

FEA DATA REQUEST
FEA-SDG&E-DR-002
SDG&E 2012 COST OF CAPITAL – A.12-04-016
SDG&E RESPONSE
DATE RECEIVED: JUNE 1, 2012
DATE RESPONDED: JUNE 18, 2012

FEA-SDG&E 02-1 Please provide the per books capital structure of Sempra Energy and San Diego Gas & Electric at December 31, 2010, and March 31, June 30, September 30, December 31, 2011 and March 31, 2012. For the purposes of this data request, please provide the information as follows:

- a) Long-term Debt (including that maturing within one year);
- b) Short-term Debt;
- c) Other Debt (specify);
- d) Preferred or Preference Stock;
- e) Common Stock;
- f) Additional Paid-in Capital;
- g) Retained Earnings; and
- h) Total Common Equity (please identify any common equity attributable to unregulated operations, if any).

Also, please also provide quarterly balance sheet support published with the Securities and Exchange Commission for each of the above-requested capital structures. If any of the balances reported in this data response are different from those published by the S.E.C., please explain why.

SDG&E Response:

The information requested above for SDG&E is available at the Securities and Exchange Commission's (SEC's) website, EDGAR, by following this hyperlink:

<http://www.sec.gov/cgi-bin/browse-edgar?company=san+diego+gas&CIK=&filenum=&State=&SIC=&owner=exclude&action=getcompany>

SDG&E objects to the above request to provide Sempra-related financial statements. Sempra Energy is not a party to SDG&E's Cost of Capital proceeding and thus the requested information is outside the scope of this proceeding.

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FEA-SDG&E 02-2 For the same time periods referenced in the preceding interrogatory, please provide the following information for San Diego Gas & Electric:

- a) Embedded cost rates for long-term debt, short-term debt, other debt and preferred or preference stock;
- b) Computation of embedded cost rates of long-term debt;
- c) Computation of embedded cost rates of short-term debt; and
- d) Computation of embedded cost rates of preferred or preference stock.

Note: Schedules should include date of issue, maturity date, dollar amount, coupon rate, net proceeds, annual interest paid and balance of principal, where applicable.

SDG&E Response:

In response to FEA DR-01, SDG&E submitted public versions of its workpapers in both PDF and Excel format via CD on May 29, 2012. FEA has since signed and returned the nondisclosure agreement in this proceeding and therefore SDG&E will provide the confidential workpapers in both PDF and Excel format via CD in a supplemental response to FEA DR-01.

Please refer to workpaper pages 1-9 for the calculation of the 2011-2013 embedded long-term cost of debt and preferred. The pertinent assumptions for these calculations are outlined in the workpapers.

The 2010 embedded cost rate computation for long-term debt and preferred stock is presented in the attached file. The workpapers and the attached file are responsive to this request.



SDGE Embedded
Cost - 2010.xlsx

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FEA-SDG&E 02-3 Please provide the per books capital structure of Sempra Energy and San Diego Gas & Electric at December 31, 2007, 2008, and 2009. For the purposes of this data request, please provide the information as follows:

- a) Long-term Debt (including that maturing within one year);
- b) Short-term Debt;
- c) Other Debt (specify);
- d) Preferred or Preference Stock;
- e) Common Stock;
- f) Additional Paid-in Capital;
- g) Retained Earnings; and
- h) Total Common Equity (please identify any common equity attributable to unregulated operations, if any).

Also, please also provide annual balance sheet support published with the Securities and Exchange Commission for each of the above-requested capital structures. If any of the balances reported in this data response are different from those published by the S.E.C., please explain why.

SDG&E Response:

The information requested above for SDG&E is available at the Securities and Exchange Commission's (SEC's) website, EDGAR, by following this hyperlink:

<http://www.sec.gov/cgi-bin/browse-edgar?company=san+diego+gas&CIK=&filenum=&State=&SIC=&owner=exclude&action=getcompany>

SDG&E objects to the above request to provide Sempra-related financial statements. Sempra Energy is not a party to SDG&E's Cost of Capital proceeding and thus the requested information is outside the scope of this proceeding.

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FEA -SDG&E 02-4 Please provide a consolidating (not consolidated) balance sheet for Sempra Energy at December 31, 2011, or the most recent date available.

SDG&E Response:

SDG&E objects to the above request to provide Sempra-related information. Sempra Energy is not a party to SDG&E's Cost of Capital proceeding and thus the requested information is outside the scope of this proceeding.

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FEA -SDG&E 02-5 Please provide a copy of the most recent bond rating agency (Standard & Poor's, Moody's, Fitch) report on Sempra Energy and San Diego Gas & Electric. [Note: The report provided should be most recent in-depth report, not a one or two-page update.]

SDG&E Response:

Credit rating agency reports are copyrighted materials available to paid subscribers and copies therefore cannot be provided to third parties, except in some instances by permission. SDG&E will make available the confidential versions of its credit reports from the major credit rating agencies published since January 1, 2010 but only at SDG&E's offices for visual examination.

SDG&E objects to the request to provide credit rating agency reports about Sempra Energy. Sempra Energy is not a party to SDG&E's Cost of Capital proceeding and thus the requested reports are outside the scope of this proceeding.

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FEA -SDG&E 02-6 Please provide a complete transcription of the most recent analysts' earnings presentation made by Sempra Energy.

SDG&E Response:

SDG&E objects to this question as Sempra Energy is not party to this proceeding, Sempra Energy information is not relevant to the utility's cost of capital proposal, and it is outside the scope of this proceeding. Without waiving this objection, which applies to portions of the transcript that do not pertain to the utility's earnings, attached is Sempra Energy's last quarterly earnings call covering SDG&E, which took place on May 3, 2012. The transcript is provided below.



Q1-12 Transcript.pdf

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FEA-SDG&E 02-7 Please provide the following:

- a) Monthly short-term debt balances for San Diego Gas & Electric for each month from January 2010 through the most recent month available. Please explain how the monthly short-term debt balance is calculated (e.g., month-ending balance, average daily balance), and provide a sample calculation.
- b) For each month, the monthly cost-rate of short-term debt for San Diego Gas & Electric, and a sample calculation showing how that monthly cost rate is derived.
- c) A narrative description of San Diego Gas & Electric's short term debt financing arrangements, as well as inter-company borrowing arrangements between Sempra Energy, its divisions and subsidiaries.

SDG&E Response:

- a) SDG&E objects to this request as out of scope, because SDG&E's short-term debt is not part of the currently authorized or the proposed capital structure and is not appropriate to use as a long-term financing source, and is therefore not relevant to determining SDG&E's cost of capital. Subject to and notwithstanding this objection, since the historical month-end recorded short-term debt balances are readily available, the enclosed attachment is provided.



SDGE Month-end
Short-term Debt Balai

- b) SDG&E objects to this request on the basis that it is out of scope – as noted above, SDG&E's short-term debt is not part of the currently authorized or the proposed capital structure and is not appropriate to use as a long-term financing source, and is therefore not relevant to determine SDG&E's cost of capital.
- c) SDG&E has no short-debt in its authorized capital structure, and SDG&E is not proposing that short-term debt be added to its authorized capital structure. As noted in the testimony of Ms. Hrna, SDG&E has developed its proposed capital structure with the appropriate long-term financing sources of long-term debt, preferred stock and common equity consistent with its current (and historical) authorized capital structure, and is proposing that only the preferred stock and common equity allocations be adjusted by 3% to help mitigate the various financial risks outlined by Ms. Hrna. The goal of the 3% adjustment to SDG&E's authorized capital percentages is to reduce financial risk (refer to pg. 20 of the testimony).

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Response to FEA-SDG&E-02-07 (Continued)

The introduction of short-term debt financing into long-term financing horizons needlessly mismatches asset financing time spans with the assets useful lives, increases financial risk, reduces financial flexibility, complicates cash management, and raises the risk of negative reactions by both credit rating agencies and investors. Consequently, consistent with SDG&E's past Cost of Capital applications/decisions, SDG&E purposely and prudently excluded short-term financing from its long-term cost of capital proposal. Furthermore, the lending agreement associated with financial institution short-term debt is confidential and contains negotiated terms and conditions between multiple banks.

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FEA -SDG&E 02-8 Please provide a copy of the San Diego Gas & Electric's most recent five-year financial forecast (or most similar document).

SDG&E Response:

The most recent five-year financial forecast was presented at the March 29th, 2012 Analyst Conference. SDG&E-specific slides are provided below.



2012 Analyst
Conference Presenta

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FEA-SDG&E 02-9 Please provide a copy of San Diego Gas & Electric's five- year capital budget forecast for each of the following years: 2007, 2008, 2009, 2010, and 2012.

SDG&E Response:

The attached five year capital budget forecast for years 2007-2012 are enclosed. The information contained herein is **considered confidential/privileged material pursuant to PUC Code § 583, General Order 66-C, and to the terms and conditions of the Non-Disclosure Agreement**

ATTACHMENT REMOVED DUE TO CONFIDENTIALITY

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- FEA-SDG&E 02-10 On pages 137 and 141 of Sempra Energy's 2011 Annual Report, the company indicates that the expected long-term return on San Diego Gas & Electric's retirement plan assets is 7.00% and, the asset mix of that retirement investment portfolio is approximately 65% equities, 35% fixed income securities at year-end 2011.
- a) Please provide the expected long-term return assessment, including long-term expectations for each class of asset in the portfolio, showing that the weighted average after-tax return from those investments approximates 7.00%.
 - b) Please provide any internal documents prepared by the Company, or its pension fund investment advisors, which support the long-term equity return expectations.

