Company: San Diego Gas & Electric Company (U 902 M)
Proceeding: 2016 General Rate Case
Application: A.14-11-003
Exhibit: SDG&E-37-R

REVISED

SDG&E

DIRECT TESTIMONY OF SANDRA K. HRNA

POST-TEST YEAR RATEMAKING

MARCH 2015

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

A Sempra Energy utility®

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My testimony for SDG&E's post-test year ratemaking framework proposes:

- A three-year term (2016-2018) for this general rate case cycle, with SDG&E's next test year in 2019.
- A post-test year ratemaking mechanism to adjust authorized revenue requirements for:
  - Labor and non-labor costs based on IHS Global Insight's forecast,
  - Medical costs based on the Towers Watson forecast, and
  - Capital investments impact on rate base.
- Continuation of the currently authorized Z-factor mechanism.
- An attrition year revenue requirement increase of $96.6 million (5.07 percent) in 2017 and $96.3 million (4.81 percent) in 2018.

SDG&E DIRECT TESTIMONY OF SANDRA K. HRNA

POST-TEST YEAR RATEMAKING

I. INTRODUCTION

A. Summary of Request

The purpose of my prepared direct testimony is to request that the California Public Utilities Commission ("Commission") approve San Diego Gas & Electric Company's ("SDG&E" or the "Company") post-test year ("PTY") ratemaking framework proposal to provide an appropriate level of authorized revenues for years 2017 and 2018. The mechanism would provide sufficient revenues to implement the principles and policies described in the prepared direct testimony of SDG&E witness Mr. Steven D. Davis (Exhibit SDG&E-01-R).

SDG&E proposes (1) a three-year term (2016-2018) for this GRC cycle, (2) a PTY ratemaking mechanism to adjust authorized revenue requirements for expense and capital related expenditures and (3) continuation of the currently authorized Z-factor mechanism. This proposal is designed to better align PTY revenue requirements: (a) to account for unique cost escalation issues, such as the expected higher growth medical costs,[1] and (b) to account for SDG&E's capital investments that improve and maintain the utility infrastructure. This proposal does not cover all anticipated expense and capital-related investments but provides the foundation for financial stability with incentives for productivity improvements.

SDG&E's proposal would yield attrition-year revenue increases of $96.6 million (5.07 percent) in 2017 and $96.3 million (4.81 percent) in 2018.

II. SDG&E'S PROPOSED GRC TERM

SDG&E proposes a three-year GRC term of 2016-2018, with its next GRC cycle beginning with Test Year ("TY") 2019. SDG&E is proposing a three-year GRC term to avoid conflicts with the expected GRC filings of Pacific Gas & Electric Company ("PG&E") and Southern California Edison Company ("SCE"). Assuming both PG&E and SCE remain on three-year GRC cycles, PG&E and SCE are expected to file in 2017 and 2018, respectively. SDG&E's proposed three-year GRC term and a subsequent TY 2019 GRC would avoid conflicts with the expected next GRCs of PG&E and SCE.

[1] Escalation is proposed to be applied to net medical expenses (i.e., after reassignments to capital).

III. POST-TEST YEAR RATEMAKING MECHANISM

A. Background

The traditional GRC framework provides for an annual attrition mechanism for interim adjustments to the test-year revenue requirements in the post-test years. Attrition mechanisms should provide reasonable and consistent funding for operating expenses and capital investments. These base margin adjustments are needed to recover increases in costs during the post-test years due to inflation, capital investments (capital additions), and growth in customers, especially given that gas and electric commodity revenues are balanced. Under balancing account treatment, revenue changes resulting from increases in volumes and prices are returned to customers and thus, revenue increases are not available to offset increases in SDG&E's costs during the PTY period. As a result, without a means to offset these PTY increases, SDG&E would not have a reasonable opportunity to earn its authorized rate of return after TY2016.

In SDG&E's TY2012 GRC decision,[2] the Commission adopted a variation of the Division of Ratepayer Advocates' proposal to use the CPI-Urban ("CPI-U") index to determine the PTY revenue requirements of SDG&E and SoCalGas. Specifically, the Commission adopted the CPI-Urban index plus 75 basis points for SDG&E's attrition adjustments. SDG&E disagrees with the use of CPI-U as a utility cost escalator on a standalone basis for the TY2016 post-test years, because it has very little relationship to SDG&E's actual cost structure. The CPI-U measures changes in the price of a representative basket of goods and services purchased by a typical U.S. household. It is not intended to and does not gauge price changes of goods and services purchased by businesses, or more specifically, utilities. Additionally, an attrition adjustment based on CPI-U will not reflect the revenue requirement increase from plant additions in excess of depreciation (rate base growth) and cost escalation SDG&E will face in the attrition years. Changes in capital revenue requirement components (authorized returns on rate base, depreciation expense, and taxes) are determined almost entirely by the relationship between capital additions and depreciation. When capital additions exceed depreciation, rate base increases and the related capital revenue requirement components also increase. These increases are unrelated to inflation and rate base growth has no correlation to CPI.

