PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

Agenda ID: 18387
RESOLUTION E-5071
June 11, 2020

R E S O L U T I O N

Resolution E-5071. San Diego Gas & Electric's adjustment to reflect the equity rate base exclusion for wildfire mitigation capital expenditures required by Assembly Bill 1054.

PROPOSED OUTCOME:

- This Resolution adopts San Diego Gas & Electric's (SDG&E) adjustment to reduce its Post Test Year (PTY) revenue requirements by $8.3 million, $10.9 million, and $10.3 million in PTYs 2020, 2021, and 2022, respectively.

SAFETY CONSIDERATIONS:

- There are no safety considerations associated with this resolution.

ESTIMATED COST:

- This Resolution is expected to reduce costs for SDG&E's ratepayers by a combined $29.5 million from PTY 2020 through PTY 2022.

By Advice Letter 3488-E, filed on December 30, 2019.

SUMMARY

This Resolution approves, without modification, SDG&E's Tier 3 Advice Letter (AL) 3488-E and supplemental 3488-E-A, requesting to reduce PTY revenue requirements by $8.3 million in 2020, $10.9 million in 2021 and $10.3 million in 2022. SDG&E filed AL 3488-E pursuant to Ordering Paragraph 6 of Decision (D).19-09-051.

BACKGROUND

On October 6, 2017, SDG&E filed its Test Year 2019 General Rate Case (GRC) Application (A.)17-10-007.

On July 12, 2019, Assembly Bill (AB) 1054 was signed into law. AB 1054 includes a provision requiring that the California Public Utilities Commission (CPUC) excludes the first $5 billion of aggregate wildfire mitigation capital expenditures from equity rate base for the three large electric investor-owned utilities.[1]

On October 1, 2019, the CPUC issued SDG&E GRC D.19-09-051that includes Ordering Paragraph 6 directing:

> *"…SDG&E shall file a Tier 3 Advice Letter concurrent with its year-end adjustment filing for 2019, providing a detailed explanation and showing of the revenue requirement impact of the Public Utilities Code section 8386.3(e) equity rate base exclusion when it makes its annual PTY revenue requirement implementation filings."*

On December 30, 2019, SDG&E filed Tier 3 AL 3488-E reducing PTY revenue requirements by $8.3 million in 2020, $10.9 million in 2021 and $10.3 million in 2022 in compliance with OP 6 of D. 19-09-051.

On March 4, 2020, SDG&E filed supplemental AL 3488-E-A clarifying the timing of the $8.3 million refund for PTY 2020, stating that implementation would occur via electric distribution rates at SDG&E's next revenue requirement change, either at April 1, 2020, or at the year-end rate change scheduled for January 1, 2021.[2]

On March 23, 2020, the Protect Our Communities Foundation (POC), filed a protest to supplemental Advice Letter 3488-E-A. SDG&E replied to the protest on March 30, 2020.

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[1] AB 1054 added Sec. 8386.3(e) to the Public Utilities Code.

[2] SDG&E Supplemental Advice Letter 3488-E-A, p. 2.

NOTICE

Notice of AL 3488-E was made by publication in the Commission's Daily Calendar. SDG&E states that a copy of the Advice Letter was mailed and distributed in accordance with Section 4 of General Order 96-B.

PROTESTS

On March 23, 2020, the Protect Our Communities Foundation (POC) filed a timely protest (Protest) to SDG&E supplemental Advice Letter 3488-E-A. The issues raised in the Protest are discussed below.