SDG&E Response:

SDG&E objects to this question as it is not reasonably tailored to lead to the discovery of admissible evidence. The information requested is not relevant and is out of the scope of SDG&E's Cost of Capital proceeding.

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FEA-SDG&E 02-11 Please provide the following:

- a) A complete listing of each of San Diego Gas & Electric's balancing accounts.
- b) In the Company's last cost of capital proceeding (Application 07-05-007), it provided the percentage of its total jurisdictional revenues that were provided through balancing accounts. Please provide that same information for 2010 and 2011.

SDG&E Response:

- a) Below are the electric and gas tariff website links to the preliminary statements which describe in detail the types of regulatory accounts that the Company carries under the authority of the California Public Utilities Commission (CPUC).

<http://sdge.com/electric-tariff-book-preliminary-statement>

<http://sdge.com/gas-tariff-book-preliminary-statement>

- b) The percentage of 2011 and 2010 Authorized Revenue Requirement recovered through Balancing/Memorandum Accounts is provided in the following attachment.



Rev Req Recovered
through Balancing Me

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FEA-SDG&E 02-12 If the Company's requested return on common equity were to change by 10 basis points, what impact would that have on the Company's rates? Please provide all relevant support for your response (i.e., assumptions regarding capital structure/common equity ratio, overall tax rate, and rate base).

SDG&E Response:

On the electric side, a 10 basis point change in ROE would result in a change to electric revenue requirement of \$3.02 million with a corresponding system average rate change of \$0.014 per kWh.

On the gas side, a 10 basis point change in ROE would result in a change to the revenue collected in gas transportation rates of \$0.33 million with a corresponding rate change of \$0.00027 per therm.

Assumptions:

- Capital structure % as requested;
- Common Equity Ratio of 52.00%;
- Long-term Debt Ratio of 45.25%;
- Preferred Stock Ratio of 2.75%;
- Tax Rates: Federal 35% & State 8.84%;
- Weighted Average Rate Base of \$3,891.56 million.

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FEA-SDG&E 02-13 For *each* witness testifying on behalf of San Diego Gas & Electric in this proceeding, please provide: 1) complete copies of any articles, treatises, reports, or chapters of texts cited in their Direct Testimony, and 2) native electronic copies of the schedules accompanying the testimony in either Word or Excel format, with cells unlocked and all original data available (e.g., if the schedule spreadsheet references data on a separate spreadsheet, please also provide the referenced spreadsheet.)

SDG&E Response:

SDG&E objects to this question to the extent it requests copies of all Commission regulatory decisions and other filed Commission documents used in the development and preparation of the application and testimony on the grounds that these documents are publicly available to FEA. SDG&E relied on all relevant law and precedent in the development and preparation of its application, including, but not limited to, the regulatory decisions cited therein. SDG&E will provide all legal arguments and citations in briefs.

SDG&E also objects to this question to the extent it requests documents and information that are copyrighted and proprietary in nature. Website citations have been provided for copyrighted information that is available online. Cited reference materials that are not within SDG&E's control and possession have not been provided.

Credit rating agency reports are copyrighted materials available to paid subscribers and copies therefore cannot be provided to third parties, except in some instances by permission. SDG&E is willing to make the credit reports from the major credit rating agencies published since January 1, 2010 available at its offices for visual examination by requesting third parties to this proceeding.

The responsive documents have been provided in an accompanying CD. The material related to witness Don Widjaja contains a revised Attachment C which corrects data entry error in one row. Both the original and revised spreadsheets are provided. The correction has no material impact on the analysis.

Schlax



Testimony Citations
and References_Schl

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Response to FEA-SDG&E-02-13 (Continued)

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Testimony citations
and references_Dere

Widjaja



Testimony Citations
and References_Widj

Hrna



Testimony Citations
and References_Hrnz

Morin



Testimony citations
and references_Morir

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QUESTIONS FOR COMPANY WITNESS SCHLAX

FEA-SDG&E 02-14 [Ref. Schlax Direct, p. 3, ll. 12-14]

- a) Please provide the analytical support for the statement that a 20 basis point reduction in ROR will result in an annual rate reduction of \$6.9 million for electric ratepayers and a \$0.76 million for gas ratepayers.
- b) How much more will electric and gas ratepayers be paying annually for an increased common equity ratio? (Please provide support for your response.)
- c) What was SDG&E's average common equity ratio during the time that debt costs declined from 5.62% (currently authorized) to 5.09% (projected)? (Please provide supporting data.)

SDG&E Response:

- a.) Gas reduction:



FEA SDGE 2-14.xls

Electric reduction:

The requested analysis is attached. Please note that in the course of responding to this data request, SDG&E identified that Franchise Fees and Uncollectible revenues had been double-counted in the original \$6.9 million electric rate reduction calculation and that figure should have been \$6.8 million. The attached provides the corrected calculations.



FEA SDG&E Electric
2-14a.xls

- b.) SDG&E has not performed the requested calculation.
- c.) SDG&E has not performed the requested calculation. A standard analysis would average the beginning and ending capitalization for any particular year as that would be more applicable to analyzing a company's situation. Attached is a file that includes end-of-year capitalization for 2008-2011.



SDGE Capitalization
2008-2011.xls

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FEA-SDG&E 02-15 [Ref. Schlax Direct, pp. 3, 4]

Mr. Schlax indicates that SDG&E needs to increase its common equity ratio in order to “enable the company to access the capital markets.” Please describe in detail the most recent event in which the Company, with a 49% common equity ratio, was unable to access capital markets in order to meet its infrastructure needs.

SDG&E Response:

The portion of Mr. Schlax’ testimony referred to by this question reads in its entirety,

The proposed reductions and adjustments to SDG&E’s capital structure better reflect current industry and operating risks and provide a structure that will enable the Company to access capital markets on an as-needed basis in order to finance its large capital investments at rates beneficial to ratepayers in the near- and long-term.

Taken as a whole, this statement is clear that Mr. Schlax is addressing the Company’s changing profile on a *forward-looking* basis, and is not making any claim – as implied by the question above – that the Company has experienced market-access difficulties in the recent past.

Mr. Schlax’ analysis is forward-looking for several important reasons. As explained in Section IV of his April 20th testimony, SDG&E is undergoing a transformation from a traditional distribution to a technologically advanced energy company. Causes of this transition include the development of the Company’s Smart Grid, a growing mandate to support California’s environmental initiatives, and new public-safety initiative in the area of natural-gas distribution. As Mr. Schlax explains at page 7:

From a practical standpoint, meeting these new requirements will present an unprecedented challenge, entailing complex contracting, incremental construction, new system-rebalancing requirements, and revised operational techniques.

In order to maintain market access during this transitional time, the Company seeks to retain its “A” credit rating, but recognizes, as Mr. Schlax states, that “positive investor perceptions, and SDG&E’s resulting financing ability, have the potential to change in the face of the numerous new risks confronting the Company.” (Schlax, p. 11.)

In light of Mr. Schlax’ broader testimony, a reader may reasonably conclude that avoiding *future* financing difficulties is the salient issue before the Commission, not ameliorating prior difficulties, as suggested by the que.

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- FEA-SDG&E 02-16 [Ref. Schlax Direct, pp. 3, 4]
- a) Is it correct, as reported in SDG&E's 2011 S.E.C. Form 14c at pages 13 and 14, that Mr. Schlax's performance-based cash bonuses are dependent on SDG&E achieving a pre-set EBIT level?
 - b) Will increasing SDG&E's rate-making common equity ratio, assuming rates are based on the Company's request, increase the Company's EBIT? If not, please explain why not.

SDG&E Response:

- a.) SDG&E objects to this question as outside the scope of this case and not reasonably tailored to lead to admissible evidence. Employee compensation is not at issue in this case. SDG&E's publicly available filings speak for themselves.
- b.) The direct tie between authorized equity levels and Earnings Before Interest and Taxes (EBIT) is not as simple and clear-cut as this question implies. Increasing the common equity ratio has a direct effect on the other components of Capitalization. As authorized equity levels change an equal and corresponding change must be made to authorized Debt or Preferred Stock levels (or sometimes both), as the total Capitalization has to remain at 100%. Because total Return on Ratebase has decreased in this application from 8.4% currently authorized to 8.2% proposed, the Revenue Requirement associated with this application will be reduced and therefore EBIT will also be reduced.

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FEA-SDG&E 02-17 [Ref. Schlax Direct, p. 8, ll. 5, 6]
Is “a competitive ROE” one that is similar to the ROE that other utilities are being awarded, or the ROE that other utilities are earning?

SDG&E Response:

A competitive ROE would be one that the markets perceive as being a fair level of return for a company commensurate with the risk under which the company operated. When capital markets, and in particular analysts, analyze a utility it is important for them to put the individual utilities on level ground with other utilities. It is up to them to determine what they would consider as “A competitive ROE”. Because the analytical process of the market analysts can be different and is unknown, it would be important for both the authorized and the actual ROEs to be competitive to be able to maximize a company’s ability to obtain and retain capital at low rates.

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FEA-SDG&E 02-18 [Ref. Schlax Direct, p. 8, ll. 25]
Please list all the utilities in the U.S. that have higher bond ratings than SDG&E.

