Decision 07-12-049 December 20, 2007

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U338E) for Authorized Cost of Capital for Utility Operations for 2008.	Application 07-05-003 (Filed May 8, 2007)
And Related Matters.	Application 07-05-007 Application 07-05-008

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OPINION ON TEST YEAR 2008 COST OF CAPITAL FOR THE MAJOR ENERGY UTILITIES

1. Summary

This decision establishes the 2008 ratemaking return on common equity (ROE) for Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E) and Pacific Gas and Electric Company (PG&E). The test year 2008 ROE for SCE is 11.50%, which results in a corresponding 8.75% return on rate base (ROR). This ROR is 2 basis points[1] lower than its currently authorized 8.77% ROR and results in a revenue requirement reduction of approximately $9.6 million.[2] The test year 2008 ROE for SDG&E is 11.10%, which results in a corresponding 8.40% ROR. This ROR is 17 basis points higher than its currently authorized 8.23% ROR and results in a revenue requirement increase of approximately $9.6 million.[3] The test year 2008 ROE for PG&E is 11.35% which results in a corresponding 8.79% ROR. This ROR is the same ROR that PG&E is currently authorized; as such there is no change in its revenue requirement.

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[1] One basis point equals 0.01%.

[2] Late-Filed Exhibit 64 shows that a 10 basis point change in SCE's authorized ROE equates to a $9.3 million revenue requirement change.

[3] Late-Filed Exhibit 65 shows that a 10 basis point change in SDG&E's authorized ROE equates to a $2.5 million revenue requirement change. Hence, $2.5 million divided by 10 basis points equals a .25 million revenue requirement change for each one basis point. Therefore, a 17 basis point change in the ROE equates to a $4.3 million (17 basis points times $.25 million) change in revenue requirement. SDG&E subsequently clarified in a December 17, 2007 ex parte communication that its revenue requirement change should be $9.6 million, not the $4.3 million derived from its late-filed Exhibit 65. This update reflects the impact of changes in SDG&E's debt and preferred stock costs not reflected in its late-filed exhibit.

2. Jurisdiction and Background

Applicants are public utilities subject to the jurisdiction of this Commission as defined in Section 218 of the Public Utilities Code.[4] SCE, a California corporation and wholly-owned subsidiary of Edison International, provides electric service principally in southern California. SDG&E, a California corporation wholly owned by Sempra Energy, provides electric service in a portion of Orange County and electric and gas services in San Diego County. PG&E, a California corporation, provides electric and gas services in northern and central California.

SCE seeks to increase its ROE to 11.80% from 11.60% while SDG&E seeks to increase its ROE to 11.60% from 10.70%. PG&E seeks to increase its electric and gas operations ROE to 11.70% from 11.35%. SCE, SDG&E and PG&E propose to maintain their currently authorized capital structures.

On June 14, 2007, the applications were consolidated pursuant to Rule 7.4 of the Commission's Rules of Practice and Procedure. The consolidation of these applications does not necessarily mean that a uniform ROE should be applied to each of the utilities. This is because each of these utilities has unique factors and differences that need to be considered in arriving at a reasonable return. These unique factors and differences encompass three distinct areas: capital structure, long-term debt and preferred stock costs, and return on common equity.

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[4] All statutory references are to the Public Utilities Code unless otherwise stated.

3. Capital Structure

Capital structure consists of long-term debt, preferred stock, and common equity.[5] Because the level of financial risk that the utilities face is determined in part by the proportion of their debt to permanent capital, or leverage, we must ensure that the utilities' adopted equity ratios are sufficient to maintain reasonable credit ratings and to attract capital.

3.1. SCE

SCE seeks a test year 2008 ratemaking capital structure of 43.00% long-term debt, 9.00% preferred stock, and 48.00% common equity. This is the same capital structure that it is currently authorized.

3.2. SDG&E

SDG&E seeks a test year 2008 ratemaking capital structure consisting of 45.25% long-term debt, 5.75% preferred stock, and 49.00% common equity. This is the same capital structure that it is currently authorized.

3.3. PG&E

PG&E seeks a test year 2008 ratemaking capital structure of 46.00% long-term debt, 2.00% preferred stock, and 52.00% common equity. This is the same capital structure that it is currently authorized.

3.4. Discussion

There is no opposition to the utilities' proposed capital structures. However, Aglet Consumer Alliance, The Utility Reform Network and Utility Consumers' Alliance jointly (ATU) recommend that PG&E's 52% equity ratio be reviewed for the calendar year following the year PG&E attains an A level credit

[5] Debt due within one year, short-term debt, is excluded.

rating. ATU's recommendation pertains to a subsequent test year and should appropriately be addressed in the next phase of this proceeding which will address cost of capital mechanisms and other changes that may alter the utilities' annual cost of capital applications.

The capital structures proposed by SCE, SDG&E and PG&E are balanced, attainable and are intended to maintain an investment grade rating and to attract capital. For these reasons, we find that the undisputed proposed capital structures of SCE, SDG&E and PG&E are fair, consistent with law, in the public interest and should be adopted. The adopted capital structures are detailed in the following tabulation:

CAPITAL RATIO	SCE	SDG&E	PG&E
Long-Term Debt	43.00%	45.25%	46.00%
Preferred Stock	9.00	5.75	2.00
Common Equity	48.00	49.00	52.00
Total	100.00%	100.00%	100.00%

The next step in determining a fair ROE is to establish reasonable long-term debt and preferred stock costs.

4. Long-Term Debt and Preferred Stock Costs

Long-term debt and preferred stock costs are based on actual, or embedded, costs. Future interest rates must be anticipated to reflect projected changes in a utility's cost caused by the issuance and retirement of long-term debt and preferred stock during the year. This is because the ROE is established on a forecast basis each year.

We recognize that actual interest rates do vary and that our task is to determine "reasonable" debt cost rather than actual cost based on an arbitrary selection of a past figure.[6] In this regard, we conclude that the latest available interest rate forecast should be used to determine embedded debt cost in ROE proceedings. Consistent with this conclusion, the assigned Commissioner's Scoping Memo and Ruling allowed the utilities to update their long-term debt and preferred stock costs based on Global Insight's September 2007 forecasted interest rates for 2008. That update was submitted on September 27, 2007 as Late-Filed Exhibits 64, 65 and 66 by SCE, SDG&E and PG&E, respectively.

4.1. SCE

SCE projected its test year 2008 long-term debt cost to be 6.20% based on a simple average of its projected year-end 2007 and year-end 2008 long-term debt forecasts. That 2008 forecast provides for the issuance of $700 million in new long-term debt. Based on its late-filed exhibit that updated the impact of the most recently forecasted interest rates, SCE increased its forecasted long-term debt cost to 6.22% from 6.20%. This revised rate is five basis points higher than the 6.17% long-term debt cost authorized in its test year 2006 ROE proceeding.[7]

SCE used that same method to calculate a preferred stock cost of 5.98%. Its forecast provided for the issuance of $135 million of preferred stock in 2008. Based on its late-filed exhibit that updated the impact of the most recent forecasted interest rates, SCE increased its forecast to 6.01% from 5.98%. This

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[6] 38 CPUC2d 233 at 242 and 243 (1990).

[7] Although cost of capital proceedings are held annually, the test year 2007 cost of capital proceeding was waived pursuant to D.06-08-026.

revised rate is eight basis points lower than the 6.09% preferred stock cost SCE was authorized in its test year 2006 ROE proceeding.

4.2. SDG&E

SDG&E projected its test year 2008 long-term debt cost to be 5.55% based on a simple average of its projected year-end 2007 and year-end 2008 long-term debt forecasts. That 2008 forecast provides for the issuance of $430 million in new long-term debt. Based on its late-filed exhibit that updated the impact of the most recently forecasted interest rates, SDG&E increased its forecast to 5.62% from 5.55%. This revised rate is 13 basis points lower than the 5.75% long-term debt cost authorized in its test year 2006 ROE proceeding. This forecasted debt cost is slightly lower than SDG&E's currently authorized debt cost mainly due to SDG&E issuing $500 million of new and $161 million of refunding first mortgage bonds, which have lower interest rates, since the last cost of capital proceeding in 2005.

SDG&E used that same method to calculate a preferred stock cost of 6.70%. Its forecast provided for a $125 million issuance of preferred stock in test year 2008. This cost is also impacted by a required 550,000 share redemption. Based on its late-filed exhibit that updated the impact of the most recently forecasted interest rates, SDG&E increased its forecast to 7.25% from 6.70%. This revised rate is 42 basis points higher than the 6.83% preferred stock costs authorized in test year 2006 ROE proceeding. The forecasted preferred stock cost is higher than SDG&E's currently authorized preferred stock cost mainly because SDG&E plans to issue $75 million and $125 million of preferred stock in 2007 and 2008, respectively.

4.3. PG&E

PG&E projected a long-term debt cost of 6.05%, an increase of 3 basis points from its currently authorized 6.02% rate. This increase in cost results from the net impact of PG&E issuing approximately $1 billion of new fixed-rate debt in 2008 at an average interest rate of 6.05%. PG&E updated its long-term debt costs to reflect the most recent forecast of interest rates. That update did not result in any change in its long-term debt cost.

PG&E projected a preferred stock cost of 5.68%, a 19 basis point reduction from its currently authorized rate of 5.87%. PG&E does not project any new issuances or redemptions of preferred stock in 2008. Hence, the updated forecast of interest rates did not impact its test year preferred stock cost.

