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

Application of Southern California Gas Company (U904G) for Authority, Among Other Things, to Update its Gas Revenue Requirement and Base Rates Effective on January 1, 2024.	Application 22-05-015
And Related Matter.	Application 22-05-016

PACIFIC GAS AND ELECTRIC COMPANY'S RESPONSE TO PETITION OF SOUTHERN CALIFORNIA GAS COMPANY (U 904 G) AND SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M) FOR MODIFICATION OF DECISION 24-12-074

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

California Public Utilities Commission

Decisions

Rules of Practice and Procedure

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Pursuant to Rule 16.4 of the Rules of Practice and Procedure of the California Public Utilities Commission (Commission), Pacific Gas and Electric Company (PG&E) respectfully submits this Response to the December 17, 2025 Petition for Modification (PFM) of Decision (D.) 24-12-074 – the Commission's decision in the Test Year (TY) 2024 General Rate Case (2024 GRC) for Southern California Gas Company and San Diego Gas & Electric Company (Companies).

I. INTRODUCTION

PG&E supports the Companies' PFM and urges the Commission to grant the PFM in its entirety, including the proposed redline changes to Section 47, Findings of Fact, and Conclusions of Law identified in Attachment A to the PFM.

The PFM asserts that the Commission's adoption of a one-part post-test year (PTY) mechanism for 2025 to 2027 was based on "misconceptions of fact" and prevents a utility from recovering its authorized capital-related costs. To address this unintended result, the PFM urges the adoption of a two-part attrition mechanism as a reasonable modification for the following reasons:

(1) Application of the one-part mechanism using a three percent escalation of revenue requirement grossly underfunds the approved capital and associated capital costs in the

> Companies' TY 2024 GRC, which impedes the provision of safe and reliable service to customers and will cause rate volatility in the next GRC;
>
> (2) Escalation of capital-related revenue requirement at the same level as Operations & Maintenance (O&M) expenses is inconsistent with the well-established principle that O&M expenses and capital costs impact the revenue requirement differently; and
>
> (3) Application of a two-part mechanism is appropriate because the Companies have also demonstrated that forecasted capital additions (i.e., new additions to plant in service included in rate base) exceed depreciation. The two-part mechanism appropriately funds forecasted capital additions.

PG&E agrees with the Companies' position.

First, application of a one-part mechanism using a three percent escalation of TY revenue requirement for both expenses and capital-related costs will not provide *any* cost recovery for significant *new and incremental* capital investments (or capital additions[1]) in the attrition years, much less the opportunity to earn a return on the capital investment. The Commission should modify D.24-12-074 to ensure cost recovery for any new and incremental capital investments in the three attrition years (2025 to 2027) necessary to provide safe and reliable service.

Second, to ensure sufficient recovery, PTY capital costs must be addressed with a separate mechanism that is distinct from the mechanism applied to O&M and other expenses. This bifurcation in treatment of capital-related spend and expense-related spend is also known as the "two-part" method, which has longstanding history and is supported by recent precedent.

Third, PG&E supports the Companies' argument that they have "demonstrated the *need for additional funds* in the post-test years to account for anticipated growth in capital additions in excess of depreciation."[2] The Companies' demonstration further underscores the underfunding

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[1] Capital expenditures result in capital additions only when project work is complete and the asset is ready and available for utility service. This response will refer to "capital additions" or "additions" to represent assets to be placed-in-service during the attrition years that require a capital revenue requirement (depreciation, taxes, and return).

[2] D.24-12-074 at p. 1027, Finding of Fact (FOF) 438 (emphasis added).

caused by the use of a one-part mechanism. For the reasons explained below, PG&E urges the Commission to grant Companies' PFM.[3]

II. BACKGROUND

In D.24-12-074, the Commission applied a three percent increase to the base revenue requirement for each attrition year in the PTY revenue requirement calculation. As explained below, the Decision's "one-part" PTY mechanism compromises Companies' obligation and ability to complete approved PTY GRC capital projects that support risk-reduction, safety, and reliability during the attrition years.