SDG&E Response:

In its January 5, 2012 report, “U.S. Regulated Electric Utilities, Strongest to Weakest,” Standard & Poor’s lists six utilities with higher ratings than SDG&E:

Company	Corporate credit rating
Madison Gas & Electric Company	AA-
Midwest Independent Transmission System Operator, Inc.	A+
American Transmission Co.	A+
NSTAR Electric Co.	A+
NSTAR	A+
California Independent System Operator Corp.	A
San Diego Gas & Electric Co.	A

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QUESTIONS FOR COMPANY WITNESS WIDJAJA

FEA-SDG&E 02-19 [Ref. Widjaja Direct, p. 2, ll. 2-4]

- a) Is a “competitive return” equal to the cost of capital, if not, please explain why not; if so, please explain why.
- b) If the Commission awards the Company a cost of equity that is equal to its cost of capital, will the Company’s financial integrity remain intact? If not, please explain why not.

SDG&E Response:

- a) The testimony referenced discusses “an authorized ROE that is competitive.” The discussion relates to the Return On Equity (“ROE”), not the Cost Of Capital or weighted average rate of return. A competitive ROE denotes to the expected return for equity investors comparable to that of investing in another company with a similar risk profile. In general, companies can raise capital through various sources, such as the issuance of debt, preferred or equity. The term “cost of capital” refers to the weighted average cost of equity, preferred and debt based on a company’s capital structure weightings. The holders of debt and preferred instruments have higher claim priorities than that of equity investors in bankruptcy proceedings, which is why the overall weighted average cost of capital is lower than the return to shareholders or ROE.
- b) As explained above, the term “cost of capital” refers to the weighted average cost of equity, preferred and debt for a given capital structure. Awarding the Company a cost of equity that is equal to its cost of capital creates a circular calculation. Mathematically, such an award makes the return of equity equal to the weight cost of debt and preferred -- *i.e.* return of equity is equivalent to the return of debt instruments. To this end, if the Commission awarded SDG&E an authorized ROE that was equal to its cost of capital, SDG&E’s financial integrity would be negatively impacted because SDG&E would have difficulty attracting equity investors with a ROE that is below the level that equity investors require. Dr. Morin’s testimony explains the consequences if the authorized ROE is below equity investors expected return. [Morin Direct, pp. 6 – 8]

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FEA-SDG&E 02-20 [Ref. Widjaja Direct, p. 2, ll. 5-7]
Does Mr., Widjaja agree that bond rating agencies take into account business, financial and regulatory risk when determining a firm's bond rating? If not, please explain why not and provide any available evidence that would support such a position.

SDG&E Response:

Yes.

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FEA-SDG&E 02-21 [Ref. Widjaja Direct, p. 3, ll. 3-6]
Please provide a list of electric utilities in the U.S. that 1) do not currently have a major capital spending program underway, 2) do not face uncertainty with regard to energy supplies, or 3) are not having to deal with new technologies being employed.

SDG&E Response:

SDG&E objects on the grounds that the question is overbroad and unduly burdensome. Notwithstanding that objection and without waiving this or any other objection, SDG&E responds as follows:

SDG&E does not possess this information.

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- FEA-SDG&E 02-22 [Ref. Widjaja Direct, p. 3, ll. 20-23]
- a) Please provide any evidence to show that either SDG&E or any other A-rated electric utility has had difficulty issuing long-term debt (e.g., a debt issuance that was undersubscribed).
 - b) Assume SDG&E's debt capital needs are equal to ½ of future \$5.8 billion in capital projects (i.e., \$2.9 billion). What percentage would that amount of investment-grade debt represent as a percentage of investment-grade debt issued in the U.S. over a five-year period? If Mr. Widjaja is unable to answer that question, please explain on what evidence he bases his belief that the debt market may be constrained with regard to SDG&E's future needs.

SDG&E Response:

- a.) While SDG&E has not experienced difficulty with recent debt issuances, SDG&E cannot address whether any of the other A-rated electric utilities have had difficulty because subscription levels and allocations of other companies' bond deals are not typically disclosed publically nor compiled in a centralized database.
- b.) SDG&E does not have access to information related to the exact size of the entire U.S. investment-grade debt market, especially over the next five years. As it relates to SDG&E's future need to access incremental capital, the challenge that SDG&E faces is accessing the debt market when its debt level is already at a very high level. Since 2008, SDG&E's long term debt has increased 90.16%, increasing from \$2.144 Billion to \$4.077 Billion in 2011. [Please refer to SDG&E SEC filings]

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DATE RESPONDED: JUNE 18, 2012

- FEA-SDG&E 02-23 [Ref. Widjaja Direct, p. 4, ll. 1-5]
- a) Please provide the objective evidence on which Mr. Widjaja relied to support the statements made: 1) there are currently fewer lending institutions in the U.S. than prior to 2008, 2) there is a “marked reduction in the amount of capital available in the financial markets caused by investors becoming more risk averse,” and 3) investors currently require higher risk premiums than in the past.
 - b) How much capital is available in the financial market place today, and how much was available in any year prior to 2008? Please provide supporting data and sources for those data.

SDG&E Response:

a-1) Due to the global financial crisis that began in 2007, the landscape of the financial services sector has changed considerably. Several large financial institutions, including, for example, Washington Mutual, Wachovia, Lehman Brothers, Bear Stern, Merrill Lynch and Countrywide Financial, have ceased to exist. The Federal Deposit Insurance Corporation (FDIC) has recorded over 400 failed U.S. financial institutions since 2008 (<http://www2.fdic.gov/hsob>). As widely reported in the media, and as evidenced through their stock performance, the surviving companies, such as Citi, Bank of America, Wells Fargo, Morgan Stanley and many middle- to small-size financial institutions, have not yet fully recovered from the crisis.

a-2) The observation that investors are more risk averse and that there is a reduction in available capital in the financial markets is based on Mr. Widjaja’s expert judgment. As the Quantitative Risk and Control Manager for SDG&E, Mr. Widjaja monitors the performance of the capital markets and issues his conclusions based on his market expertise. Most informed professionals are aware that investors have been concerned about the stability of the financial systems due to the global financial crisis, especially considering that the Euro zone is still in the midst of a major crisis.

Investors’ aversion to risk and their “flight to quality” is acknowledged in the media and among informed finance professionals. Objective evidence of this phenomenon includes, for example, changes in the price of gold that coincide with the onset of the financial crisis. During times of financial uncertainty, investors typically invest in gold, which is viewed as a “safe haven”, in order to avoid risk. The increase in gold demand drives gold price increases, based on supply/demand economics (see Figure 1 below). The massive increase in gold investment over the recent period has reduced the amount of capital available for other types of market investments.

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Response to FEA-SDG&E-02-23 (Continued)

Figure 1 Gold Price from 2007 – June 12, 2012



a-3) In 1993, the Chicago Board Options Exchange® (CBOE®) introduced the CBOE Volatility Index® (VIX®), which has become the benchmark for stock market volatility. It is widely followed and is cited in many news articles in the Wall Street Journal, Barron's and other leading financial publications. Since volatility often signifies financial turmoil, VIX is often referred to as the "investor fear gauge". The greater the fear, the higher the VIX level (<http://www.cboe.com/micro/vix/faq.aspx>). Therefore, VIX can be used as a proxy for the market required risk premium. Figure 2 shows that the VIX has been increased since the financial crisis.

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Figure 2 VIX Index from 2003 – June 12, 2012



b.) SDG&E does not have access to information regarding the precise amount of capital that is available in the financial market place as of today's date, as compared with prior years.

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- FEA-SDG&E 02-24 [Ref. Widjaja Direct, p. 4, ll. 7-8]
- a) Please explain why, if the Company expects to borrow significantly to fund future capital projects, dividing current free cash flow by current book value represents expected investment risk.
 - b) Please provide a copy of or cite to any investor advisory publication that indicates free cash flow divided by book value is a reliable measure of capital investment risk for an A-rated electric utility company.
 - c) In Mr. Widjaja's experience, is it unusual for a company that is in a capital expansion project to have negative free cash flow?

SDG&E Response:

- a) The purpose of the calculation is not to represent a specific level of investment risk. The purpose is to illustrate the relative size of the capital investment program as compared to the overall size of the company.
- b) This ratio calculation is developed internally to illustrate the level of a company's capital investment.
- c) It is not unusual for a company that is in a capital expansion project to have negative free cash flow. However, it signals to the investing community that liquidity for the company has become constrained and that the company could have liquidity issues if market conditions change unfavorably.

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FEA-SDG&E 02-25 [Ref. Widjaja Direct, p. 6, ll. 4-6]
Please list all instances in which the California Commission has not been supportive to the Company with regard to implementing RPS standards enacted by the Legislature. In each instance, please quantify the revenue impact (as a percentage of total Company jurisdictional revenues) of the negative action taken by the Commission.

SDG&E Response:

SDG&E objects on the grounds that the question is overbroad, unduly burdensome, and is vague and ambiguous, in particular with regard to the phrase “not been supportive.” Notwithstanding that objection and without waiving this or any other objection, SDG&E responds as follows:

The Commission’s implementation of California’s RPS program, through its current proceeding (R.11-05-005) and its various predecessor proceedings (R.04-04-026, *et seq.*), has been going on for close to a decade. There are numerous instances of the Commission adopting positions not supported by SDG&E. SDG&E has not quantified the revenue impact of each such instance.

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FEA-SDG&E 02-26 [Ref. Widjaja Direct, p. 6, l. 21]
Please provide objective evidence that investors believe that California electric utilities are more risky investments than electric utilities in any other state, for RPS goals, or any other reason.