4.4. Discussion

There is no opposition to the utilities proposed long-term debt and preferred stock costs for the test year 2008. We have reviewed these undisputed costs which have been updated to reflect the most recent forecasted interest rates and find that the following long-term debt and preferred stock costs for the utilities are consistent with the law, in the public interest and should be adopted.

Rates	SCE	SDG&E	PG&E
Long-Term Debt	6.22%	5.62%	6.05%
Preferred Stock	6.01	7.25	5.68

Having determined the appropriate long-term debt and preferred stock costs, we address the appropriate ROE.

5. Return on Common Equity

The legal standard for setting the fair rate of return has been established by the United States Supreme Court in the *Bluefield* and *Hope* cases.[8] The *Bluefield* decision states that a public utility is entitled to earn a return upon the value of its property employed for the convenience of the public and sets forth parameters to assess a reasonable return.[9] Such return should be equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings attended by corresponding risks and uncertainties. That return should also be reasonably sufficient to ensure confidence in the financial soundness of the utility, and adequate, under efficient management, to maintain and support its credit and to enable it to raise the money necessary for the proper discharge of its public duties.

The *Hope* decision reinforces the *Bluefield* decision and emphasizes that such returns should be sufficient to cover operating expenses and capital costs of the business. The capital cost of business includes debt service and stock dividends. The return should also be commensurate with returns available on alternative investments of comparable risks. However, in applying these parameters, we must not lose sight of our duty to utility ratepayers to protect them from unreasonable risks including risks of imprudent management.

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[8] The Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591 (1944) and Bluefield Water Works & Improvement Company v. Public Service Commission of the State of Virginia, 262 U.S. 679 (1923).

[9] *Hope* held that the value of a utility's property could be calculated based on the amount of prudent investment minus depreciation.

We attempt to set the ROE at a level of return commensurate with market returns on investments having corresponding risks, and adequate to enable a utility to attract investors to finance the replacement and expansion of a utility's facilities to fulfill its public utility service obligation. To accomplish this objective, we have consistently evaluated analytical financial models as a starting point to arrive at a fair ROE.

5.1. Financial Models

The financial models commonly used in ROE proceedings are the Capital Asset Pricing Model (CAPM), Discounted Cash Flow (DCF) Analysis, and Historical Risk Premium Model (HRP). In addition to those financial models, SCE and SDG&E applied the Fama French Model to support their respective proposals. Detailed descriptions of these financial models are contained in the record and are not repeated here.

5.1.1. Proxy Groups

SCE, SDG&E and PG&E started with the same Value Line Investment Survey (Value Line) electric utility industry group list to establish proxy groups for their financial models. The utilities then screened those companies to ensure that the companies in their proxy groups were comparable to their respective utility. PG&E also selected a second proxy group consisting of non-utility companies.

5.1.1.1. Screens

The following tabulation summarizes the primary screens used by the utilities to verify the comparability of their utility proxy groups of companies:

REQUIREMENT	SCE	SDG&E	PG&E

Constant Dividend	YES	YES	YES
No Restructure/Merger Activity	YES	YES	YES
Standards & Poor's Comparable Rating	YES	NO	YES
$1 Billion + Electric Revenue	NO	NO	YES
Zack's Growth Rate[10]	NO	YES	NO

The screening process resulted in a comparable group of 24 companies for SCE, 43 for SDG&E and 28 for PG&E. SDG&E's proxy group is larger than the other utilities because SDG&E employed fewer screens than SCE and PG&E.

The Division of Ratepayer Advocates (DRA) accepted the utility proxy groups and screens of SCE, SDG&E, and PG&E for use in DRA's financial models.

The Federal Executive Agencies (FEA) accepted the utility proxy groups of SCE, SDG&E and PG&E as base proxy groups. However, FEA applied an additional screen that excluded companies having less than 70% of revenues from electric utility operations. That additional screen resulted in FEA using smaller proxy groups in its financial models than SCE, SDG&E and PG&E. SCE and PG&E's proxy groups consisting of 24 and 28 companies, respectively, were each reduced to 22 companies. SDG&E's proxy group of 43 companies was reduced to 29 companies.

ATU declined to use the proxy groups selected by the utilities on the basis that ATU had no empirical basis to screen companies out of the proxy groups.[11]

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[10] Investment research company long-term growth rates.

[11] Exhibit 55, p. 19.

Instead, ATU used a single proxy group consisting of 82 companies from Value Line's electric, combination and natural gas distribution utilities lists.

PG&E also used screens in selecting its non-utility proxy group of 54 companies. Those screens consisted of an S&P credit rating of A+ and three Value Line benchmarks. Those benchmarks were the payment of common dividends, a safety rank of 1,[12] and a beta value of 0.94 or less.[13]

5.1.1.2. Discussion

All parties used Value Line electric industry classifications for their proxy groups. A proxy group of non-utility companies was used solely by PG&E as a second proxy group. With each party using different companies in their proxy groups it is difficult to evaluate and assess the reasonableness of the financial model results and difficult to determine which results are comparable to SCE, SDG&E and PG&E.

Those difficulties are highlighted by ATU's lack of screening their proxy group and, unlike other parties, use of different companies from their proxy group for each of their financial models. For example, ATU used 75 of the 82 companies in their proxy group for their CAPM financial model and 65 companies in their DCF financial model.[14] Approximately seven of the companies included in their proxy group did not have investment grade credit ratings.[15] ATU used different companies from their proxy group in each of their

[12] A safety rank of 1 is the highest rank from a range of 1 to 5.

[13] This threshold is equal to the average beta value for PG&E's utility proxy group.

[14] Reporter's Transcript, Volume 5, p. 626 and p. 628.

[15] *Id.*, p. 629.

financial models because they did not have sufficient data to run the individual models with their entire proxy group.[16] In other instances, ATU deemed data not meaningful for inclusion in their financial models.[17]

A proxy, by common definition, is a substitute. Hence, companies selected for a proxy of a utility should have characteristics similar to the utility that the companies are selected to proxy. In order to assess comparability and reasonableness of financial model results, there should be no deviation from financial model to financial model of the companies selected for a proxy model. ATU's proxy group fails these basic principles. With ATU's use of different companies from its proxy group for each of its financial models, inclusion of non-investment grade companies, and exclusion of data for which no criteria or reasons have been given, comparability of their proxy group and financial model results can not be reasonably determined. Hence, the financial model results of ATU are given minimal weight for consideration in this proceeding.

PG&E utilized its non-utility proxy group on the basis that relative risk, not a particular business activity or degree of regulation, should be the salient criteria in establishing a meaningful benchmark to evaluate a fair rate of return.[18] However, a 70 basis point CAPM and 250 basis point DCF model result differential between its utility and non-utility proxy groups leads us to question

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16 *Id*., p. 626.

17 *Id*., p. 634.

18 Exhibit 23, pp. 2-21 and 2-22.

whether the non-utility proxy group is comparable to its utility proxy group and to PG&E.[19]

PG&E contends that the salient difference between the proxy groups, as compared with the utility companies, is that they have average investment risks associated with the non-utility companies having a higher credit rating of A+ versus BBB-, a safety range of 1 versus 3 or better, and financial strength of A+ versus B+. Accordingly, PG&E suggests that ROE estimates from its non-utility group should provide a conservative estimate of investors' required ROE for the utility operations of PG&E.[20]

PG&E has not substantiated that investment risks of its non-utility proxy group is comparable to the investment risks of its utility proxy group or to PG&E. The only explanation of comparability provided by PG&E was that its non-utility proxy group, having four indicators higher than its utility proxy group, demonstrates that PG&E needs an ROE that is higher than its utility proxy group results. However, risks between its non-utility and utility proxy groups associated with, among other matters, pricing and earnings do not appear to be comparable. Earnings for non-utility companies are dependent on the extent of competition and ability to price products or services at rates a buyer is willing to pay for a product or service while maintaining a competitive edge. Earnings for utility companies are dependent on a fair return on investments

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[19] PG&E derived a 12.10% CAPM result from its utility proxy group and a 12.80% result from its non-utility proxy group. It derived a 10.30% DCF result from its utility proxy group and a 12.80% DCF result from its non-utility proxy group.

[20] Exhibit 23, pp. 2-22 to 2-23.

with reasonable pricing of utility services, irrespective of what a buyer is willing to pay for a product or service for which they may have no alternative.

Absent evidence that supports a comparison of the non-utility proxy group to its utility proxy group and to PG&E, we decline to consider the financial model results from PG&E's non-utility proxy group.

We acknowledge that each party should be able to choose a representation of companies that they deem appropriate for their proxy group. However, those proxy groups should be subject to basic criteria to enable us to determine comparability of the proxy groups to the utilities. As such, Value Line electric industry classifications should continue to be used in ROE proceedings where financial models require the use of a proxy group. Three basic screens should be used in selecting a comparable proxy group. Those screens are: (1) to exclude companies that do not have investment grade credit ratings, (2) exclude companies that do not have a history of paying dividends and (3) exclude companies undergoing a restructure or merger. Additional screens may be used to the extent that justification is provided. Also, to the extent feasible, parties should use comparable factors in their respective financial models.

We next review the financial models used by the parties to assess the comparability and reasonableness of their results.

5.1.2. CAPM

The CAPM is a risk premium approach that gauges an entity's cost of equity based on the sum of an interest rate on a risk-free bond and a risk premium. CAPM results for SCE ranged from a low of 8.80% by DRA to a high of 11.59% by SCE, results for SDG&E ranged from a low of 8.90% by DRA to a high of 11.73% by SDG&E, and results for PG&E ranged from a low of 8.90% by

DRA to a high of 12.10% by PG&E. Those differences resulted in a 279 basis point spread for SCE, 283 basis points for SDG&E and 320 basis points for PG&E.