A one-part PTY mechanism involves applying a single cost escalation rate to TY revenue requirements composed of both expense and capital components. A "two-part" mechanism involves applying a separate, distinct, and specific PTY mechanism to capital costs. The capital mechanism, in turn, has two important steps: 1) use *test year capital additions* to produce capital additions in the attrition years, and 2) calculate a capital-related revenue requirement (including depreciation, return, and taxes) based on those capital additions for each of the three attrition years.

Commission GRC decisions are based on its extensive review of the TY forecasts. Per the Rate Case Plan "[t]he post-test year revenue requirements are typically determined by (1) escalating the test-year O&M expenses, and (2) authorizing capital expenditures at a level determined by either (i) applying additional escalation factors, or (ii) further review of the applicant utility's actual capital budgets for those years."[4] D.20-01-002 extended investor-owned utilities' GRC rate case cycles from three years to four years. Thus, the number of attrition years

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[3] The PFM, pp. 44-45, addresses the use of a seven-year average of capital additions from 2018-2024 as a proxy for capital additions in attrition years, which resulted from a settlement. PG&E notes that the settlement on this issue should not serve as precedent for pending or future GRCs under Commission Rule 12.5. The PFM, pp. 46-47, suggests alternative treatments (five-year average with escalation or TY capital additions with zero escalation). PG&E supports each of these approaches because all *are foundational to the two-part mechanism to include capital additions in the attrition years to calculate a capital revenue requirement*.

[4] Rate Cass Plan (RCP), D.20-01-002, p. 8.

in a cycle increased from two to three[5] and, critically, raised the importance and challenge of "authoriz[ing] an investor-owned utility to recover through rates the reasonable capital investment costs and annual expenses necessary to operate and maintain its facilities and equipment in a safe and reliable manner."[6]

Both PG&E's 2023 GRC and SCE's 2025 GRC decisions correctly noted that the PTY mechanisms adopted in GRCs are not intended to replicate a TY analysis or cover all potential cost changes. Rather, the mechanism should cover inflationary price increases and allow the utility to perform the PTY work authorized in its GRC, as well as provide the utility with a reasonable opportunity to earn the authorized rate of return.[7] The Commission has further articulated that PTY mechanisms are intended to provide sufficient funding so that "a well-managed utility can provide safe and reliable service while maintaining financial integrity" during the attrition years of the GRC cycle.[8]

As discussed below, the D.24-12-074 PTY mechanism breaks with this well-established Commission policy, practice and precedent by simply escalating the TY revenue requirement without consideration of the underlying capital costs components (depreciation, taxes, and the authorized return on rate base associated with capital additions) of the revenue requirements. For the reasons explained below, PG&E urges the Commission to modify D.24-12-074 to adopt a two-part PTY mechanism.

III. ARGUMENT

A. The Commission Should Modify D.24-12-074's Adoption Of A One-Part Mechanism Using A Three Percent Escalation Of Revenue Requirement Because It Will Significantly Underfund Capital Additions

In the PFM, the Companies argue that a one-part attrition mechanism has caused significant underfunding of authorized capital-related work in the attrition years, point out

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[5] *Id*. p. 77, Conclusion of Law (COL) 4.

[6] *Id*, p. 8.

[7] D.25-09-030, pp. 844-846.

[8] D.14-08-032 (PG&E 2014 GRC), pp. 652-653.

permanent loss of recovery for capital-related costs, and note problems of rate volatility and rate shock when these costs are reflected in the Companies' next GRC. PG&E agrees. The fundamental problem with the PTY mechanism in D.24-12-074 is that it ignores the specific cost components of the PTY capital-related revenue requirements (depreciation, taxes, and authorized return on rate base associated capital additions) and fails to fully fund the work that has been authorized during the PTYs. The PTY mechanism adopted in a GRC should cover inflationary price increases in order to allow the utility to complete PTY work authorized in the final decision, while providing the utility with a reasonable opportunity to earn the authorized rate of return. The appropriate approach would be to implement a PTY mechanism based on a two-part calculation that treats the cost recovery of capital-related spending and expense-related spending separately. For capital-related spending, cost recovery should include capital-related revenue requirements that are based on escalated TY capital additions and specific cost components within the revenue requirement.

