64	5.62	5.47
ROE	6.15	6.21	6.22	6.11
Preferred	N/A	N/A	N/A	N/A
COD	4.61	4.99	5.01	4.70
<b>Capital Structure</b>				
Common equity	52.6	52.9	50.4	54.7
Preferred equity	0.0	0.0	0.0	0.0
Debt	47.4	47.1	49.6	45.3
<b>Annual Savings</b>				
Annual Savings	\$330 million 11.9%	\$440 million 11.4%	\$3.33 billion 15.9%	\$2.02 billion 17.5%

<sup>152</sup> SC/PCF-01 (Ellis), p. 50-56; SC/PCF-08 (Ellis), p. 5-30.

<sup>153</sup> SC/PCF-01 (Ellis), p. 53-56; SC/PCF-08 (Ellis), p. 5-17.

<sup>154</sup> SC/PCF-01 (Ellis), p. 22, 85-99; *see* Section IV, *supra*.

<sup>155</sup> Excerpted from SC/PCF-01 (Ellis), p. 7 (Figure 2).

## VIII. CONCLUSION

The Utilities' failure to consider the impact of their applications on ratepayers requires that the Commission deny the Utilities' applications. The only evidence in this proceeding that considers ratepayer impact remains Mr. Ellis' expert testimony submitted by Sierra Club and PCF. Accordingly, the Commission should authorize the capital structure and the Utilities' returns on equity and debt detailed and supported in the Sierra Club and PCF's expert testimony and identified above.

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