DISCUSSION

On July 12, 2019, AB 1054 was signed into law by the Governor of California. Among its many provisions, AB 1054 added Section 8386.3(e) to the Public Utilities Code (PUC). Section 8386.3(e) states:

> *The commission shall not allow a large electrical corporation to include in its equity rate base its share, as determined pursuant to the Wildfire Fund allocation metric specified in Section 3280, of the first five billion dollars ($5,000,000,000) expended in aggregate by large electrical corporations on fire risk mitigation capital expenditures included in the electrical corporations' approved wildfire mitigation plans. An electrical corporation's share of the fire risk mitigation capital expenditures and the debt financing costs of these fire risk mitigation capital expenditures may be financed through a financing order pursuant to Section 851, subject to the requirements of that financing order.*

Excluding capital expenditures from equity rate base, as required by Section 8386.3(e), means that the capital-related shareholder return on equity (ROE), (and associated income taxes) is removed from the utility's revenue requirement and replaced with less costly debt financing. As a result, implementing the Section 8386.3(e) capital exclusion from equity rate base saves utility ratepayers money by reducing financing costs in rates.

Financing capital expenditures with debt is less expensive than financing with equity, because debt is viewed as less risky by investors and thus a lower risk premium is required by investors[3]. For example, SDG&E's PTY 2020 adopted cost of equity financing is 10.20%, while SDG&E's adopted cost of debt financing is 4.59%[4].

For ratemaking purposes, a utility's capital expenditures are accounted for in its rate base, which is financed by a roughly 50/50 mix of debt and equity[5]. This mix, weighted by the individual authorized costs of equity and debt, results in a ratio known as the rate of return. SDG&E's 2020 Commission-authorized rate of return is 7.55%[6].

The significance of the authorized rate of return is that prior to implementation of Section 8386.3(e) SDG&E ratepayers would have been required to finance the related capital at 7.55%, plus tax impacts, however, after implementation of Section 8386.3(e) ratepayers will finance the related capital at the 4.59% cost of debt only for PTYs 2020-2022.

SDG&E's Methodology

As referred to in Section 8386.3(e), PUC Section 3280 states that SDG&E's allocation metric is 4.3% of the excluded $5 billion aggregate large electric corporation spending, meaning that SDG&E is required to exclude $215 million of approved wildfire mitigation plan capital expenditures from equity rate base.

As set forth in AL 3488-E, SDG&E's method for implementing the requirement of Section 8386.3(e) begins by tracking approved wildfire mitigation capital expenditures as of August 1, 2019, the first month after AB 1054 was signed into law. SDG&E notes this is consistent with the application of Section 8386.3(e) proposed by the other large electrical corporations.[7]

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[3] Debt financing for ratemaking does not require additional revenue for income taxes, because the interest expense on debt is deductible from taxable income.
[4] D.19-12-056, p. 2.
[5] The debt/equity ratio of 50/50 is used for illustrative purposes. Actual capital structure will vary by utility and include a small percentage of preferred equity.
[6] D.19-12-056, p. 2.
[7] SCE: A.19-08-013 and PG&E: A.18-12-009.

Next, AL 3488-E sets forth a schedule of the capital expenditures from 2019 through 2020 and the related capital deployment from PTY 2020 through PTY 2022. SDG&E then computes the standard revenue requirement using its 7.55% rate of return and compares it to the revenue requirement result using its 4.59% cost of debt only.

Table 1: from SDG&E AL 3488-E:

Capital Expenditures and Equity Exclusion from PTY Revenue Requirements (dollars in millions)					
	2019	2020	2021	2022	Total PTY
Capital Expenditures	182.9	32.1			215
Revenue Requirement (4.59%)		13	19.9	21	53.9
Revenue Requirement (7.55%)		21.3	30.8	31.3	83.4
Revenue Requirement Equity Exclusion		(8.3)	(10.9)	(10.3)	(29.5)

As shown in Table 1, SDG&E is scheduled to reach its first $215 million in capital expenditures during PTY 2020. By comparing the revenue requirement on the capital using the full 7.55% rate of return to the revenue requirement using the 4.59% cost of debt only, SDG&E is able to isolate the revenue requirement difference that is equivalent to including the capital in equity rate base.