SDG&E Response:

California utilities face unique risks. For example, California imposes significant monetary penalties (\$50/MWh) if a California IOU does not meet the RPS goals and California's RPS compliance goal of reaching 33% by 2020 is the most aggressive goal in the U.S. Thus, all else being equal, a prudent investor would perceive greater risk for California utilities due to the aggressive RPS goals and potential for RPS non-compliance penalties.

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FEA-SDG&E 02-27 [Ref. Widjaja Direct, p. 7, ll. 7-19]
Do the risks cited apply only to California utilities? Please provide any available support for your response.

SDG&E Response:

No, but it is a question of degree. SDG&E has observed that some risks are more acute or pronounced in California – for example, the permitting process in California, CAISO’s lengthy queue for interconnection studies and the length of the CPUC approval process. It should also be noted that although the risks cited are not all unique to California IOUs, the general challenges that the renewable energy industry faces has greater impacts to California IOUs than other states because of the aggressive RPS goals and penalty structure for non-compliance that California IOUs face.

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- FEA-SDG&E 02-28 [Ref. Widjaja Direct, p. 9, ll. 10-17]
- a) What percentage of SDG&E's total kWh sales are provided by roof-top solar?
 - b) What percentage of SDG&E's total annual kWh sales are comprised of vehicle charging?
 - c) Please provide any available objective evidence that roof-top solar and/or electric vehicles "contribute[] to a perception of a higher risk profile for SDG&E."

SDG&E Response:

- a) Data regarding the exact percentage is not available. Since SDG&E net meters, SDG&E does not record how much energy the roof-top solar customers actually use or how much energy their solar systems generate.
- b) For the period January-December 2008, 0.0001% of SDG&E's kWh sales were comprised of residential electric vehicle charging on separately metered electric vehicle rates. For the period June 2011-May 2012, 0.0050% of SDG&E's kWh sales were comprised of electric vehicle charging on separately metered residential electric vehicles rates. Separately metered electric vehicle rates include EV-TOU, EPEV-X, EPEV-Y, and EPEV-Z. It is also important to note that additional electric vehicle charging occurs on other residential and commercial rates where the electric vehicle use is not separately metered. This additional electric vehicle usage is not included in the percentages provided above.
- c) At the beginning of 2008, 4,929 SDG&E customers had installed 32.2 MW of solar. As of the end of May 2012, 17,617 SDG&E customers have installed 135.3 MW of solar. SDG&E solar customers, and solar capacity installed by SDG&E customers, are over 350% and 400% of 2008 levels.

Using the percentages provided in response to part b), SDG&E has experienced more than a 5000% increase in separately metered electric vehicles sales since 2008. Customers with electric vehicles are not required to notify SDG&E or select an electric vehicle rate, which means that SDG&E has even more electric vehicle load than what is captured on separately metered rates. Therefore the increase in electric vehicle load is even higher than calculated. High growth rates are expected to continue in the future as more electric vehicles are introduced into the market and the electric vehicle charging infrastructure evolves.

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Response to FEA-SDG&E-02-28 (Continued)

Due to these tremendous growths, SDG&E faces increasing reliability and power quality challenges. Various government agencies and industry groups, such as Department of Energy (DOE), Massachusetts Institute of Technology, The Electric Power Research Institute, the California Energy Commission, the California Public Utilities Commission, Pacific Northwest National Labs, Sandia National Lab and the IRC ISO/RTO Council, have published reports on issues created by plug-in electric vehicles and renewable generation resources while discussing the need for technology and research for smart grid solutions. The DOE specifically acknowledges the “heightened risk, both technology and policy, associated with innovative clean energy technologies”¹ in its 2011 Strategic Plan.



DOE Vision 2011.pdf

¹ DOE/CF-0067 “Strategic Plan”, Department of Energy, May 2011, at p.13

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FEA-SDG&E 02-29 [Ref. Widjaja Direct, p. 11, ll. 2-6]
Given the expected increase in PEV's does the Company's projected infrastructure expansion anticipate upgrading distribution systems to serve that load? If not, please explain why not; if so, why would the additional O&M expense be characterized as "unexpected"?

SDG&E Response:

SDG&E's projected infrastructure expansion accounts for its forecasted PEV load, however, the actual adoption rate of PEV and customer PEV charging behavior are two large unknowns. Due to this uncertainty, O&M expenses may vary from what is expected.

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FEA-SDG&E 02-30 [Ref. Widjaja Direct, p. 12]
Regarding generation risk, please respond to the following:

- a) Please provide a complete copy of any testimony or pleading by the Company before the California Commission in which it claimed to be less-risky after it was required to divest its generation assets.
- b) If the sample of group of similar-risk companies used to estimate the cost of capital contain generation assets, why would SDG&E's cost of equity be any different due to generation risk?

SDG&E Response:

- a) This information is not available.
- b) The referenced testimony relates primarily to differences in SDG&E's current business risk as compared with its business risk in 2008, it does not expressly address comparison with the proxy group.

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- FEA-SDG&E 02-31 [Ref. Widjaja Direct, pp. 13, 14]
- a) Has the Company, in its presentations to bond rating agencies, made them aware of its insurance/litigation risks? If so, please so state; if not, please explain why not.
 - b) Should a utility be immune from the effects of all operating risks? If not, please explain why not; if so, please explain why.

SDG&E Response:

- a) The Company fully discloses its insurance and litigation risks in its filings with the Securities and Exchange Commission. These public disclosures are available to the rating agencies - and all other members of the investment community - for use in assessing the Company's creditworthiness.
- b) SDG&E objects on the grounds that the question calls for a legal conclusion and is argumentative.

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FEA-SDG&E 02-32 [Ref. Widjaja Direct, p. 15, ll. 18-20]
Does an allowed ROE equal to the cost of equity capital provide “adequate compensation for investor risk”? If not, please explain why not and provide support from the literature of regulatory finance.

SDG&E Response:

Please see response 02-19 regarding confusion in use of terminology. The cost of equity capital for a company should be equal to the return on equity for equity investors. Therefore, an authorized ROE that is equal to the cost of equity capital (*i.e.* return on equity for investors) provides adequate compensation for equity investor risk.

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FEA-SDG&E 02-33 [Ref. Widjaja Direct, p. 18, ll. 5-12]
If the Commission granted intervenor requests in full (i.e., zero allowed return), what would be the dollar impact on SDG&E's annual revenues as a percent of total revenues? Please provide support for your response.

SDG&E Response:

Intervenors have proposed that SDG&E's legacy meters are no longer used and useful and that \$85.1 million of un-depreciated book value should not be included in the ratebase. They have proposed 0% rate of return instead of SDG&E's commission authorized return of 8.40% on ratebase. Should the Commission approve the intervenor's request with no return, SDG&E revenues will be lower by \$7 million (0.4% of total revenues) in the test year (2012) and SDG&E will also continue to lose revenues for the next 25 years of the remaining life of the legacy meters.

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FEA-SDG&E 02-34 [Ref. Widjaja Direct, p. 21, ll. 11-16 and p. 22, Figure 2]
Please list all the bonds used to calculate the yield spread shown in Figure 2
and, for each bond for each company, please provide the coupon yield.

SDG&E Response:

Please see the attached Excel file (Answer_FEA_SDGE_02-34.xls).



Answer_FEA_SDGE_
02-34.xls

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QUESTIONS FOR COMPANY WITNESS HRNA

FEA-SDG&E 02-35 [Ref. Hrna Direct, p. 2, l. 1, Attachment A]

- a) With regard to the projected embedded cost of debt (5.09%) shown on Attachment A, for each debt issue, please provide: 1) the date of issuance, 2) the term of the issuance, and 3) the coupon rate of each issuance.
- b) For each projected debt issuance (\$250 million in 2012 and 2011), please provide the basis for the assumed coupon rate.

SDG&E Response:

In response to FEA DR-01, SDG&E submitted public versions of its workpapers in both PDF and Excel format via CD on May 29, 2012. FEA has since signed and returned the nondisclosure agreement in this proceeding and therefore SDG&E will provide the confidential workpapers in both PDF and Excel format via CD in a supplemental response to FEA DR-01. The workpapers are responsive to this request.

Please refer to workpaper pages 1-6 for the calculation of the proposed long-term debt cost rate. The pertinent assumptions for projected long term debt issuances are outlined in the workpapers.

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FEA-SDG&E 02-36 [Ref. Hrna Direct, p. 2, ll. 2, 3]

- a) Please define the term “low interest” used when referencing debt issued since 2007.
- b) How was SDG&E able to issue “low interest” debt with an authorized common equity ratio of 49% of total capital?

SDG&E Response:

- a) The term “low interest” used in this context is used relative to SDG&E’s currently authorized cost of debt of 5.62%. The issuance of new debt at lower than authorized costs has helped bring down SDG&E’s overall cost of debt down since the last cost of capital. “Low interest” means a lower interest cost than SDG&E’s currently authorized cost of debt.
- b) Debt market investors evaluate SDG&E’s debt offerings based on market conditions and SDG&E’s credit profile at the time of issuance. SDG&E’s credit profile includes its capital structure and other risk criteria/factors as outlined in the testimonies of Mr. Schlax, Mr. Widjaja, and Ms. Hrna. Ms. Hrna discusses one of these significant risk (debt equivalents) factors within section IV of her testimony. SDG&E will have substantially greater (over \$1.3 billion greater) debt equivalence in 2013 – 2015 than in past years as noted by Ms. Hrna’s on Table 4 (pg. 10). Debt equivalence are risk factors that impact capital structure by raising imputed debt assumptions in rating agency evaluations of SDG&E’s credit. Consequently, a higher equity ratio is an appropriate mitigation measure to proactively manage SDG&E’s credit profile to mitigate significantly rising risk factors which include debt equivalence as well as SDG&E’s other significant risks. SDG&E’s credit profile and financial risks are changing and SDG&E’s proposals in this case are designed to proactively manage these risks.