5.1.3. Risk-Free Rate

The risk-free rate is based on long-term treasuries. SCE, SDG&E and PG&E used a 2008 forecasted 20-year treasury rate for their risk-free rates.[21] However, those rates were not comparable because they each used different time periods and sources. SCE used Global Insight's April 2007 forecast of an average 30-year treasury rate plus 12 basis points to project a 20-year rate.[22] SDG&E used an average of Global Insight's 2008 forecasted 10-year and 30-year treasury rates. PG&E used a 2008 projected yield for a 20-year treasury from Global Insight, EIA and Blue Chip.

FEA and DRA also used long-term treasuries for their risk-free rates. However, both of those parties based their risk-free rate on historical data. FEA relied on a recent six-week time period for a 4.90% risk-free rate and DRA relied on actual July 26, 2007 rate of 5.00% based on 10-year and 30-year treasury rates.[23]

5.1.4. Risk Premium

A beta coefficient (BETA), a company-specific multiplier of general market risk, is the first of two components used to derive a risk premium. Each party used a different composite beta due to the use of different companies in their

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[21] SCE used a 5.33% risk free rate, SDG&E 5.13% and PG&E 5.40%.

[22] Although Global Insight forecasts 30-year and 10-year treasuries it does not forecast an interest rate for 20-year treasuries.

[23] Exhibit 44, p. 44 and 45 and Exhibit 34, p. 4-27.

proxy groups and due to the use of different data sources and time periods. Irrespective of these differences, there was only a ten basis point difference in composite betas between the parties, which ranged from .85 to .95. That difference in betas is minor and does not significantly affect the CAPM equity cost rate results.[24]

Equity risk is the other component used to derive a risk premium. A risk premium is derived by multiplying a beta to an equity risk. Two methods, arithmetic and geometric, were used to calculate equity risks.[25] SCE, SDG&E and PG&E used a 7.10% arithmetic equity risk based on Morningstar's *Stocks, Bonds, Bills, and Inflation Valuation Edition Yearbook*.[26] FEA and DRA used arithmetic and geometric averages to develop their equity risk. FEA used a 5.30% mid-point long-term equity risk from a financial study while DRA used a 4.14% equity risk based on the results of studies performed by over a dozen academic scholars, the individual results of which ranged from a low of 2.00% to a high of 7.14%.

5.1.5. Discussion

Financial models, such as the CAPM, are dependent on subjective inputs. However, to the extent that the criteria for those subjective inputs can be standardized, the spread between the parties' financial model results will diminish, avoid controversy, and provide us with comparable results.

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24 Exhibit 34, p. 5-14.

25 An arithmetic average accumulates changes year by year. A geometric average measures changes over more than one period on a buy and hold strategy.

26 SCE and SDG&E relied on a 2007 edition as shown in Exhibit 4, p. D-1 and Exhibit 45, Attachment 5, respectively. PG&E relied on a 2006 edition, as shown in Exhibit 23, p. 2-46.

The CAPM risk-free rate is a good candidate for criteria standardization given that the parties all used long-term treasuries for their risk-free rates. Although the risk-free rate differed among the parties, those differences occurred from the use of different time periods. This is a test year ROE proceeding and, as such, risk-free rates should be based on what the interest rate is forecasted to be in the test year.

In prior ROE proceedings, the utilities have been allowed to update their test year debt and preferred stock costs based on test year forecasted interest rates from Global Insight. This ROE proceeding is no exception. With prior Commission adopted reliance on the forecasted interest rates of Global Insight, the risk-free rate should be based on Global Insight's long-term treasury rate for the test year. Hence, the individual parties' risk-free rates should be adjusted to a uniform rate. Although each party used a different method to derive their risk-free rates, we will apply a uniform 4.78% rate, based on a simple average of Global Insight's September updated forecast of 4.65% for a 10-year treasury and 4.91% for a 30-year treasury for this proceeding.[27] This is the same method that SDG&E used to arrive at its risk-free rate.[28]

The risk premium components of a CAPM are not viable candidates for standardization. That is because they are derived from subjective financial literature on historical and geometric data of which there is no evidence of a consensus on a preferred or acceptable method to mitigate perceived equity risks by investors. That lack of consensus is the primary cause of the approximate

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[27] See, for example, Late-Filed Exhibits, 64, 65, and 66.

[28] Exhibit 45, p. 11.

300 basis point difference between the low and high CAPM estimates for SCE, SDG&E and PG&E.

The following tabulation compares the individual CAPM results based on risk-free rates derived by the individual parties to a uniform 4.78% risk-free rate.[29] The adjusted model results are incorporated into our overall evaluation of the financial models results for each utility prior to applying informed judgment to arrive at a fair return on equity for SCE, SDG&E and PG&E.

	SCE		SDG&E		PG&E	
	PRE	POST	PRE	POST	PRE	POST
Utility	11.59%	11.03%	11.73%	11.38%	12.10%	11.45%
FEA	9.41	9.29	9.41	9.29	9.56	9.44
DRA	8.80	8.59	8.90	8.63	8.90	8.68

5.2. DCF

The DCF model is used to estimate an equity return from a proxy group by adding estimated dividend yields to investors' expected long-term dividend growth rate.

DCF results for SCE ranged from a low of 9.11% by FEA to a high of 10.96% by SCE, results for SDG&E ranged from a low of 9.14% by FEA to a high of 11.11% by SDG&E, and results for PG&E ranged from a low of 8.99% by FEA

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29 The pre CAPM equity result is the individual party's CAPM result based on that individual party's risk–free rate. The post CAPM equity result is the result of changing only the individual party's risk-free rate to Global Insight's September 2007 forecast of 2008 average 30-year and 10-year treasury rates.

to a high of 10.30% by PG&E.[30] Those differences resulted in a spread of 185 basis points for SCE, 197 basis points for SDG&E and 131 basis points for PG&E.

5.2.1. Dividend Yield

Although the utilities and interested parties calculated their dividend yields differently they each derived a 3.50% rate, when rounded to a tenth of a percent.[31] For example, SDG&E used a full year 2006 dividend on its proxy group as reported by Value Line, DRA used an average six months and July 2007 dividend yield for its proxy groups and FEA used Value Line year-ahead dividend per share projection for its proxy groups.

5.2.2. Expected Growth Rate

The expected growth rate amongst the parties varied from a low of 5.00% to a high of 7.00%. This variation was due to the use of different time periods and different financial services that provide historic and forecasted growth rates. SCE, SDG&E and PG&E based their expected growth rates on five-year growth forecasts applicable to their proxy groups from various financial services. DRA based its expected growth rates on an average of five-year and ten-year growth forecasts from three financial services. FEA relied on both a five-year historical and five-year growth forecast from Value Line, Reuters and Zacks.

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[30] The DCF results of FEA are the simple average of its standard, mechanical and two-stage DCF results.

[31] There is a tenth of a percent minor deviation from FEA and DRA's calculated 3.4% dividend yields for SCE.

5.2.3. Discussion

Differences in the DCF results are attributed to subjective growth forecasts for which there is no consensus on an acceptable method to derive them. The following DCF results are incorporated into our overall evaluation of the financial models for each utility prior to applying informed judgment to arrive at a fair return on equity for SCE, SDG&E and PG&E.

	SCE	SDG&E	PG&E
Utility	10.96%	11.11%	10.30%
FEA[32]	9.11	9.14	8.99
DRA	10.00	9.70	9.60

5.2.4. Historical Risk Premium (HRP)

Similar to the CAPM, the HRP is a financial model that gauges a company's cost of equity capital. The cost of equity capital is measured by adding a risk premium to a risk-free long-term treasury or utility bond yield. A risk premium is derived by an assessment of historic utility stock and bond returns.

5.2.4.1. Risk-Free Long-Term Treasury & Bond Yields

SCE, SDG&E and PG&E used the April 2007 Global Insight 2008 forecasted bond rate for their base yields. SCE and SDG&E used a 6.23% AA utility bond forecast and PG&E used a 7.00% BBB forecast. SDG&E conducted a second HRP analysis using a projected 20-year Treasury yield by averaging Global Insight's 10-year and 30-year forecasts.

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32 FEA DCF results reflect a simple average of its standard DCF, mechanical DCF and two-stage DCF results for SCE, SDG&E and PG&E.

Unlike the utilities' use of forecasted rates for their base yields, FEA and DRA used historical rates. FEA used a current 4.90% long-term treasury yield for each of the utilities. DRA used a current 6.00% Aa bond rate for SCE and SDG&E and a 6.25% current BBB bond rate for PG&E. Similar to SDG&E, DRA conducted a second HRP analysis using a current 4.88% long-term treasury rate.

5.2.4.2. Risk Premium

SCE, SDG&E and PG&E derived arithmetical risk premiums by comparing S&P electric utility group historical returns to public utility bonds. SCE and PG&E used a 1946 to 2006 historical period and SDG&E used a 1937 to 2006 historical period. From those comparisons, SCE derived a risk premium of 4.64%, SDG&E 4.63% and PG&E 4.34%. SDG&E also derived a 5.23% risk premium from an alternate HRP based on its comparison of S&P's electric utility group historical returns to long-term treasuries.