For example, SDG&E calculates a $21.3 million revenue requirement using the adopted 7.55% rate of return on PTY 2020 capital placed in service while calculating a $13.0 million revenue requirement using only a debt return of 4.59% on the same capital placed in service. The difference between the two revenue requirements for PTY 2020 is $8.3 million, which represents the return on equity for the capital.

SDG&E then proposes reducing the revenue requirement by $8.3 million in 2020, $10.9 million in 2021, and $10.3 million in 2022 in order to comply with the equity rate base exclusion required by Section 8386.3(e).

SDG&E AL 3488-E includes an Attachment A with additional calculation details. For example, Table 2 below is reproduced from Attachment A and demonstrates how SDG&E arrives at the $8.3 million reduction for PTY 2020:

Table 2: from SDG&E AL 3488-E, Attachment A
(dollars in millions)

	4.59%	7.55%	Equity Exclusion
2020 Revenue Requireme	**13.0**	**21.3**	**(8.3)**
FF&U	0.5	0.8	**(0.3)**
O&M			**-**
Working Capital			**-**
Depreciation	5.8	5.8	**-**
Return on Common		7.9	**(7.9)**
Return on Preferred		0.3	**(0.3)**
Return on Debt	6.8	3.1	**3.7**
Federal Taxes		2.5	**(2.5)**
State Taxes		1.0	**(1.0)**
Property Taxes			

As shown in Table 2, the $8.3 million reduction for PTY 2020 is mostly attributed to the removal of the Return on Common Equity and the associated taxes, while there is an offsetting increase for the additional cost of debt that replaces the equity financing. Depreciation expense remains unchanged as the amount of capital deployed is the same under either scenario.[8]

Supplemental AL 3488-E-A

SDG&E filed supplemental AL 3488-E-A on March 4, 2020 clarifying the proposed implementation of the calculated reductions to revenue requirement. AL 3488-E-A states:

> *"The implementation of this refund will be part of SDG&E's next available revenue requirement rate change and will be amortized through the end of the year. Currently, SDG&E is expected to implement a revenue requirement rate change April 1, 2020 for the Self-Generation Incentive Program (SGIP) pursuant*

[8] See SDG&E AL 3488-E, Attachment A for additional PTYs 2021-2022 calculation details.

> *to D.20-01-021 and SDG&E's 2019 ERRA Trigger Application (D.20-02057). Subsequent to April 1, 2020, SDG&E's next expected revenue requirement rate change will be submitted through its year-end electric consolidated advice letter for rates effective January 1, 2021."*[9]

SDG&E filed supplemental AL 3488-E-A at the request of Energy Division for more clarification regarding the timing of the implementation of the proposed refunds.

CPUC Review of SDG&E's Proposal

From a practical standpoint, by excluding capital expenditures from equity rate base, Section 8386.3(e) ensures that large electric corporation shareholders will not profit from the first $5 billion spent, in aggregate, on approved wildfire mitigation capital expenditures.

However, from a ratemaking implementation standpoint, excluding certain capital from equity rate base is a financial adjustment that reduces financing costs for *already-approved* capital expenditures by substituting the full rate of return with the debt only return. Thus, for SDG&E, the exclusion from equity rate base can be distilled to a dollar amount reduction to a previously-approved revenue requirement.

It is therefore reasonable for SDG&E to determine ratepayer savings for PTYs 2020-2022 from the AB 1054 equity rate base exclusion by calculating the difference between the revenue requirement on the capital expenditures using the full 7.55% rate of return and the revenue requirement on the same capital expenditures using the 4.59% return on debt.

Since AB 1054 became law on July 12, 2019 and capital accounting systems generally work on a monthly accrual basis, it is also reasonable for SDG&E to begin tracking its $215 million of excludable capital expenditures as of August 1, 2019.

[9] SDG&E Supplemental AL 3488-E-A, p. 2.