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FEA-SDG&E 02-37 [Ref. Hrna Direct, p. 2, ll. 4, Attachment B]
For each of the series of preferred stock, please provide the date of issuance, and for the projected issuances, please provide support for the assumed dividend yield.

SDG&E Response:

In response to FEA DR-01, SDG&E submitted public versions of its workpapers in both PDF and Excel format via CD on May 29, 2012. FEA has since signed and returned the nondisclosure agreement in this proceeding and therefore SDG&E will provide the confidential workpapers in both PDF and Excel format via CD in a supplemental response to FEA DR-01.

Please refer to workpaper pages 7-9 for the calculation of the proposed preferred stock rate. The pertinent assumptions for projected preferred stock issuances are outlined in the workpapers.

Furthermore, the date of issuance for each series of outstanding preferred stock is below. The workpapers and table below are responsive to this request.

Issue date	Series
9/28/1940	5% Series
4/5/1949	4.5% Series
1/16/1951	4.4% Series
12/28/1962	4.6% Series
9/18/1993	\$1.70 Series
11/15/1993	\$1.82 Series

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FEA-SDG&E 02-38 [Ref. Hrna Direct, p. 2, Table 2]
Please provide a quarter-by-quarter comparison, from 2007 forward, between the Authorized capital structure for SDG&E and the Company's actual capital structure. Please also provide published balance sheet support for the annual capital structures provided.

SDG&E Response:

As stated in Sandra Hrna's Testimony, SDG&E's currently authorized capital structure of 45.25% debt, 5.75% preferred stock, and 49% common equity has been in place for the last 12 years.

The attached Excel file contains the actual ratemaking capitalization amounts and ratios for 2007 through March 2012, on a quarterly basis.



SDG&E
Capitalization.xls

In regards to published balance sheet support, the information for SDG&E is available at the Securities and Exchange Commission's (SEC's) website, EDGAR, by following this hyperlink:

<http://www.sec.gov/cgi-bin/browse-edgar?company=san+diego+gas&CIK=&filenum=&State=&SIC=&owner=exclude&action=getcompany>

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FEA-SDG&E 02-39 [Ref. Hrma Direct, p. 3, ll. 18, 19]
Please provide a copy of the April Global Insight publication from 2007 forward through 2012.

SDG&E Response:

SDG&E objects to this request to the extent it seeks proprietary third-party information. Global Insight's service agreement restricts Sempra Energy companies from disseminating to third parties the entirety of Global Insight's proprietary forecasts unless they are used in public regulatory proceedings.

Subject to and notwithstanding this objection, attached is the complete April 2012 Global Insight forecast of 30-year Treasury Bond yields which SDG&E used in this proceeding.



GI Apr12
30yrTBondq.xls

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FEA-SDG&E 02-40 [Ref. Hrna Direct, p. 5, ll. 7-11]

The Company's projected debt ratio is the same as the currently authorized capital structure, however, in its projected capital structure the Company has elected to finance its operations with more common equity and less preferred stock.

- a) Please explain how financing with common equity versus preferred stock will improve cash flow coverage of interest costs.
- b) If financing with common equity versus preferred equity will not improve cash flow coverages of interest costs, please explain how it will enhance creditworthiness.
- c) Please explain whether or not financing 3% of the Company's rate base with common equity versus preferred stock will be more costly for ratepayers.
- d) Please provide any cost-benefit analyses undertaken by the Company that show financing with common equity versus preferred stock is cost effective.

SDG&E Response:

- a) Rating agencies generally look at preferred stock as a hybrid financing source consisting of both debt and equity characteristics. As noted in Ms. Hrna's testimony (section IV pg. 16), preferred stock has preferential treatment for dividends unlike common equity. Common dividends are considered discretionary payments while preferred dividends are often times "cumulative" and have more serious ramifications for non-payment. During times of financial stress or crisis, a common dividend can simply be suspended with little near-term operating ramifications; however, if preferred dividends were suspended, serious ramifications could result that would impact near-term and long-term operations. During credit profile reviews, a portion of the preferred stock is assigned an imputed cost much like interest expense that impacts the cash flow coverage ratio. Consequently, SDG&E can expect a lesser cash flow coverage ratio from using additional preferred stock as compared to using common equity (all else being equal) when being evaluated by rating agencies.
- b) As mentioned above, preferred stock is considered a debt/equity hybrid security and receives imputed "interest like" costs which impacts SDG&E's cash flow coverage ratios. As noted above, common dividend payments are more discretionary than preferred stock dividends and during times of economic stress or crisis, common equity financing offers more financial flexibility. Consequently, an investor would perceive a company that has greater financial flexibility to be less risky and more creditworthy, all else being equal.

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- c) Common equity in the near-term appears more costly than preferred stock due to the characteristics outlined above. However, over longer-term horizons and during times of financial stress or crisis, common equity has advantages over preferred stock as outlined above. SDG&E recommends retaining a 2.75% allocation to preferred stock and moving 3% of its preferred authorized capital structure to common equity to specifically offset the increasing risk factors that Ms. Hrna, Mr. Schlax and Mr. Widjaja discuss in their testimonies. SDG&E manages its capital structure over the long-term horizon and believes this specifically outlined tradeoff (preferred equity for common equity) is conducive to its goal to maintain a strong investment profile, which helps enable SDG&E to continue to access competitive rates of financing over the long-term.
- d) Ms. Hrna has provided rationale and analysis within her testimony that reflects that the 3% movement of preferred equity to common equity alleviates obvious and significantly growing debt equivalences risk impacts (outlined in section IV pages 4 – 19). Additionally, Dr. Morin's testimony also discusses how the impact of debt equivalences impacts capital structure, credit metrics and raises financial risk.

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FEA-SDG&E 02-41 [Ref. Hrma Direct, p. 6, Table 3]

- a) Are bond rating agencies, in assessing SDG&E's creditworthiness currently taking into account ASC 810 consolidation and projected purchased power levels? If not, please explain why not.
- b) Please provide a complete copy of SDG&E's most recent in-depth bond rating agency presentation.

SDG&E Response:

- a) SDG&E objects to this request to the extent it seeks analysis or information that is not within SDG&E's possession or control. SDG&E cannot comment on all bond rating agency methodology. However, those Power Purchase Tolling Agreements that are currently consolidated on SDG&E's balance sheet would already be included in the financial statement assessment by outside analysts.
- b) Recent presentations made to rating agencies and/or investment firms covering SDG&E took place on March 29, 2012 and May 3, 2012. Investment analysts attended the March 29, 2012 Analyst Conference or were able to access the attached presentation materials through www.sempra.com. SDG&E specific slides from the 1st quarter earnings call presentation on May 3, 2012 were presented via a webcast and are attached. The complete Analyst Conference and 1st quarter earnings call presentations can be found at www.sempra.com.



2012 Analyst
Conference Presenta



2012 Q1 -
Presentation.pdf

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FEA-SDG&E 02-42 [Ref. Hrma Direct, p. 9, ll. 10-17]

- a) Does Senate Bill “SB 2” change the amount of purchased power that SDG&E needs to meet its customer load or does it change the mix of that purchased power by increasing the amount that has to come from RPS-approved sources? Please provide support for your response.
- b) If Senate Bill “SB 2” does not require SDG&E to buy more purchased power than it would have otherwise, please explain why it would increase the Company’s purchased power risk.
- c) Would the Company’s risk be lowered if it elected to generate its own RPS-friendly power, and not purchase it from other suppliers? If so, please explain why; if not, please explain why not.

SDG&E Response:

- a) SB 2 changes the mix of purchased power that SDG&E needs to meet its customer load by increasing the amount that has to come from RPS eligible renewable energy resources. SB 2 extends the RPS goal from 20% of retail sales of all California investor-owned (IOUs), electric service providers (ESPs), and community choice aggregators (CCAs) by the end of 2010, to not less than 33% of retail sales of IOUs, ESPs, CCAs and publicly owned utilities by the end of 2020. Specifically, § 399.15(b) establishes multi-year compliance period targets whereby RPS-obligated entities are required to procure at least 20% of retail sales from eligible renewable energy resources by 2013, 25% by 2016 and no less than 33% by 2020. The obligation to maintain 33% of retail sales from eligible renewable energy resources continues every year thereafter.
- b) SB 2 does not require that we purchase additional power, but could result in increased power purchases in order to accommodate the risk of failure from less proven renewable technologies.
- c) Even if SDG&E generated its own RPS power, it would still need to purchase power from independent sources. It is unlikely that SDG&E could meet its RSP goals solely with utility owned renewable generation. Therefore, the risk associated with purchasing from other suppliers would not be eliminated.

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FEA-SDG&E 02-43 [Ref. Hrma Direct, p. 9, l. 22]

- a) Please provide a complete copy of the June 2011 S&P Report referenced.
- b) Please also explain why S&P overlooked the Company's anticipated increase in purchased power use.