FEA modified SDG&E's HRP to reflect a total return yield instead of an income return yield. FEA then averaged its 3.83% geometric mean result with its 4.85% arithmetic mean result for an overall 4.34% risk premium to be applied to SCE, SDG&E, and PG&E. DRA converted each of the utilities HRP arithmetic means to geometric means and derived a 3.88% risk premium for SCE, 3.77% for SDG&E based on long-term bonds and 3.84% based on 20-year treasuries, and 3.54% for PG&E.

5.2.4.3. Discussion

The parties employed similar methodologies in arriving at their HRP base yields as they did in arriving at their CAPM risk-free rates. For the reasons addressed in our prior CAPM discussion, the HRP base yields should be uniform and consistent. Hence, the criterion to be used in deriving base yields for the HRP model should be based on Global Insight's test year forecast of utility bond rates. The utility bond yield for those utilities having less than an A bond rating, such as PG&E, should be estimated by adding a premium to the Global Insight forecasted test year AA bond rate based on the average premium for utility bonds rated Baa over bonds rated AA during the most recent 24 months, as published by Moody's.

Differences in the individual party's HRP risk premium are due to the same reasons addressed in our prior CAPM discussion. Although there is a lack of consensus on the use of subjective inputs for calculating risk premiums, spreads between the parties' individual HRP results adjusted for an uniform base yield are less than 80 basis points after reflecting uniform long-term treasury and utility long-term bond rates.

It is general knowledge that public utility bonds are riskier than treasury bonds. Absent specific evidence justifying the use of either treasury or utility bonds over the other in the HRP, adjusted utility bond results should be used in considering a reasonable ROE range for SCE, SDG&E and PG&E. Those adjusted model results are incorporated into our overall evaluation of the financial models results for each utility prior to applying informed judgment to arrive at a fair return on equity for SCE, SDG&E and PG&E. The following tabulation compares the individual HRP results based on their respective risk-free long-term and utility bond yields rates and the uniform utility long-term bond yield criterion.

	PRE-ADJUSTED[33]	ADJUSTED
	BONDS	BONDS
SCE		
SCE	10.87%	10.79%
FEA	-	10.49
DRA	9.88	10.03
SDG&E		
SDG&E	10.86	10.78
FEA	-	10.48
DRA	9.77	9.99
PG&E		
PG&E	11.34	10.89
FEA	-	10.89
DRA	9.83	10.13

5.2.5. Fama French

SCE and SDG&E also used a Fama French model to estimate their cost of equity capital. The model provides us with an additional methodology to consider in setting a fair and reasonable ROE. Fama French is a three factor model designed to reward investors for a market factor (CAPM), exposure to a size risk and exposure to a value risk (high book-to-market vs. low book-to-market). SCE and SDG&E used the same time periods and nearly identical

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[33] Blanks exist in the pre-adjusted columns because not all parties reported RPM results based on long-term treasury rates.

annualized arithmetic averages and risk-free rate on their proxy groups. However, SCE derived an average 15.04% equity cost from its proxy group and SDG&E 13.89%.

The Fama French model was introduced in a California ROE proceeding in 2005 by SCE. In that proceeding, SCE derived a 14.00% average and 13.90% midpoint result from its use of the model, which were significantly higher than its requested 11.80% ROE. Unable to explain that difference, SCE acknowledged that it would take a few years working with the model to see if that phenomenon would persist and if the estimates derived from the model are highly unstable from period to period.[34] That stability concern has yet to be answered.

Proponents of the model assert that Fama French is an improvement on the CAPM because it adds two variables for consideration, a difference between market values and book value and company size compared to a norm. Opponents of the model assert that insufficient information about the model requires additional subjective inputs based on information not readily available and provides excessive results, as summarized in the following tabulation:

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[34] D.05-12-043 (2005), *mimeo.*, p. 31.

	SCE[35]	SDG&E[36]
Proxy Companies	24	43
Range	7.42% - 29.00%	6.02% - 27.96%
Mid Range	18.21%	16.99%
Average	15.04%	13.89%
Companies >12.00%	16	29
Companies >20.00%	4	6
Requested ROE	11.80%	11.60%

Although the Fama French model has been used in other jurisdictions, it is not clear that the methodology has been accepted for regulated utilities. It was used in a Massachusetts case which resulted in a settlement and in a Nevada case which may have accepted it as a data point.[37] Irrespective of its use in other jurisdictions, Fama French results continue to appear unrealistically high in comparison to the results of SCE and SDG&E's other financial models, as summarized in the following tabulation:

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[35] Exhibit 4, p. F-1.

[36] Exhibit 45, Attachment 6.

[37] Reporter's Transcript Vol. 4, p. 531.

	SCE	SDG&E
Fama French	15.04 %	13.89%
CAPM	11.59	11.73
DCF	10.96	11.11
MRP	10.87	10.36

There is insufficient evidence to substantiate that the additional subjective risk factors, size and exposure, are relevant to companies in a regulated industry in a state in which over 50% of the energy utilities revenue requirements are protected by balancing account recovery.[38] There is also insufficient evidence to validate that the Fama French results are reasonable compared to the CAPM, DCF and HRP model results.

We conclude there is insufficient evidence to assess the applicability of the Fama French model to California regulated utilities and decline to incorporate the Fama French results into our ROE analyses.

5.2.6. Summary

Although the parties agree that the financial models are objective, the results are dependent on subjective inputs, as we have addressed in our prior financial models discussion. From these broad financial models results the parties advance arguments in support of their respective analyses and in criticism of the input assumptions used by other parties. These arguments will

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[38] Exhibit 6, p. A.1; Exhibit 2, p. 11; and, Exhibit 26, p. 3.

not be addressed extensively in this opinion, since they do not materially alter the model results. However, it should be noted that none of the parties agreed with the financial model results of the others.

In the final analysis, it is the application of informed judgment, not the precision of financial models, which is the key to selecting a specific ROE estimate. We affirmed this view in D.89-10-031, noting that it is apparent that all these models have their flaws and, as we have routinely stated in past decisions, the models should not be used rigidly or as definitive proxies for the determination of the investor-required ROE. Consistent with that skepticism, we found no reason to adopt the financial modeling of any one party. The models are only helpful as rough gauges of the realm of reasonableness.

5.3. Additional Risk Factors

We also consider additional risk factors not specifically included in the financial models. Those additional risk factors fall into three categories: financial, business and regulatory.

5.3.1. Financial Risk

Financial risk is tied to the utility's capital structure. The proportion of its debt to permanent capital determines the level of financial risk that a utility faces. As a utility's debt ratio increases, a higher return on equity may be needed to compensate for that increased risk.

Debt equivalence has an impact on the financial risk of SCE, SDG&E, and PG&E. As recognized in D.04-12-047, debt equivalence has been reflected in the utilities' credit ratings since at least 1990. In D.05-12-043, we affirmed that debt equivalence would be assessed on a case-by-case basis along with other financial, regulatory and operational risks in setting a balanced capital structure and fair ROE. Our goal in so doing was, and continues to be, to provide reasonable confidence in the utilities' financial soundness, maintain and support investment-grade credit ratings, and provide utilities the ability to raise money necessary for the proper discharge of their public duty. We have no reason to change that goal. Debt equivalence is considered in arriving at an overall ROE.

Although SDG&E has proposed an equity rebalancing mechanism for its capital structure, as addressed in our subsequent SDG&E's ROE discussion, none of the utilities have proposed a major change in their capital structure for the test year. Hence, we find no additional financial risk to address associated with their debt/equity ratios.

5.3.2. Business Risk

Business risk pertains to uncertainties resulting from competition and the economy. That is, a utility that has the most variability in operating results has the most business risk. An increase in business risk can be caused by a variety of events that include deregulation, poor management, a failed marketing campaign and greater fixed costs in relationship to sales volume.

Those risks result from operating in a hybrid generation industry composed of unregulated generators and regulated utility generation leading to an uncertainty with respect to how the California electric industry will be structured in the future. The primary business risk identified by the parties in this proceeding is electric procurement.

The primary components of electric procurement risks are purchase power agreements, Direct Access and renewable energy. However, recent actions by the Commission are leading toward a more defined California electric industry. Those actions include the issuance of a proposed decision in R.07-05-025 initiating a rulemaking to determine whether, when, or how Direct Access should be restored in California and establishment of a 20% renewable goal by

2010, in comparison to other states looking at renewable standards in a 2015 to 2020 time period.

California energy utilities are facing electric procurement risks today that are similar to the procurement risks that were reflected in the utilities' currently authorized ROEs approved in D.05-12-043. In that proceeding, the base range of ROE for SCE was increased 70 basis points to account for electric procurement risk and debt equivalence, SDG&E was increased 50 basis points for debt leverage, debt equivalence and electric procurement risk, and PG&E was increased 70 basis points for debt leverage, debt equivalence and electric procurement risks. Included in those increased basis points was a premium for perceived regulatory risk in California.[39] Although regulatory risk was not specifically broken out from those premium basis points, we opt to do so in this proceeding and will address regulatory risk next.

The Commission has a history of protecting ratepayers while making the utilities whole. As recognized by SCE, the Commission has done much to mitigate investor risks since the height of the California energy crisis.[40] There is no basis to conclude that we will do otherwise in the future. With recent Commission action leading toward a more defined California electric industry, the procurement risks reflected in D.05-12-043 should subside. Based on informed judgment, a 50 basis point premium for debt leverage, debt equivalence and procurement risk should be added to the ROE base range for SCE and PG&E, a 40 basis point premium for debt leverage, debt equivalence

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[39] See for example D.05-12-043, mimeo., p. 23.

[40] Exhibit 4, p. 7.

and procurement risk should be added to the ROE base range for SDG&E. We next address whether a basis point premium is needed for regulatory risk.