With respect to SDG&E 's statement indicating its intent to file a financing order application, we find this to be consistent with language in PUC Sec. 8386.3(e):

> *…An electrical corporation's share of the fire risk mitigation capital expenditures and the debt financing costs of these fire risk mitigation capital expenditures may be financed through a financing order pursuant to Section 851, subject to the requirements of that financing order.*

The CPUC has reviewed SDG&E AL 3488-E, supplemental AL 3488-E-A and SDG&E's underlying calculations that substantiate Tables 1 and 2, and finds the proposed revenue requirement reductions and the timing for such reductions contained therein to be reasonable. SDG&E AL 3488-E and AL 3488-E-A therefore, are approved.

It is important to note that the revenue requirement adjustments proposed by SDG&E in AL 3488-E and supplemental AL 3488-E-A for PTYs 2020-2022 are not the final equity rate base adjustments related to the $215 million capital expenditures. Pursuant to PUC Section 8386.3(e), SDG&E will be required to make revenue requirement adjustments in each year after 2022 reflecting the exclusion from equity rate base for the entire useful life of these capital expenditures.

<u>Protest of the Protect Our Communities Foundation and SDG&E's Reply</u>

POC's Protest states that supplemental AL 3488-E-A "neither explains what additional information was requested nor how the information provided in the Advice Letter meets those requirements. Nor is it clear as to whether SDGE [sic] 3488-E-A is in fact adding to Advice Letter 3488-E or eliminating aspects of Advice Letter 3488-E."[10]

Regarding the additional information, supplemental AL 3488-E-A contains a section titled "Discussion- Timing Of Refund"[11] that explains that implementation of the PTY 2020 refund "will be part of SDG&E's next available revenue requirement rate change and will be amortized through the end of the

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[10] POC Protest of SDG&E supplemental AL 3488-E-A, p. 1.
[11] SDG&E Supplemental AL 3488-E-A, p. 2.

year."[12] This information was not previously included in AL 3488-E and therefore provides the additional information.

Regarding the Protest's concern whether supplemental AL 3488-E-A is eliminating aspects of the original AL 3488-E, supplemental AL 3488-E-A clearly states that it "supplements in part and will not change the integrity of the original AL 3488-E"[13] As a result, the Commission finds that supplemental AL 3488-E-A does not eliminate <u>any</u> information contained in AL 3488-E.

POC's Protest adds that "Advice Letter 3488-E-A fails to include any reference to the recent decision D.20-01-002 which is currently under discussion in I.19-10-010/011, requires SDG&E to file a petition to modify D.19-09-051 in A.17-10-007, and which involves SDG&E's requested revenue requirements in 2022 and 2023."[14] However, as noted in SDG&E's Reply, AL 3488-E was not protested and the Commission's General Order (GO) 96-B, General Rule 7.5.1, states that "any new protest shall be limited to the substance of the supplemental or additional information contained herein."

Supplemental AL 3488-E-A contains additional information related to the timing of the PTY 2020 customer refund, does not eliminate information from AL 3488-E (which was not protested) and does not reference D.20-01-002. Therefore, pursuant to GO 96-B, POC's Protest should be limited to the additional information presented in supplemental AL 3488-E-A.

The Protest further states that "Although the decision in the cost of capital proceeding was issued on December 20, 2019, SDG&E provides no update or explanation regarding the effect of D.19-12-056 on this Advice Letter or how this Advice Letter incorporates the holdings of D.19-12-056."[15] Again, pursuant to GO 96-B General Rule 7.5.1, supplemental AL 3488-E-A does not discuss SDG&E's cost of capital proceeding, therefore POC's protest should be limited to the additional information presented. Nevertheless, SDG&E's Reply explains that as a result of D.19-12-056 and AL 3499-E/2836-G "all the components of

[12] Ibid.
[13] Ibid.
[14] POC Protest of SDG&E supplemental AL 3488-E-A, p. 2.
[15] POC Protest of SDG&E supplemental AL 3488-E-A, p. 2.