SDG&E Response:

- a) Credit rating agency reports are copyrighted materials available to paid subscribers and copies therefore cannot be provided to third parties, except in some instances by permission. SDG&E will make available to FEA the confidential versions of SDG&E's June 2011 S&P credit report only at SDG&E's offices for visual examination.
- b) The debt equivalence as reported in the S&P 2011 report reflects only PPA's online as of June 30, 2011. As discussed in Sandra Hrma's Direct Testimony, SDG&E expects the debt equivalency to climb to approximately \$1.6 billion as approved and filed PPAs come online over the cost of capital term.

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FEA-SDG&E 02-44 [Ref. Hrma Direct, p. 10, Table 4]
Please provide, in as much detail as possible, all assumptions and calculations supporting the debt equivalence for the purchased power contracts. Please also show that the calculation comports with rating agency guidelines.

SDG&E Response:

In response to FEA DR-01, SDG&E submitted public versions of its workpapers in both PDF and Excel format via CD on May 29, 2012. FEA has since signed and returned the nondisclosure agreement in this proceeding and therefore SDG&E will provide the confidential workpapers in both PDF and Excel format via CD in a supplemental response to FEA DR-01. The workpapers are responsive to this request.

Please refer to workpaper pages 28-64 for the assumptions and calculations supporting the debt equivalence for the purchased power contracts.

SDG&E objects to the second sentence of this request as vague and unclear, and to the extent it requests analysis outside of SDG&E's possession and control.

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FEA-SDG&E 02-45 [Ref. Hrma Direct, p. 13, Table 5]
Please provide, in electronic spreadsheet format, the supporting calculations and assumptions used to create Table 5.

SDG&E Response:

In response to FEA DR-01, SDG&E submitted public versions of its workpapers in both PDF and Excel format via CD on May 29, 2012. FEA has since signed and returned the nondisclosure agreement in this proceeding and therefore SDG&E will provide the confidential workpapers in both PDF and Excel format via CD in a supplemental response to FEA DR-01. The workpapers are responsive to this request.

Please refer to workpaper pages 26-27 for the assumptions/calculations supporting Table 5.

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FEA-SDG&E 02-46 [Ref. Hrma Direct, p. 13, Table 6]
Please provide a complete copy of the source document from which this
Table is excerpted.

SDG&E Response:

Credit rating agency reports are copyrighted materials available to paid subscribers and copies therefore cannot be provided to third parties, except in some instances by permission. SDG&E is willing to make the S&P credit methodology report available to FEA at SDG&E's offices for visual examination.

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QUESTIONS FOR COMPANY WITNESS DEREMER

FEA-SDG&E 02-47 [Ref. Deremer Direct]

Please detail and describe the ways, other than the “off-ramp” provision, in which Mr. Deremer’s ROE benchmarking proposal is different from the method currently being used by the Commission.

SDG&E Response:

Other than the “off-ramp” provision, the ROE benchmarking proposal is the same as the currently authorized method. The details behind SDG&E’s proposal are discussed in Section IV of Kenneth Deremer’s direct testimony.

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QUESTIONS FOR COMPANY WITNESS DEREMER

FEA-SDG&E 02-47 [Ref. Deremer Direct]

Please detail and describe the ways, other than the “off-ramp” provision, in which Mr. Deremer’s ROE benchmarking proposal is different from the method currently being used by the Commission.

SDG&E Response:

Other than the “off-ramp” provision, the ROE benchmarking proposal is the same as the currently authorized method. The details behind SDG&E’s proposal are discussed in Section IV of Kenneth Deremer’s direct testimony.

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FEA-SDG&E 02-48 [Ref. Morin Exhibits]

Please provide copies of all of Dr. Morin's supporting Exhibits (RAM-1 through RAM-7) in electronic format with cells unlocked, formulas and original data available.

SDG&E Response:

The requested Exhibits are being provided in Excel format. As described in Dr. Morin's direct testimony and in the exhibit footnotes, the raw data on these exhibits were estimated using the Value Line Investment Analyzer and Zacks Investment Research software which are commercially available to investors on a paid subscription basis. Value Line and Zacks do not allow the electronic dissemination of their proprietary data for obvious copyright reasons. Dr. Morin and/or his staff will be glad to make available for inspection proprietary copyrighted software materials at the Company's premises during normal working hours by arrangement upon reasonable prior notice. The formal Value Line copyright notification in the software reads as follows:

Value Line Investment Analyzer

Copyright © 1999-2012 Value Line Publishing

This product is licensed to

Roger A. Morin

WARNING

This computer program is protected by copyright law and international treaties. Unauthorized reproduction or distribution of this program, or any portion of it, will result in severe civil and criminal penalties, and will be prosecuted to the maximum extent allowed under the law.

Dr. Morin notes that much of the information contained in the Value Line Investment Analyzer software is available in paper format from the latest edition of the traditional Value Line Investment Survey coinciding with the month of publication of the software version. Such reports are available at most university libraries in paper format.

The analyst growth rates in the DCF exhibits were obtained from the Zacks Investment Research Web site and are also available from the aforementioned Value Line software.



Morin_SDG&E_Exhibi
ts.xls

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FEA-SDG&E 02-49 [Ref. Morin Direct, p. 5, ll. 7, 8]

Please explain why a utility with a higher-than-average bond rating can simultaneously have “higher than average investment risks.”

SDG&E Response:

Bond ratings measure risk from a bondholder’s perspective and capture a borrower’s creditworthiness, that is, the ability to repay principal and interest. In contrast, risk from a shareholder perspective is concerned with variability. It is quite conceivable that a company can possess low credit risk from a debt perspective and high risk from an equity perspective, as is the case for Sempra and its operating utility companies. To wit, Sempra possesses a higher beta risk than average while at the same time the bonds of its operating utility companies are rated single A.

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FEA-SDG&E 02-50 [Ref. Morin Direct, p. 20, ll. 14-15]

Please provide support from the published work of Professor Myron Gordon, the originator of the DCF, to support Dr. Morin's statement that the "standard DCF model...assumes that dividends are paid at the end of each year..."

SDG&E Response:

It is almost universally assumed that the standard Gordon DCF model assumes annual cash flows. Most, if not all, finance textbooks provide a derivation of the DCF model assuming annual end-of-year dividends. For example, see the widely used corporate finance textbook by Professor Brigham (Brigham, E. F. and Ehrhardt, M. C., Corporate Finance: A Focused Approach, 3rd ed., South-Western, 2008, Chapter 7, page 237).

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FEA-SDG&E 02-51 [Ref. Morin Direct, p. 20, l. 19 through p. 21, l. 2]
Regarding the sample groups selection:

- a) Please explain why it is reasonable to assume that the investment risk of a utility that has 50% electric utility operations and 50% unregulated operations is the same as that of SDG&E.
- b) What is the percent of revenues from regulated operations for each of Dr. Morin's sample group companies? Please provide support for your response.
- c) What percent of SDG&E's revenues are provided by regulated operations?
- d) What is the common equity ratio as a percent of total capital of each of the companies in Dr. Morin's sample groups? Please provide support for your response.
- e) Please explain the rationale for selecting a sample group of companies in the western United States.
- f) Please provide a list of all other cost of capital testimony in which Dr. Morin has selected a similar-risk sample group based only on location.

SDG&E Response:

- a) The 50% figure was used as a screening criterion rather than as a formal measure of risk. The construction of reference groups inevitably involves a tradeoff between statistical adequacy and scientific accuracy. On the one hand, the screening criteria have to be stringent enough so as to capture companies whose risk is the same as the target utility, but on the other they must be flexible enough to allow enough companies to survive for the analysis to be statistically meaningful. In Dr. Morin's opinion, the 50% screen optimizes the tradeoff between statistical reliability and economic relevance. In fact, the average percentage of revenues from regulated operations in Dr. Morin's sample of integrated electric utilities is 82%.
- b) See attachment from AUS Utility Reports May 2012 edition.
- c) SDG&E objects to this question on the grounds that the term "regulated operations" is vague. Notwithstanding this objection, all or virtually all of SDG&E's operations could be considered "regulated."
- d) See response to b).
- e) Value Line Investment Survey segregates electric utilities on the basis of location, that is, Eastern, Western, and Central, presumably on the basis that these utilities differ in risk as to fuel mix, quality of regulation, regional economics, regulatory policies, etc.
- f) Dr. Morin has never relied on a single group of companies based only on location but has always relied on reference groups similar to those used in his testimony.

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FEA-SDG&E 02-52 [Ref. Morin Direct, p. 21, ll. 19-21]

How are the Value Line Investment Analyzer dividend yields calculated? Please provide support from Value Line for your response.

SDG&E Response:

In the traditional paper version of the Value Line Investment Survey, the dividend yield (shown in the top right-hand corner of the Value Line page) is the estimated total of cash dividends to be declared over the next 12 months, divided by the recent price of the stock. In the software version of the Value Line Investment Analyzer, dividend yield is defined as the “current dividend yield”.

The annual DCF model states very clearly that the expected rate of return on a stock is equal to the expected dividend at the end of the year divided by the current price of the stock, plus the expected growth rate.

Moreover, the basic annual DCF model ignores the time value of quarterly dividend payments and assumes dividends are paid once a year at the end of the year. Multiplying the spot dividend yield by $(1 + g)$ is actually a conservative attempt to capture the reality of quarterly dividend payments and understates the expected return on equity. Use of this method is conservative in the sense that the annual DCF model ignores the more frequent compounding of quarterly dividends.

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FEA-SDG&E 02-53 [Ref. Morin Direct, p. 24, ll. 11-14]

Please provide a complete copy of the “financial literature” to which Dr. Morin refers in the cited portion of his testimony.