5.3.3. Regulatory Risk

Regulatory risk pertains to new risks that investors may face from future regulatory actions that we, and other regulatory agencies, might take. Examples include the potential disallowance of operating expenses and rate base additions, comparability of utility ROEs throughout the United States and rating agencies' outlooks for the California regulatory environment.

ATU considered the California regulatory climate from an investor's standpoint to be above average.[41] In support of that position they and FEA identified the favorable balancing and memorandum account treatment that California utilities receive. That evidence shows that the potential for disallowance of operating expenses and rate base additions are low given the utilities' ability to recover a substantial portion of their revenue requirements through balancing and memorandum accounts. For example, SCE recovers 55% of its revenue requirements through these mechanisms, SDG&E 60%, and PG&E 48% overall, 41% of its electric and 60% of its gas revenue requirements.[42] Disallowances from these balancing and memorandum accounts have not been material.[43] Although comparisons between balancing and memorandum accounts of California utilities to utilities in other states were not provided, the

41 Reporter's Transcript Vol. 5, p. 617.

42 Exhibits 6, 2, and 26, respectively.

43 Reporter's Transcript Vol. 4, p. 429.

extent and recovery of California balancing and memorandum accounts should be considered a positive aspect of the California regulatory climate.

Also in support of a favorable regulatory climate in California, ATU identified 17 energy companies throughout the United States that were authorized an average 10.28% ROE in the first half of 2007 in comparison to authorized ROEs of California energy companies.[44] However, it is difficult from this to conclude that California energy companies experienced a favorable regulatory climate or that they should earn ROEs comparable to those ROEs authorized for energy companies throughout the United States. That is because those 17 energy companies, some (or all) of which may be part of a holding company, were not specifically identified in any of the proxy groups used in this proceeding. More importantly, there is no evidence on whether the capital structures of those utilities are comparable to California utilities. Finally, there is no evidence as to whether those authorized ROEs were approved with conditions or resulted from settlements.[45]

We do observe that the outlook for California's regulatory climate from rating agencies and investment companies is mixed. Comments from these entities vary, including that the regulatory environment in California for electric utilities has become more predictable and reliable, remains reasonable and

[44] Exhibit 27, p. 2.

[45] Under Rule 12.5 of this Commission's Rules of Practice and Procedure, settlements do not constitute approval of, or precedent for any future proceeding.

balanced, has vastly improved, and is below average.[46] Most of these comments are from sources with which investors are familiar.

The below average rating comes from Value Line, a source which all parties to this proceeding relied on for inputs to their financial models and on which investors rely. We understand that investors perceive California to have regulatory risk. We also acknowledge that investors are awaiting California regulatory action on, among other matters, whether, when and how direct access would be restored in California and how our current hybrid energy market structure between regulation and competition will end up. There is, however, no evidence that this Commission would change its past practice of making utilities whole should direct access be reintroduced. Hence, investors' perceived California regulatory risks warrant a 10 basis point upward adjustment to the base ROE ranges being adopted in this proceeding.

5.3.4. Summary

In addition to addressing these three risk factors, we could analyze each of the risks identified by the utilities to determine an appropriate risk adjustment to the financial model results. However, irrespective of the final result of any such exercise, the utilities are being increasingly driven by business and regulatory factors that include energy availability, ability to attract capital to raise money for the proper discharge of their public utility duties and to maintain investment-grade creditworthiness, all of which are important components of the *Hope* and *Bluefield* decisions. Based on the above financial, business and regulatory risks discussion; our duty to utility shareholders to protect them from unreasonable

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[46] Exhibit 57, pp. 42, 44, 46, and 18 thought 20, respectively.

risks; and, application of informed judgment we conclude that the ROE ranges being adopted in this proceeding warrant a cumulative 60 basis point upward adjustment for SCE and PG&E, and a cumulative 50 basis point upward adjustment for SDG&E.[47] Based on that same analysis, we conclude that the adopted ROEs should be set at the upper end of an ROE range found just and reasonable for each utility.

Having addressed the generic factors used in setting an ROE we now address a fair and reasonable return for the individual utilities.

5.4. SCE's Return on Equity

We will establish a base ROE range from the financial model results which reflects our above analysis of additional financial, business and regulatory risks.

The following tabulation summarizes the results of the individual financial models used by the parties, excluding Fama French, and adjusted to reflect utility bond yields, including the simple weighted average of the financial model results and proposed test year ROE for SCE:

	CAPM	DCF	HRP	Average[48]	Proposed ROE
SCE	11.03%	10.96%	10.79%	10.90%	11.80%
FEA	9.29	9.11	10.49	9.60	9.25
DRA	8.59	10.00	10.03	9.50	10.00

47 The 60 basis point upward adjustment consists of 50 basis points for business risk and 10 basis points for regulatory risks. The 50 basis point upward adjustment consists of 40 basis points for business risk and 10 basis points for regulatory risks.

48 Averages are rounded to a tenth of a percent.

ATU	-	-	-	-	9.80

After considering the evidence on market conditions, trends, creditworthiness, interest rate forecasts, quantitative financial models, additional risk factors, and interest coverage presented by the parties and applying our informed judgment, we arrive at a base ROE range of 9.60% (simple average of FEA and DRA's adjusted financial model results) to 10.90% (simple average of SCE's adjusted financial model results).[49] To that range we apply a 60 basis point upward adjustment for business and regulatory risks resulting in a fair and reasonable ROE range from 10.20% to 11.50%. Consistent with our conclusion that the adopted ROE should be set at the upper end of an ROE range found just and reasonable, the proposed decision recommended a 11.40% ROE for SCE's test year 2008. However, upon consideration of and agreement with of SCE's comments to the proposed decision and oral argument (November 26, 2007) that its ROE should be set higher because its credit statistics under a 11.40% ROE is weaker than SDG&E's and PG&E's credit statistics, we find that SCE's ROE should be set at 11.50%, the top of the ROE range found reasonable in this proceeding.

Having arrived at an authorized ROE for SCE, we must assess whether that ROE is sufficient to maintain and support its credit ratings. Last year, SCE regained a business profile score of five that it held before SCE's financial crisis.

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[49] FEA's argument that the equal weighting of one DCF result with two risk premium results inappropriately gives more weight to risk premium is moot. The same 9.60% to 10.90% range is derived by equally weighting the two risk premium results and equally weighing that result with the DCF result.

Hence, its credit rating has improved from its previous business profile score of six. Because SCE's debt equivalence is much greater than it was before SCE's financial crisis, it is necessary to consider what impact its debt equivalence will have on its test year credit rating.[50] A comparison of SCE's currently authorized 11.60% ROE and requested 11.80% ROE set forth in Appendix A, which reflects a worst case scenario that the impact of debt equivalence and three common credit ratios are the only factors used to set a utility's rating, demonstrates that the adopted ROE, which falls 10 basis points below the bottom of that ROE range, would not materially change SCE's BBB+ credit rating position within the S&P benchmarks. SCE's cash flow interest coverage would remain within the S&P mid-A credit rating range, its debt to capital ratio would remain within the mid-BBB range, and its cash flow to debt ratio remains in the lower BBB range. A test year 2008 ROE of 11.50% for SCE is fair, reasonable and adequate for SCE to maintain and support its credit ratings. This ROE is reasonably sufficient to ensure confidence in the financial soundness of the utility while, at the same time, balance the interests between shareholders and ratepayers.

5.5. SDG&E's Return on Equity

In addition to seeking a company-wide ROE for its test year 2008, SDG&E seeks to bifurcate from its company-wide investments its investment in San Onofre Nuclear Generation Station (SONGS). SDG&E also seeks approval of an equity rebalancing mechanism. Both of these issues must be resolved prior to addressing a company-wide ROE for SDG&E.

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[50] Exhibit 4, p. 5.

5.5.1. San Onofre Nuclear Generation Station

SDG&E seeks an ROE on its minority investment in the SONGS that is the equal to the company-wide ROE of SCE, a majority partner in SONGS. The basis for this request is that SDG&E perceives significant risk in a steam generator replacement project (SGRP) involving SONGS 2 and SONGS 3 due to cost caps adopted by the Commission and due to system upgrades that require moving 600-ton steam generators by barge from Long Beach, up the beach, and into containment structures. In addition, SDG&E contends that the prospect of being required to participate in future capital projects represents significant cost management risks for SDG&E over which it has little control.[51]

SDG&E's current investment in SONGS is less than $50 million and almost fully depreciated. Hence SDG&E is no longer earning a return on that investment. The SGRP involving SONGS 2 is not expected to be completed and placed into rate base until 2010. The SONGS 3 portion of the SGRP is not expected to be completed and placed into service until 2010-2011. Until those projects are completed and placed in service, SDG&E will earn an interest allowance for its investment used during construction of that project. That interest allowance will be capitalized and recoverable through an authorized ROE when it is placed in service. SDG&E expects its SONGS investment, excluding the interest allowance, to reach approximately $180 million by 2012.

Although SDG&E perceives substantial risk in its minority partnership in the SONGS SGRP, it has not substantiated why its investment in the project

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[51] Exhibit 12, p. MMS-7.

should earn the same ROE as its majority partner.[52] This proceeding pertains to a 2008 test year ROE for SDG&E. Given that SDG&E's current investment in SONGS is almost depreciated, there is no immediate impact on SDG&E. Company-wide risk is considered in arriving at a fair ROE along with the other factors addressed in this order. Although there is an ROE difference between SDG&E and its majority partner SCE, there are reasons for that difference. The ROEs are based on company-wide factors including different capital structures, debt costs and credit ratings.