SDG&E's Cost of Capital will remain unchanged from D.17-07-005."[16] As a result, there will be no impact from SDG&E's recent Cost of Capital proceeding on AL 3488-E or supplemental AL 3488-E-A.

To summarize, the Commission finds that the Protest's concerns regarding the possible elimination of information from AL 3488-E is unwarranted, discussion of D.20-01-002 is out of scope, and there is no impact from SDG&E's cost of capital proceeding on the PTY refund amounts calculated in AL 3488-E.

For the reasons stated above, POC's Protest of supplemental AL 3488-E-A is denied.

The Commission approves the revenue requirement reductions for PTYs 2020, 2021 and 2022 proposed by SDG&E in AL 3488-E. The PTY 2020 reduction of $8.3 million shall be implemented during SDG&E's next available revenue requirement change.

If SDG&E's next available revenue requirement change is not until January 1, 2021, SDG&E will include the PTY 2020 reduction of $8.3 million, simultaneously with the PTY 2021 revenue requirement reduction of $10.9 million. The PTY 2022 reduction of $10.3 million shall be included in SDG&E's annual revenue requirement implementation filing effective for January 1, 2022.

COMMENTS

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review. Please note that comments are due 20 days from the mailing date of this resolution. Section 311(g)(2) provides that this 30-day review period and 20-day comment period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day review and 20-day comment period for the draft of this resolution was neither waived nor reduced. Accordingly, this draft resolution was mailed to parties for comments, and will be placed on the Commission's agenda no earlier than 30 days from today.

[16] SDG&E Reply to POC's Protest of SDG&E supplemental AL 3488-E-A, p. 2.

FINDINGS

1. AB 1054, signed into law on July 12, 2019, requires the Commission to exclude the first $5 billion of approved wildfire mitigation capital expenditures of the three large electric IOUs from equity rate base.
2. According to Public Utilities Code Section 3280 SDG&E's share of the first $5 billion aggregate wildfire mitigation capital spending is 4.3%, or $215 million.
3. August 1, 2019 is an acceptable date for SDG&E to begin tracking the $215 million of approved wildfire mitigation capital spending to be excluded from equity rate base.
4. Ordering Paragraph 6 of D.19-09-051 directed SDG&E to file a Tier 3 Advice Letter "…providing a detailed explanation and showing of the revenue requirement impact of the Public Utilities Code section 8386.3(e) equity rate base exclusion when it makes its annual PTY revenue requirement implementation filings."
5. SDG&E's underlying calculations and revenue requirement reductions set forth in AL 3488-E appropriately capture the equity rate base exclusion requirements of AB 1054 for years 2020, 2021, and 2022.
6. The equity rate base exclusion described in Public Utilities Code Section 8386.3(e) is not limited to PTYs 2020-2022 and remains in effect for the entire useful life of the assets.

THEREFORE IT IS ORDERED THAT:

1. The request of SDG&E to reduce PTY revenue requirements by $8.3 million in 2020, $10.9 million in 2021, and $10.3 million in 2022 as proposed in Advice Letter 3488-E and supplemental 3488-E-A is approved without modification.
2. SDG&E should implement the $8.3 million PTY 2020 revenue requirement reduction at the next possible rate change.
3. If SDG&E's next rate change takes place on January 1, 2021, SDG&E will implement the PTY 2020 savings of $8.3 million, concurrently with the $10.9 million savings for PTY 2021. SDG&E's PTY 2022 revenue requirement reduction of $10.3 million shall be implemented effective January 1, 2022.
4. Pursuant to Public Utilities Code Section 8386.3(e), for each year following 2022, SDG&E is required to reflect the equity rate base exclusion for the first $215 million of approved wildfire mitigation capital expenditures until the end of the useful life of the assets.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on June 11, 2020; the following Commissioners voting favorably thereon:

ALICE STEBBINS
Executive Director