The following table illustrates the funding shortfall for capital expenditures created by the 2024 GRC's "one-part" attrition mechanism. For simplicity, the example assumes a hypothetical $1 billion of capital additions in the TY, plus additional capital in the PTYs escalated at three percent (as provided in D.24-12-074). The table compares "two-part" PTY revenue requirements calculated properly based upon relevant cost components (depreciation expense, taxes, and return on rate base) to the "one-part" mechanism that simply escalates the TY revenue requirement without considering these components. Simply escalating the TY revenue requirement also fails to consider the cumulative impact of PTY capital additions that will increase rate base and the resulting revenue requirement over the course of the three attrition years of the rate case cycle. In this example, based on $1 billion of TY capital additions, the corresponding TY revenue requirement would be $144 million (line 11). Simply escalating that test-year revenue requirement by three percent will result in revenue requirements of $148 million, $153 million, and $157 million for each attrition year, respectively. Based on a two-part calculation methodology that includes capital additions approved for all four years of the rate case cycle, the attrition revenue requirement (line 9) that covers the TY and PTY capital additions, the cost components of depreciation, taxes and return would derive attrition revenue requirements of $286 million, $427 million, and $566 million, in each respective attrition year. This results in revenue requirement shortfalls of $138 million, $274 million, and $408 million each attrition year, respectively, for all approved capital additions. As the example shows, the one-part mechanism funds $1.0 billion of capital additions for only the first year of a four-year GRC rate case cycle, and provides zero funding for the remainder of the cycle.

Line No.	*$ in millions of dollars*	Test Year	Post-Test Year 1	Post-Test Year 2	Post-Test Year 3
1	**Revenue Requirements (RRQ) - One-Part v. Two-Part Attrition Mechanism**				
2	Test Year Adopted Capital Additions	1,000	"two-part"		
3	Post-Test Year Capital Additions: Escalate Test Year Additions by 3%		1,030 ✓	1,061 ✓	1,093 ✓
4	Plant (prior year + current year capital additions)	1,000	2,030	3,091	4,184
		"one-part"			
5	Book Depreciation (Ln 4 x 4% depreciation rate)	40	81	124	167
6	Accumulated Depreciation (A/D)	40	121	245	412
7	Rate Base Estimate (Plant less A/D) (Ln 4 - Ln 6)	960	1,909	2,846	3,771
8	RRQ Capital Factor (Depreciation, Taxes, Return)	15%	15%	15%	15%
9	**RRQ with Capital Additions in Post-Test Years (Ln 7 x Ln 8)**	**144**	**286**	**427**	**566**
10	**RRQ Estimate Using 3% Escalation For Post-Test Years**		3%	3%	3%
11	**RRQ with 3% Growth of TY Revenue Requirement**	**144**	**148**	**153**	**157**
12	**RRQ Gap - 3% of TY RRQ (one-part) v Cap Adds in PTYs (two-part) (Ln 11 - Ln 9)**	**0**	**(138)**	**(274)**	**(408)**

** For Simplicity, Accumulated Deferred Income Taxes are not considered here.*

As the table above shows, a one-part mechanism that only escalates *base year revenue requirements* and ignores approved capital additions in the attrition years will not adequately fund approved and critical capital additions that must be made in the attrition years. Thus, the shortfall in PTY funding approved in D.24-12-074 would severely hinder the Companies' ability to carry out capital projects essential for reducing risk and improving safety and reliability.

The Companies demonstrated that attrition year capital additions exceed depreciation[9] and further provided an example of a specific program resulting in an "unfunded mandate" [10] due to flaws in the one-part mechanism. Further, this underfunded mandate *permanently depriv*es Companies of "return on" incremental deployed assets. This result is confiscatory; "return on" the deployed assets will not start until the next rate case cycle, and the missing return for the three attrition years can never be made up.