SDG&E has not justified why its SONGS investment should earn the company-wide ROE of SCE. The Commission has already approved upfront ratemaking treatment for the SONGS SGRP.[53] To the extent that SDG&E perceives substantial risk above that considered in its overall ROE due to its participation in the SGRP, consideration of reduced risk exposure of SCE should be considered as a result of SCE taking on a partner.

To the extent that SDG&E should be authorized to earn an ROE equal to that of SCE, that ROE should be based on the impact of consolidating the investments, risks, capital structures, debt costs and credit ratings of both utilities for that specific project. If those differences were consolidated, SDG&E may be authorized a higher ROE on its SONGS investment than its company-wide investments if its SONGS investment is found riskier than its company-wide risk. The opposite would result for SCE if its SONGS investment was

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[52] SDG&E clarified that the ROE request pertains only to the equity portion of its SONGS investment.

[53] Exhibit 55, p. 8.

found to be less risky than its company-wide risk. Approval of this request would also require the company-wide ROEs of SDG&E and SCE to be re-calibrated based on the exclusion of SONGS investments from their company-wide investments. SDG&E's request for an ROE on its SONGS investment equal to that of SCE is denied.

5.5.2. Equity Rebalancing Mechanism

SDG&E seeks an automatic equity rebalancing mechanism to mitigate its perceived adverse effect of debt equivalence[54] and to mitigate any credit impacts of Variable Interest Entities (VIE), the accounting of which impacts its balance sheet as determined by Financial Accounting Standards Board Interpretation No. 46 (FIN 46). SDG&E proposes to use its rebalancing mechanism each time it enters into a new purchase power agreement (PPA) or contract that results in debt equivalence or FIN 46 treatment. Although SDG&E seeks approval of its equity rebalancing mechanism back to May 8, 2007, the date of its application, we decline that request on the basis that any approval back to May 8, 2007 would conflict with our practice of authorizing rates on a prospective basis. However, we will consider it on a prospective basis.

SDG&E proposed its rebalancing mechanism on the basis that debt equivalence and VIEs adversely impact its credit ratings and, unless mitigated, will negatively impact its credit profile. To mitigate that negative credit profile, SDGE proposes to add equity and to reduce its debt in an amount equal to its

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[54] Debt equivalence is a term used by credit analysts for treating long-term obligations which are perceived as analogous to the long-term debt, such as purchased power agreements, leases, or other contracts, as if they were debt in assessing an entity's credit rating.

authorized equity factor of the imputed debt equivalent and VIEs. SDG&E would then calculate the revenue requirement effect of that rebalancing by using its authorized common equity return and factoring in a gross-up for income tax expense and authorized debt costs.[55]

There is no dispute that debt equivalence and FIN 46 costs are economic costs and not accounting costs.[56] Although FIN 46 is a new issue, debt equivalence is not.[57] SDG&E is proposing an automatic adjustment to its capital structure each time it negotiates a new PPA or adjusts its balance sheet to comply with FIN 46. Those automatic adjustments would result in incremental revenue requirement increases caused by SDG&E increasing its equity ratio.

SDG&E's current S&P credit rating of A is based on a number of factors. Three of the many factors considered by S&P are: funds from operations to adjusted debt; adjusted total debt to total capitalization; and funds from operations to interest coverage. S&P provides a range of acceptability for each of those factors. As shown in Appendix A, a S&P credit rating of A reflects, among other matters not specifically identified, a 30% to 22% range for funds from operations to adjusted debt, a 42% to 50% range for debt to capital, and a 4.5 times to 3.8 times range for cash flow to interest coverage.

As acknowledged by SDG&E "you don't know what is going to degrade and what condition is ultimately going to put the company in a position where

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[55] Exhibit 12, p. MMS-22.

[56] Reporter's Transcript Vol. 3, p. 209.

[57] Neither SCE nor PG&E has raised a FIN 46 concern or presented any testimony on the impact of FIN 46 on their respective financial statement and earnings.

its credit gets downgraded."[58] Hence, an adjustment due to debt equivalence or FIN 46 treatment would not automatically result in a credit downgrade. Absent compelling evidence, we decline to begin unbundling ROE on a project by project basis. SDG&E's rebalancing mechanism is not adopted.

5.5.3. Summary

The following tabulation summarizes the results of the individual financial models used by the parties, excluding Fama French, adjusted to reflect uniform utility bond rates, including the simple weighted average of the financial model results and proposed test year ROE for SDG&E:

	CAPM	DCF	HRP	Average[59]	Proposed ROE
SDG&E	11.38%	11.11%	10.78%	11.10%	11.60%
FEA	9.29	9.14	10.48	9.60	9.15
DRA	8.63	9.70	9.99	9.40	9.60
ATU	-	-	-	-	9.60

After considering the evidence on market conditions, trends, creditworthiness, interest rate forecasts, quantitative financial models, additional risk factors, and interest coverage presented by the parties and applying our informed judgment, we arrive at a base ROE range of 9.50% (simple average of FEA and DRA's adjusted financial model results) to 11.10% (simple average of

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58 *Id.*, p. 237.

59 Averages are rounded to a tenth of a percent.

SDG&E's adjusted financial model results). To that range, we make two adjustments.

The first adjustment results from a disparity of credit ratings among the utilities included in the proxy groups of SDG&E, FEA, and DRA. Approximately 60% of those utilities have a lower medium grade credit rating of BBB in comparison to SDG&E's upper medium grade credit rating of A.[60] Ten percent of the utilities in the proxy group have an investment grade credit rating of BBB-, only one notch above the lowest investment grade credit rating. With BBB utilities being more risky than SDG&E, the financial models results are skewed toward a riskier side. Therefore, it is necessary to counter-balance the skewed financial models results that include more risky utilities. We adopt a 30 basis point downward adjustment to the base ROE range being adopted for SDG&E. In making this downward adjustment, we recognize that the BBB credit rating of SDG&E's parent company is comparable to the majority of the proxy group utilities. However, the appropriate comparison in this instance is SDG&E, a regulated entity under our jurisdiction, to a proxy group of utilities.

The second adjustment results from our discussion of additional risk factors. That adjustment is a 50 basis points upward adjustment for business and regulatory risks. Those adjustments result in a net 20 basis point increase (minus 30 basis points plus 50 basis points) in base financial model range of 9.50% to 11.10% resulting in a fair and reasonable ROE range from 9.70% to 11.30%. Consistent with our conclusion that the adopted ROE should be set at the upper

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60 Exhibit 2, p.2 and Exhibit 34, pp. 3-11 and 3-12.

end of an ROE range found just and reasonable, we find that an 11.10% ROE is fair and reasonable for SDG&E's test year 2008.

Having arrived at an authorized ROE for SDG&E, we must assess whether that ROE is sufficient to maintain and support its credit ratings. A comparison of SDG&E's currently authorized 10.70 ROE and requested 11.60% ROE set forth in Appendix A, which reflects a worst case scenario that the impact of debt equivalence and the three common credit ratios are the only factors used to set a utility's credit rating, demonstrates that the adopted ROE, which falls within that ROE range, would not materially change SDG&E's A credit rating position within the S&P benchmarks. SDG&E's cash flow interest coverage would remain above the S&P top-A credit rating range, its debt to capital ratio would remain within the mid-BBB range and its cash flow to debt ratio in the upper BBB range. A test year 2008 ROE of 11.10% for SDG&E is fair, reasonable and adequate for SDG&E to maintain and support its credit ratings. This ROE is reasonably sufficient to assure confidence in the financial soundness of the utility while at the same time balance the interests between shareholders and ratepayers.

5.6. PG&E's Return on Equity

In D.06-06-014, the Commission ordered PG&E to identify, explain, and compare its assumed and actual Pension fund ROE to its requested ROE in future cost-of-capital (ROE) proceedings. The purpose of this comparison is to assess whether pension return assumptions are comparable to the ROE used in utility ratemaking. Hence, this issue must be resolved prior to setting PG&E's test year 2008 ROE.

5.6.1. Pension ROE

PG&E reported an assumed 8.0% long-run projected pension return for its year-ended December 31, 2006, which included returns to equity, debt, and other assets. Its projected ROE on investments for the same period was 9.0%. That 9.0% pension return is 270 basis points lower than the 11.70% ROE that PG&E is requesting for its company-wide test year 2008.

PG&E disputes the comparability of its pension ROE to its company-wide ROE and provides three reasons for the non-comparability. First, the pension ROE is not equivalent to a specific benchmark for investors' forward-looking required ROE. Second, the pension projection applies to equity investments made in the pension portfolio selected by pension managers. Third, the pension plan projection used some, but not all, of the same historical information referenced in its ROE analysis.

The objectives of a pension fund are fundamentally different from that of an equity investor in a single utility and the risk profiles are not comparable. The Employee Retirement Income Security Act dictates that pension funds must be diversified whereas a utility's ROE is based on risks specific to that utility's operations.