SDG&E Response:

Extensive academic research in the past two decades has documented and confirmed repeatedly the overwhelming superiority of analysts’ earnings forecasts over the uni-variate time-series forecasts. This latter category includes many *ad hoc* forecasts from statistical models, ranging from the naive methods of simple averages, moving averages, etc. to the sophisticated time-series techniques such as the Box-Jenkins modeling techniques.

In other words, this literature suggests that analysts’ earnings forecasts incorporate all the public information available to the analysts and the public at the time the forecasts are released. Furthermore, these forecasts are statistically more accurate than forecasts solely based on historical earnings, dividends, book value equity, and the like.

Important papers include Brown and Rozeff (1978), Cragg and Malkiel (1982), Harris (1986), Vander Weide and Carleton (1988), and Lys and Sohn (1990). The cited sources were consulted by Dr. Morin at the university library and are available from most university libraries. A summary of these papers follows.

Summary of Papers Reviewed

Lawrence D. Brown and Michael S. Rozeff, 1978, **The Superiority of Analyst Forecasts as Measures of Expectations: Evidence from Earnings**, *Journal of Finance*, Vol. XXXIII, No. 1, pp. 1 to 16

Using data (1951 to 1975) from 50 non-utility firms, the authors compared forecasting errors between forecasts reported in Value Line Investment Survey and forecasts from a sophisticated time-series methodology (Box-Jenkins). They concluded that “Value Line Investment Survey consistently makes significantly better earnings forecasts than the BJ [Box-Jenkins] and naive time series models.” (p.13)

J. Cragg and B. G. Malkiel, **Expectations and the Structure of Share Prices**, National Bureau of Economic Research, University of Chicago Press, 1982

See quotation below from Harris (1986).

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Robert S. Harris, 1986, **Using Analysts' Growth Forecasts to Estimate Shareholder Required Rates of Return**, *Financial Management*, Spring 1986, pp. 58 - 67

The main focus of this paper was to derive required return on equity using expected rather than historical earnings growth rates. Harris used IBES consensus earnings forecasts as a proxy for investor expectation. In his review of the literature on financial analysts' forecasts (FAF), Harris wrote:

Moreover, a growing body of knowledge shows that analysts' earnings forecasts are indeed reflected in stock prices. Such studies typically employ a consensus measure of FAF calculated as a simple average of forecasts by individual analysts. Elton, Gruber, and Gultekin show that stock prices react more to changes in analysts' forecasts of earnings than they do to changes in earnings themselves, suggesting the usefulness of

FAF as a surrogate for market expectations. In an extensive NBER study using analysts' earnings forecasts, Cragg and Malkiel conclude "the expectations formed by Wall Street professionals get quickly and thoroughly impounded into the prices of securities. Implicitly, we have found that the evaluations of companies that analysts make are the sorts of ones on which market valuation is based." (p.59, footnote omitted)

James H. Vander Weide and Willard T. Carleton, 1988, **Investor Growth Expectations: Analysts vs. History**, *The Journal of Portfolio Management*, Spring 1988, pp. 78 - 82

This paper updated the study by Cragg and Malkiel (1982), which suggests that the stock valuation process embodies analysts' forecasts rather than historically based growth figures such as the ten-year historical growth in dividends per share or the five-year growth in book value per share. (The Cragg and Malkiel study is based on data for the 1960s). In this paper, the authors used data from 1971- 1983 for approximately sixty-five utility firms. They "found overwhelming evidence that the consensus analysts' forecasts of future growth is superior to historically oriented growth measures in predicting the firm's stock price." Their results "also are consistent with the hypothesis that investors use analysts' forecasts, rather than historically oriented growth calculations, in making stock buy-and-sell decisions." (p. 81)

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Thomas Lys and Sungkyu Sohn, 1990, **The Association between Revisions of Financial Analysts' Earnings Forecasts and Security-Price Changes**, *Journal of Accounting and Economics*, vol. 13, pp. 341 - 363

Using virtually all publicly available analyst earnings forecasts for a sample of 58 companies in the 1980 - 86 period (over 23,000 individual forecasts by 100 analyst

firms), the authors showed that stock returns responded to individual analyst earnings forecasts, even when they were closely preceded by earnings forecast made by other analysts or by corporate accounting disclosures.

Empirical studies have also been conducted showing that investors who rely primarily on data obtained from several large reputable investment research houses and security dealers obtain better results than those who do not². Thus, both empirical research and common sense indicate that investors rely primarily on analysts' growth rate forecasts rather than on historical growth rates alone.

See attached reference list.

Analyst Forecasts References

Brown, L.D. and Rozeff, M.S. "The Superiority of Analyst Forecasts as Measures of Expectations: Evidence from Earnings." *Journal of Finance*, March 1978, 1-16.

Cragg, J.G. and Malkiel, B.G. "Expectations and the Structure of Share Prices." National Bureau of Economic Research. Chicago: University of Chicago Press, 1982.

Cragg, J.G. and Malkiel, B.G. "The Consensus and Accuracy of Some Predictions of the Growth of Corporate Earnings." *Journal of Finance*, March 1968, 67-84.

Easterwood, J. C. and Nutt, S. R., "Inefficiency in Analysts' Earnings Forecasts: Systematic Misreaction or Systematic Optimism?" *Journal of Finance*, Vol. LIV, No. 5, 1999, pp. 1777-1797.

Elton, E.J., Gruber, M.J., and Gultekin, J. "Expectations and Share Prices." *Management Science*, September 1981, 975-981.

²Examples of these studies include Stanley, Lewellen & Schlarbaum (1981) and Touche Ross Co. (1982).

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Fried, D. and Givoly, D., "Financial Analysts Forecasts of Earnings, A Better Surrogate for Market Expectations", *Journal of Accounting and Economics*, Vol. 4, 1982.

Harris, R. S., "Using Analysts' Growth Forecasts to Estimate Shareholder Required Rates of Return." *Financial Management*, Spring 1986, pp. 58 – 67.

Harris, R. S., and Marston, F. C., "The Market Risk Premium: Expectational Estimates Using Analysts' Forecasts," *Journal of Applied Finance*, 11:6-16, 2001.

Lys, T. and Sohn, S., "The Association between Revisions of Financial Analysts' Earnings Forecasts and Security-Price Changes," *Journal of Accounting and Economics*, vol. 13, 1990, pp. 341 – 363.

Moyer, R. C., Chatfield, R. E., and Kelley, G. D., "The Accuracy of Long-Term Earnings Forecasts in the Electric Utility Industry," *International Journal of Forecasting* Vol. I, 1985.

Stanley, L., Lewellen, W., and Schlarbaum, G. "Further Evidence on the Value of Professional Investment Research," *Journal of Financial Research*, Spring 1981, 1-9.

Timme, S.G. and Eiseman, P.C. "On the Use of Consensus Forecasts of Growth in the Constant Growth Model: The Case of Electric Utilities." *Financial Management*, Winter 1989, 23-35.

Touche Ross Co. "Proxy Disclosures and Stockholder Attitude Survey." Washington DC: National Association of Corporate Directors, May 1982.

Vander Weide, J.H. and Carleton, W. T. "Investor Growth Expectations: Analysts vs. History." *The Journal of Portfolio Management*, Spring 1988, 78-87.

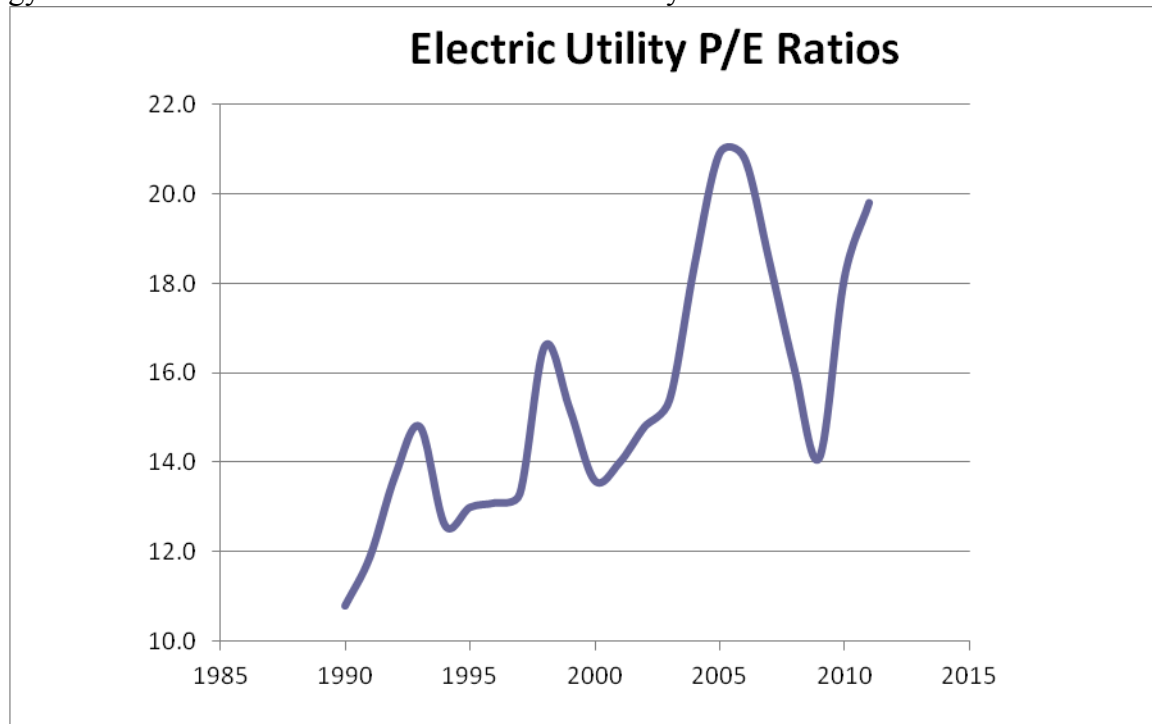
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FEA-SDG&E 02-54 [Ref. Morin Direct, p. 27, ll. 4, 5]

Please provide support for the statement made regarding the current volatility in the marketplace for stocks generally, and for utility stocks.