B. The Commission's Adoption of The Same Escalation For Capital-Related Revenue Requirement And O&M Expenses Is Inconsistent With Well-Established Regulatory Principles and Should be Modified

Commission precedent supports application of a two-part mechanism to ensure that the Companies receive an appropriate "return on" deployed capital assets in attrition years. The Commission has on numerous occasions acknowledged that there are different drivers for the capital and expense components of attrition, warranting that each be separately addressed to determine reasonable expectations for PTY cost-of-service growth.[11] With this in mind, the Commission has further noted that while use of a single index to determine PTY revenue increases between expenses and capital additions offers simplicity, "*such an approach [also] fails to adequately capture the distinctions between expense and capital expenditure attrition*."[12] Furthermore, the Commission has recognized that the Consumer Price Index (CPI) "reflects

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[9] PFM pp. 38-39.

[10] PFM, p. 38, fn. 121 ("These PHMSA requirements have been adopted by the CPUC, and more specifically SED. The CPUC's delegated authority from PHMSA rests on an expectation and an obligation that these federal requirements will be authorized, funded, and enforced. This PD authorizes the work to be done, as it must. But, the money to fund that work in the post-test years is not adequate. This mismatch, between the expectation to continue doing the capital work through the post-test years and the failure to fund that same level of work, sends a potentially dangerous mixed message. From the federal world that I spend time in, the term of art to describe this situation is 'an unfunded mandate.'")

[11] *See, e.g.*, D.23-11-069, pp. 707-708 (finding it "reasonable" in PG&E's 2023 GRC to adopt a bifurcated methodology "[c]onsistent with the Commission's recent decisions"); D.21-08-036, pp. 546-547 (separately escalating expenses and capital costs in SCE's 2021 GRC because they affect revenue requirement differently, and further bifurcating treatment between wildfire and non-wildfire capital additions); D.19-09-051, p. 707 (finding it "reasonable" in Sempra's 2019 GRC to apply different PTY mechanisms for expenses and capital additions because they affect revenue requirement differently).

[12] D.14-08-032, p. 653 (emphasis added).

consumer retail price changes, not the escalation in wholesale purchases of utility goods and services," and, as such, industry-specific escalation factors are generally adopted.[13]

In light of this long history of the Commission's application of a two-part mechanism, D.24-12-074 stands out as an anomaly. PG&E urges the Commission to grant Sempra's PFM in its entirety and allow use of this well-established two-part mechanism.

C. The Companies Have Also Demonstrated That Forecasted Capital Additions Exceed Depreciation Further Justifying The Modification Of The Decision To Adopt A Two-Part Mechanism

The Companies have demonstrated net additions in excess of depreciation.[14] Just as compelling, the PFM details what goes "missing" when the flawed one-part mechanism excludes capital additions. "For both Companies, the missing depreciation expense and capital-related revenue requirement shortfall total approximately $5 billion of inadequately funded recurring capital projects over the post-test year period."[15] "This is not a theoretical problem. 74% of SoCalGas's authorized capital expenditures and 71% of SDG&E's are recurring in nature and are subject to the missing depreciation expense issue and capital-related revenue requirement shortfall identified above."[16] "The spending above-authorized in the test year, coupled with underfunding in the post-test years (missing money or shortfall), creates an *untenable* situation that undercuts the Companies' efforts to maintain safe and reliable service."[17]

IV. CONCLUSION

For the foregoing reasons, PG&E respectfully recommends that Commission grant the changes requested by the PFM as described herein.

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[13] *Id.* See also D.21-08-036, p. 547 (affirming that utility specific indices more accurately reflect how utilities incur costs than CPI); D.19-09-051, p. 708 (applying Global Insight escalation rates specific to the utility industry to more accurately reflect SDG&E's and SoCalGas' inflationary cost increases).

[14] PFM, p. 39.

[15] PFM, p. 3.

[16] PFM, p. 18.

[17] PFM, p. 29 (emphasis added)

Respectfully Submitted,

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