More importantly, pension fund returns are related to market value of assets held in the pension fund while a utility's ROE is applied to a book value rate base. This difference can best be illustrated by dividing an average pension fund return by PG&E's market-to-book ratio. Based on ATU's 9.62% calculated average pension fund return and DRA's market-to-book ratio of 1.9 for PG&E, PG&E would only need to earn a 5.06% ROE on its rate base to equal the 9.62%

average pension fund return.[61] However, a 5.06% ROE is 116 basis points below its long-term debt cost, effectively eliminating PG&E's ability to support its credit and to raise the equity necessary to fulfill its public utility responsibilities as required by *Bluefield* and *Hope*. Pension return assumptions are not comparable to the ROE used in utility ratemaking. Having resolved this issue, PG&E should not be required to continue comparing its pension return assumptions to its ratemaking ROE in future ROE proceedings.[62]

5.6.2. Summary

The following tabulation summarizes the results of the individual financial models used by the parties, excluding Fama French, and adjusted to reflect utility bond yields, including the simple weighted average of the financial model results and proposed test year ROE for PG&E:

	CAPM	DCF	HRP	Average[63]	Proposed ROE
PG&E	11.45%	10.30%	10.89%	10.90%	11.70%
FEA	9.44	8.99	10.89	9.80	9.25
DRA	8.68	9.60	10.13	9.50	10.00
ATU	-	-	-	-	9.80

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61 Exhibit 52, p. 3, and Exhibit 34, p. 5-52.

62 This issue was raised in a PG&E general rate case proceeding. See D.06-06-014.

63 Averages are rounded to a tenth of a percent.

After considering the evidence on market conditions, trends, creditworthiness, interest rate forecasts, quantitative financial models, additional risk factors, and interest coverage presented by the parties and applying our informed judgment, we arrive at a base ROE range of 9.70% (simple average of FEA and DRA's adjusted financial model results) to 10.90% (simple average of PG&E's adjusted financial model results). To that range, we add a 60 basis point upward adjustment for business and regulatory risks resulting in a fair and reasonable ROE range from 10.30% to 11.50%. In setting PG&E's test year 2008 ROE, we recognize that in April of 2007, Moody's placed PG&E on review for possible upgrade and that S&P upgraded its rating for PG&E to BBB+ from BBB in May of 2007.[64] Consistent with the recently favorable credit ratings of PG&E, our duty to utility ratepayers and our conclusion that the adopted ROE should be set at the upper end of an ROE range found just and reasonable, we find that PG&E's authorized ROE for test year 2008 should remain at 11.35% ROE.

Having arrived at an authorized ROE for PG&E, we must assess whether that ROE is sufficient to maintain and support its credit ratings. A comparison of PG&E's authorized 11.35% ROE and requested 11.70% ROE set forth in Appendix A, which reflects a worst case scenario that debt equivalence and the three common credit ratios are the only factors use to set a utility's credit rating, demonstrates that the adopted ROE would not materially change PG&E's BBB+ credit rating position within the S&P benchmarks. PG&E's cash flow interest coverage would remain above the S&P top-A credit rating range, its debt to capital ratio would remain within the top-BBB range, and its cash flow to debt

[64] Exhibit 55, p. 3.

ratio moves to the lower A range. A test year 2008 ROE of 11.35% for PG&E is fair, reasonable and adequate for PG&E to maintain and support its credit ratings. This ROE is reasonably sufficient to assure confidence in the financial soundness of the utility while balancing the interests between shareholders and ratepayers.

6. Implementation

SCE shall consolidate the revenue requirement change being authorized in this decision with revenue changes from other SCE applications through a Tier 2 advice letter filing to become effective January 1, 2008.

SDG&E shall consolidate the revenue requirement changes being authorized in this decision with other electric and gas rate changes which are filed at the end of December 2007 to become effective January 1, 2008.

Consistent with PG&E's implementation proposal, the change in total electric and gas rates will be implemented with its next electric and gas rate changes. PG&E anticipates that its electric rate changes would be consolidated in its Annual Electric True-Up filing for January 1, 2008 implementation. Changes applicable to Direct Access rates for electric service would be made at the same time as changes in bundled electric customer rates. All gas rate changes for January 1, 2008 will be consolidated with its Annual Gas True-Up of Balancing Accounts for implementation January 1, 2008.

7. Rule 13.1 Violation

Rule 13.1 requires energy companies to give notice of a hearing, not less than five nor more than 30 days before the date of the hearing, to entities or persons who may be affected thereby, by posting notice in public places and by publishing notice in a newspaper or newspapers of general circulation in the area or areas concerned, of the time, date, and place of hearing.

To comply with "not less than five days … before the date of the hearing," SCE, SDG&E and PG&E were required to publish their notice of the hearing no later than August 23, 2007, five days prior to the start of evidentiary hearings on August 28, 2008.[65]

SCE and PG&E complied with Rule 13.1. However, SDG&E did not. SDG&E's hearing notice was not published until August 31, 2007, eight days after the August 23, 2007 compliance date and three days after the date its policy witness testified.[66]

We intend to set a second phase of this proceeding to consider potential penalties.

8. Procedural Matters

The utilities requested that their respective ROE application be categorized as a ratesetting proceeding within the meaning of Rule 1.3(e). By Resolution ALJ 176-3192, dated May 24, 2007, the Commission preliminarily determined that the applications of SCE, SDG&E and PG&E were ratesetting proceedings and that hearings were expected. This ratesetting classification was subsequently affirmed in the Assigned Commissioner's June 21, 2007 Scoping Memo and Ruling.

[65] A hearing schedule was set at a June 14, 2007 PHC. That schedule provided for hearings to start on August 28, 2007 for the examination and receipt of exhibits on SDG&E's policy witness and hearings to continue beginning September 10, 2007 for the examination and receipt of exhibits on all other witnesses.

[66] SDG&E's September 7, 2007 Rule 13.1 compliance filing shows that its hearing notice was published in the San Diego Union-Tribune and North County Times on August 31, 2007.

That Scoping Memo and Ruling, among other matters, designated Administrative Law Judge (ALJ) Galvin as the principal hearing officer, established a bifurcated evidentiary hearing schedule and determined the issues of this proceeding. The issues to be addressed in the first series of evidentiary hearings encompassed all matters impacting the utilities' test year 2008 cost of capital including capital structure, costs of long-term debt and preferred stock, return on common equity, debt equivalency, and related revenue requirement recovery. The second set of evidentiary hearings will address cost of capital mechanisms that may replace the utilities' annual cost of capital applications.

The first series of evidentiary hearings were held on August 28, 2007, and continued on September 10, 2007 through September 13, 2007. Each of the utilities, FEA, DRA and ATU, submitted testimony and evidence. The utilities' test year 2008 cost of capital issues were submitted upon the receipt of October 5, 2007 reply briefs.

9. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure.

Comments were filed on November 26, 2007, and reply comments were filed on December 3, 2007. To the extent changes were necessary as result of the filed comments, they were addressed in the body of this order. The only substantive change is a 10 basis point increase in SCE's ROE to 11.50% from 11.40% due to its weak credit statistics as addressed in the body of this order.

10. Assignment of Proceeding

John A. Bohn is the assigned Commissioner and Michael J. Galvin is the assigned ALJ in this proceeding.

Findings of Fact

1. Applicants are public utilities subject to the jurisdiction of this Commission.

2. SCE seeks to increase its test year 2008 ROE to 11.80% from 11.60%.

3. SDG&E seeks to increase its test year 2008 ROE to 11.60% from 10.70%.

4. PG&E seeks to increase its test year 2008 ROE to 11.70% from 11.35%.

5. SCE, SDG&E and PG&E's applications were consolidated pursuant to Rule 7.4.

6. SCE, SDG&E and PG&E propose no change to their currently authorized capital structures.

7. On September, 13, 2007, SCE, SDG&E and PG&E submitted late-filed Exhibits 64, 65, and 66 respectively, to reflect the most recent Global Insight forecasted interest rates.

8. There is no opposition to SCE, SDG&E, or PG&E's long-term debt or preferred stock costs.

9. An ROE is set at a level of return commensurate with market returns on investments having corresponding risks, and adequate to enable a utility to attract investors to finance the replacement and expansion of a utility's facilities to fulfill its public utility obligation.

10. The parties used CAPM, DCF and HRP financial models to support their respective ROE recommendations.

11. SCE and SDG&E also used a Fama French financial model to support their respective ROE recommendations.

12. SCE, SDG&E and PG&E used electric utility industry group lists from Value Line to establish proxy groups to be used in their financial models.

13. SCE, SDG&E and PG&E screened the companies in their proxy groups.

14. DRA accepted the utilities proxy groups and screens for use in its financial models.

15. FEA accepted the utilities proxy groups and screens.

16. FEA applied an additional screen that excluded companies having less than 70% of revenues from electric utility operations.

17. ATU used a single proxy group consisting of 82 companies from Value Line electric, combination and natural gas distribution utilities. They did not use any screens.

18. ATU used a different set of companies from their proxy group for use in the different financial models.

19. ATU's proxy group included approximately seven companies that did not have investment credit ratings.

20. PG&E utilized two proxy groups in its financial models, one consisting of utility companies and the other consisting of non-utility companies.

21. Long-term treasury rates were used for the risk-free rate component of the CAPM model.

22. The Fama French model is a three factor model designed to reward investors for a market factor (Beta coefficient), exposure to a size risk and exposure to a value risk.

23. Financial risk is tied to the utility's capital structure.

24. Debt equivalence has been reflected in the utilities' credit ratings since at least 1990.

25. None of the utilities proposed a major change in their capital structures.

26. Business risk pertains to uncertainties resulting from competition and the economy.

27. SDG&E seeks an ROE on its minority investment in SONGS that is equal to the company-wide ROE of SCE.

28. SDG&E's current investment in SONGS is less than $50 million and almost fully depreciated.

29. The SGRPs involving SONGS 2 and 3 are not expected to be completed and placed into rate base until 2010 and 2010 to 2011, respectively.