SDG&E Response:

The core assumption underlying the DCF model is stability, and that all financial metrics, including dividends, earnings, book value, stock price, price/earnings (P/E) ratio, experience constant growth forever. The assumption of constant and stable P/E ratio in the electric utility industry is particularly problematic at this time, given the gyrations in that ratio over the past two decades, especially in the 1990-2011 period, as is evident from the graph below. The Standard DCF model assumes constancy in the P/E ratio. When investors expect the P/E ratio to increase, the DCF model fails to capture that particular component of price appreciation. The converse is true as well. The following graph displays the instability in electric utility stocks' P/E Ratios over the 1990-2010 period. The applicability of the DCF model increases with the degree of stability of relative market valuation ratios (P/E ratio, M/B ratio). Market conditions today are significantly different than in the past. The same is true for the equity markets as a whole, as evidenced by the gyrations in the VIX index of stock market volatility and various indices of investor confidence.



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FEA-SDG&E 02-55 [Ref. Morin Direct, p. 37, ll. 8-16]

Please provide copies of the T-bond yield data from each source on which Dr. Morin relied for his CAPM risk-free rate, and also provide the most recent T-Bond yield data from the same sources.

SDG&E Response:

As shown in the attachments, Global Insight and Value Line project higher long-term Treasury interest rates in 2013-2015 and beyond. These are the latest forecasts that were available to Dr. Morin when he prepared his testimony.



FEA 02-55 GI fin
forecasts.xls



FEA 02-55 VL Econ
Fcts Nov 2011.pdf

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FEA-SDG&E 02-56 [Ref. Morin Direct, p. 39, ll. 12-18]

Please provide a copy of the portion of the Morningstar publication cited, i.e., that containing the historical return differences between the earned return on stock and the earned return on bonds as well as Morningstar's explanation of why the latter is preferable.

SDG&E Response:



FEA 02-56 Ibbotson page 73.pdf



FEA 02-56Ibbotson page 74 CA-IR-310.p

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FEA-SDG&E 02-57 [Ref. Morin Direct, p. 40, ll. 6-11]

- a) Please provide support for the statement that the average historical yield difference between 30-year and 20-year T-Bonds is “not material.”
- b) If the yield difference between 20-year and 30-year bonds is “not material” please explain whether the use of a current 20-year T-Bond yield as the risk-free rate in a CAPM analysis would be appropriate?

SDG&E Response:

- a. As shown on the attached spreadsheet, the difference in yield between 30-year and 20-year bonds was very close to zero and actually frequently negative over the period studied.
- b. Yes, although as explained in Dr. Morin’s testimony, the appropriate proxy for the risk-free rate in the CAPM is the return on the longest term Treasury bond possible. This is because common stocks are very long-term instruments more akin to very long-term bonds. The ideal estimate for the risk-free rate has a term to maturity equal to the security being analyzed. Since common stock is a very long-term investment because the cash flows to investors in the form of dividends last indefinitely, the yield on the longest-term possible government bonds, that is the yield on 30-year Treasury bonds, is the best measure of the risk-free rate for use in the CAPM.



FEA 02-57.xls

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FEA-SDG&E 02-58 [Ref. Morin Direct, p. 46, ll. 9-12]

- a) Is it true that Brealey & Meyer's 5% to 8% market risk premium is based on short-term Treasury securities as the risk free rate?
- b) If the response to "a)," above is negative, please provide copies of the pertinent portions of the Brealey & Meyer's text to support that response.
- c) If the response to "a)," above is positive, please explain why Dr. Morin did not discuss that fact in his testimony.
- d) If Brealey & Meyer's 5% to 8% market risk premium were based on long-term Treasury bonds instead of short-term Treasury bonds, and the historical yield difference between T-bonds and T-Bills is 1.7%, what market risk premium range would result? Please explain your response.

SDG&E Response:

- a. Yes.
- b. Yes.
- c. Dr. Morin's market risk premium (MRP) estimate of 6.7% rests within that range even when adjusted for the maturity premium of 1%. Moreover, Dr. Morin's MRP does not rest solely on the Brealey-Myers estimate but also rests on the Ibbtson historical estimates of the MRP and also on his own survey of the MRP literature, which appears in Chapter 5 of his latest textbook, The New Regulatory Finance. Finally, Dr. Morin deems his MRP estimate of 6.7% conservative, given the continuing volatile conditions in the equity market.
- d. Approximately 4% to 7%. See also response to c. above.

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FEA-SDG&E 02-59 [Ref. Morin Direct, p. 48]

- a) Please show how the selection of an “alpha” factor of 1% to 2% results in the mathematical expression shown on line 13.
- b) Has Dr. Morin used a higher alpha in prior testimonies, or has he always assumed an alpha range of 1% to 2% when using an ECAPM analysis? Please explain.

SDG&E Response:

- a. The alpha factor has the effect of increasing the intercept of the risk-return relationship and decreasing its slope, just as the ECAPM does. Using an alpha factor of 2% in the equation shown on page 30 line 5 produces the same result as the empirical CAPM expression shown on page 30 line 13. For example, for a MRP of 8% and alpha of 2%, the two equations produce identical results.
Dr. Morin notes that an alpha range of 1% - 2% is somewhat lower than that estimated empirically. The use of a lower value for alpha leads to a lower estimate of the cost of capital for low-beta stocks such as regulated utilities. This is because the use of a long-term risk-free rate rather than a short-term risk-free rate already incorporates some of the desired effect of using the ECAPM. That is, the long-term risk-free rate version of the CAPM has a higher intercept and a flatter slope than the short-term risk-free version which has been tested. Thus, it is reasonable to apply a conservative alpha adjustment. Moreover, the lowering of the tax burden on capital gains and dividend income enacted in 2002 may have decreased the required return for taxable investors, steepening the slope of the ECAPM risk-return trade-off and bring it closer to the CAPM predicted returns.
- b. Dr. Morin has always assumed an alpha range of 1%-2%.

FEA DATA REQUEST
FEA-SDG&E-DR-002
SDG&E 2012 COST OF CAPITAL – A.12-04-016
SDG&E RESPONSE
DATE RECEIVED: JUNE 1, 2012
DATE RESPONDED: JUNE 18, 2012

FEA-SDG&E 02-60 [Ref. Morin Direct, pp. 47-50]

- a) Please provide a list of regulatory jurisdictions of which Dr. Morin is aware that have explicitly relied on the ECAPM to set the allowed return in a utility rate proceeding.
- b) Please provide a list of regulatory jurisdictions of which Dr. Morin is aware that have explicitly rejected the ECAPM as a means to determine the allowed return in a utility rate proceeding.

SDG&E Response:

- a, & b. Dr. Morin did not conduct any comprehensive survey of jurisdictions where the ECAPM is either endorsed or refuted explicitly. Regulatory commissions are naturally reluctant to divulge the computational details and the specifics of each methodology employed in arriving at their ROE determination. Understandably, they are reluctant to disseminate the details, methods, and assumptions underlying their determination. As a general rule, commissions are not dogmatic as to which method they adhere. Dr. Morin is not aware of any recent published survey of how regulatory commissions derive their estimate of the allowed ROE, and there are very few explicit references to the use or non-use of various ROE methodologies in the vast majority of rate orders. A NARUC survey of ROE methodologies indicated that the vast majority of regulatory commissions rely on a variety of methodologies.

Following the mammoth generic rate of return proceeding for electric utilities (Docket No. 91-M-0509), following countless testimonies filed by a myriad experts, including Dr. Morin, the New York Public Service Commission endorsed the validity of the ECAPM, which they referred to as the Morin CAPM and the “zero-beta” CAPM. The NYPSC routinely relies on the ECAPM in its generic rate of return formula. In past years, the Mississippi jurisdiction relied on the ECAPM in determining the benchmark ROE in its Performance Evaluation Plan (“PEP”) performance-based regime.

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FEA-SDG&E 02-61 [Ref. Morin Direct, p. 66, ll. 15-19]

Is it reasonable to believe that Sempra's unregulated generation assets and its international business have an impact on its beta coefficient? If not, please explain why not.

SDG&E Response:

Dr. Morin did not investigate the risks of SEMPRA, but rather focused on SDG&E as a stand-alone entity. Given that 81% of SEMPRA's revenues are from regulated electric operations according to AUS Reports dated May 2012, it is reasonable to assume its beta coefficient is reflective of its regulated operations, and that investors perceive Sempra as an energy utility similar in risk to SDG&E.

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DATE RESPONDED: JUNE 18, 2012**

FEA-SDG&E 02-62 [Ref. Morin Direct, p. 71]

If the utility in Dr. Morin's example (50/50 capital structure, cost of equity = 11%) were to experience a 5% reduction in its debt ratio, so that the common equity was 55% and the debt was 45%; is it

SDG&E Response:

All else remaining constant, yes.