30. SDG&E will earn an interest allowance for its investment used during the SONGS SGRP construction.

31. SDG&E seeks an automatic equity rebalancing mechanism retroactive to May 8, 2007 to mitigate its perceived adverse effect of debt equivalence and to mitigate any credit impacts of VIEs.

32. Debt equivalence and FIN 46 costs are economic costs.

33. SDG&E doesn't know what is going to degrade and what condition is ultimately going to put the company in a position where its credit gets downgraded.

34. Approximately 60% of the utilities in SDG&E's proxy group have a lower medium grade credit rating of BBB compared to SDG&E's upper medium grade credit rating of A.

35. Ten percent of the utilities in SDG&E's proxy group have an investment grade credit rating of BBB-, only one notch above the lowest investment grade credit rating.

36. Pension fund returns are related to the market value of assets held in the pension fund while a utility's ROE is applied to a book value rate base.

37. SCE has an investment grade rating of BBB+ from S&P.

38. SDG&E has an investment grade rating of A from S&P.

39. PG&E has an investment grade rating of BBB+ from S&P.

40. Quantitative financial models are commonly used as a starting point to estimate a fair ROE.

41. Two important components of the *Hope* and *Bluefield* decisions are that the utilities have the ability to attract capital to raise money for the proper discharge of their public utility duties and to maintain creditworthiness.

42. The September 2007 AA utility bond interest rate forecast for test year 2008 is 6.15%, an eight basis point reduction in interest rate from the April 2007 forecast of 6.23% used by the utilities.

43. Rule 13.1 requires energy companies to give notice of a hearing, not less than five nor more than 30 days before the date of the hearing, to entities or persons who may be affected thereby, by posting notice in public places and by publishing notice in a newspaper or newspapers of general circulation in the area or areas concerned, of the time, date, and place of hearing.

44. SDG&E published its hearing notice required by Rule 13.1 on August 31, 2007, eight days after the August 23, 2007 compliance date and three days after the date its policy witness testified.

Conclusions of Law

1. The consolidation of these applications does not mean that a uniform ROE should be applied to each of the utilities.

2. The legal standard for setting the fair ROE has been established by the United States Supreme Court in the *Bluefield* and *Hope* cases.

3. The capital structures proposed by SCE, SDG&E and PG&E should be adopted because they are balanced, attainable, and intended to maintain an investment grade rating and attract capital.

4. Companies selected for a proxy group should have basic characteristics similar to the utility that the companies are selected to proxy.

5. Companies within a proxy group should not deviate from financial model to financial model.

6. The reasonableness of ATU financial model results can not be determined.

7. The financial model results of ATU should be given minimal weight in this proceeding.

8. PG&E has not substantiated that investment risks of its proxy group of non-utility companies is comparable to its proxy group of utility companies or to PG&E.

9. The financial model results from PG&E's proxy group of non-utility companies should not be considered in this proceeding.

10. Value Line electric industry classifications should continue to be used in ROE proceedings where financial models require the use of a proxy group.

11. Companies within a proxy group should be screened to ensure that the included companies have investment grade credit ratings, a history of paying dividends and are not undergoing a restructure or merger.

12. Financial models are dependent on subjective inputs.

13. CAPM risk-free rates should be uniform and based on a simple average of Global Insight's test year forecasted 10-year and 30-year treasury rates.

14. HRP rates should be uniform and based on Global Insight's test year forecast of long-term bond rates.

15. Absent evidence justifying the use of either treasury or utility bonds over the other in the HRP, adjusted utility bond results should be used in considering a reasonable ROE range for SCE, SDG&E and PG&E.

16. Results of the Fama French model continue to appear unrealistically high in comparison to other financial model results.

17. Although the quantitative financial models are objective, the results are dependent on subjective inputs.

18. It is the application of informed judgment, not the precision of quantitative financial models, which is the key to selecting a specific ROE.

19. There is insufficient evidence to substantiate that the additional subjective factors in a Fama French model are relevant to California regulatory companies.

20. There should be no reliance on Fama French results in this proceeding.

21. Company-wide factors such as risks, capital structures, debt costs and credit ratings are considered in arriving at a fair ROE.

22. A 30 basis point downward adjustment to SDG&E's base ROE range should be made to offset its skewed financial model results that include more risky utilities.

23. SCE and PG&E's base ROE range should be increased by 50 basis points to reflect their additional business risks.

24. SDG&E's base ROE range should be increased by 10 basis points to reflect its additional business risks.

25. Investors' perceived California regulatory risk warrants a 10 basis point upward adjustment to the ROE ranges being approved.

26. SDG&E has not substantiated a need to set an ROE on its SONGS investment equal to that of the company-wide ROE of SCE.

27. The impact of SDG&E's debt equivalence and FIN 46 should be considered along with its other risks in arriving at a fair and reasonable ROE.

28. SDG&E's equity rebalancing mechanism should not be adopted.

29. Regulatory risk pertains to new risks that investors may face from future regulatory actions that we, and other regulatory agencies, may take.

30. The Employee Retirement Income Security Act dictates that pension funds must be diversified whereas a utility's ROE is based on risks specific to that utility's operations.

31. Pension fund equity return assumptions are not comparable to the ROE used in utility ratemaking.

32. The long-term debt and preferred stock costs being proposed by the utilities are consistent with the law, in the public interest, and should be adopted.

33. The latest available interest rate forecast should be used to determine embedded long-term debt and preferred stock costs in ROE proceedings.

34. A test year 2008 ROE range from 10.20% to 11.50% is just and reasonable for SCE.

35. A test year 2008 ROE range from 9.70% to 11.30% is just and reasonable for SDG&E.

36. A test year ROE range from 10.30% to 11.50% is just and reasonable for PG&E.

37. A test year 2008 ROE of 11.50% is just and reasonable for SCE.

38. A test year 2008 ROE of 11.10% is just and reasonable for SDG&E.

39. A test year 2006 ROE of 11.35% is just and reasonable for PG&E.

40. SDG&E did not comply with Rule 13.1.

41. The assigned ALJs should set a second phase of this proceeding to consider whether SDG&E should be subject to the monetary penalties set forth in Section 2107 of the Public Utilities Code for its violation of Rule 13.1.

42. The utilities' ROE applications should be granted to the extent provided for in the following order.

O R D E R

IT IS ORDERED that:

1. Southern California Edison Company's (SCE) cost of capital for its test year 2008 operations is as follows:

	Capital Ratio	Cost Factor	Weighted Cost
Long-Term Debt	43.00%	6.22%	2.68%
Preferred Stock	9.00	6.01	0.55
Common Stock	48.00	11.50	5.52
Total	100.00%		8.75%

2. San Diego Gas and Electric Company's (SDG&E) cost of capital for test year 2008 electric and gas operations is as follows:

	Capital Ratio	Cost Factor	Weighted Cost
Long-Term Debt	45.25%	5.62%	2.54 %
Preferred Stock	5.75	7.25	0.42
Common Stock	49.00	11.10	5.44
Total	100.00%		8.40%

3. Pacific Gas and Electric Company's (PG&E) cost of capital for its test year 2008 electric and gas operations is as follows:

	Capital Ratio	Cost Factor	Weighted Cost
Long-Term Debt	46.00%	6.05%	2.78%
Preferred Stock	2.00	5.68	0.11
Common Stock	52.00	11.35	5.90
Total	100.00%		8.79%

4. Value Line Investment Survey electric industry classification shall continue to be used in return on equity (ROE) proceedings where financial models require the use of a proxy group. Three basic screens shall be used in selecting a comparable proxy group. Those screens are to exclude companies that do not have investment grade credit ratings, exclude companies that do not have a history of paying dividends and exclude companies undergoing a restructure or merger. Additional screens may be used to the extent that justification is provided.

5. PG&E is not required to continue comparing its pension return assumptions to its ratemaking ROE in future ROE proceedings.

6. SCE, SDG&E and PG&E shall implement the revenue requirement changes authorized by this decision as set forth in Section 6 of this decision. Tariffs in those filings shall be subject to review by the Energy Division in accordance with General Order 96-B.

7. Application (A.) 07-05-003, A.07-05-007, and A.07-05-008 remain open to consider the adoption of a cost of capital mechanism to replace the utilities annual cost of capital applications.

8. The annual cost of capital applications scheduled to be filed on May 8, 2008 shall be deferred pending a final decision in this proceeding or further order of the Commission.

This order is effective today.

Dated December 20, 2007, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners

APPENDIX A
CREDIT RATIOS INCLUDING DEBT EQUIVALENCE
TEST YEAR 2008

	CASH FLOW TIMES (x) INTEREST COVERAGE	DEBT/ CAPITAL	CASH FLOW/ DEBT
S&P Rating Benchmarks			
@ Business Profile 5			
A Range	4.5 – 3.8 x	42%-50%	30% - 22%
BBB Range	3.8 – 2.8 x	50% - 60%	22% - 15%
SCE			
@ Requested 11.80% ROE	4.2x	**54.4%**	**15.7%**
@ Current 11.60% ROE	4.1x	**54.4%**	**15.5%**
SDG&E			
@ Requested 11.60% ROE	4.6x	**56.3%**	**20.8%**
@ Current 10.70% ROE	4.5x	**56.5%**	**20.4%**
PG&E			
@ Requested 11.70% ROE	5.6x	**53.8%**	22.1%
@ Current 11.35% ROE	5.6x	**53.9%**	**21.9%**

Note: Bold Numbers are within S&P Business Position 5 guidelines for a BBB credit rating.

(END OF APPENDIX A)