SDG&E expects to make significant annual capital investments during the TY2016 GRC term, such that TY2016 GRC PTY adjustment mechanism should reflect the anticipated growth

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[2] D.13-05-010, p. 1010.

in capital additions in excess of depreciation in the PTY period. CPI plus an adder is not the proper method to determine increases in depreciation, taxes and returns. These amounts should be determined by quantifying capital additions, the associated impact on rate base, and then calculating the resulting increases for each revenue requirement component. As an example, and as further explained in the Capital Additions section of my testimony, SDG&E calculated the PTY revenue requirements (associated with rate base growth) from its capital investments. The actual capital related revenue requirement as compared with CPI escalation results in a significant shortfall as shown below:

($ in millions)	2017		2018	
Capital–Related Revenue Requirement	$76.1	6.85%	$76.1	6.41%
CPI-U Escalation Forecast	$20.0	1.80%	$22.6	2.00%
Revenue Requirement Shortfall	**$56.1**		**$53.5**	

B. Proposed PTY Ratemaking Mechanism

SDG&E's PTY ratemaking mechanism comprises two components[3]:

- O&M escalation (Labor and Non-Labor and Medical)
- Capital Additions

As part of this framework, SDG&E does not seek escalation of miscellaneous revenues and proposes to absorb customer growth as a productivity factor by having no specific adjustment for customer growth or productivity in the PTY mechanism. This proposal would require that SDG&E achieve a level of productivity sufficient to offset the costs associated with customer growth in each of the two post-test years. Mr. Ken Schiermeyer's (Electric) and Ms. Rose-Marie Payan's (Gas) customer growth forecast is shown below. These implicit productivity factors are six times higher for electric and seven times higher for gas than the 0.2% productivity factor most recently adopted for Southwest Gas.[4]

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[3] The two-component mechanism proposed in this filing is consistent with the August 2014 final decision authorizing PG&E's general rate case revenue requirement for 2014-2016 (D.14-08-032, p. 653).
[4] D.14-06-028.

	2017	2018
Electric (Exhibit SDG&E-31,workpapers)	1.27%	1.25%
Gas (Exhibit SDG&E-32,workpapers)	1.47%	1.47%

Each element of the proposed PTY ratemaking mechanism, except for Miscellaneous Revenues and Franchise & Uncollectible,[5] are described in the sections below. Appendix A provides a calculation of the 2017 and 2018 SDG&E revenue requirements using the current Global Insight forecasted 2017 and 2018 O&M and capital cost escalation factors.

1. O&M Escalation

a) Labor and Non-Labor

SDG&E is proposing a post-test year ratemaking mechanism that escalates labor costs using IHS Global Insight's Power Planner (Global Insight) forecast as described in the testimony of Scott Wilder (Exhibit SDG&E-33). Mr. Wilder explains how the Global Insight data is weighted to incorporate "Utility Service Workers," "Managers and Administrators" and "Professional and Technical Workers" to arrive at the appropriate escalation rate for SDG&E.

Consistent with labor, non-labor (O&M and administrative) adjustments are calculated using escalation rates described in the testimony of Scott Wilder. Mr. Wilder explains how the various Global Insight cost series are combined and weighted to develop escalation indexes for non-labor costs.

As discussed in Mr. Wilder's testimony, for simplicity in calculating PTY escalation, the labor and non-labor rates have been weighted proportionately to the total costs and combined into a single factor. The weighted results of labor and non-labor and the associated revenue requirement are:

($ in millions)	2017		2018	
Labor and Non-Labor Adjustment	2.58%	$17.6	2.46%	$17.3

To account for prospective changes in escalation rates, SDG&E proposes that the Global Insight forecast available in September 2016 be used to determine the TY2016 O&M escalation index. The dollar escalation increase for attrition year 2017 would be effective January 1, 2017,

[5] Miscellaneous revenues are proposed to be fixed amounts for the post-test year periods and franchise fees and uncollectible expense items are not subject to escalation (as they are proposed to be applied as fixed rates for the post-test year period).

and the Global Insight forecast available in September 2017 would be used to determine the 2017 O&M escalation index. The dollar escalation increase for attrition year 2018 would be effective January 1, 2018.

b) Medical Cost Adjustment

The second component of the O&M PTY ratemaking mechanism is an adjustment to medical costs. Medical costs have grown at a higher rate than the broad based inflation in the general economy. Because SDG&E's medical costs are expected to increase faster than general utility cost inflation, medical costs are escalated separately based on actuarial forecasts, as described in the direct testimony of SDG&E witness Ms. Debbie Robinson (Exhibit SDG&E-22). The actuarial forecast by Towers Watson, which is based on preliminary 2015 renewal rates, is more reflective of the cost trends in Southern California. SDG&E notes that this forecasted rate is similar to the post-test year medical expense escalation rate (7.5%) the Commission adopted in the SCE TY2012 GRC final decision.[6] The proposed medical cost escalation based on the Towers Watson's actuarial forecast and the associated revenue requirement is:

($ in millions)	2017		2018	
Medical Cost Adjustment	7.8%	$2.1	7.8%	$2.3

2. Capital Additions

The second component of the proposed PTY ratemaking mechanism is the adjustment to capital-related revenue requirements to reflect the cost of plant additions. As previously mentioned, the capital-related portion of the revenue requirement consists of authorized returns on rate base, depreciation expense, and taxes. SDG&E proposes that during the post-test years its rate base and associated revenue requirements be adjusted to reflect the impact of forecasted capital additions. SDG&E is not proposing to adjust the rate base elements of materials and supplies, customer advances, or working cash.

SDG&E bases its PTY computation on a seven-year (2010-2016) recorded and forecasted average of capital additions using consistent methodologies (rate base, depreciation, taxes[7]) and escalation factors throughout this NOI request. Using a seven-year average of historical capital

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[6] D.12-11-051, p. 608.

[7] The estimates were calculated using current federal and state tax laws enacted through the filing date of this testimony.

additions as a proxy for future capital additions is appropriate since the factors contributing to plant additions in 2010-2016 will drive the need for further investment in the post-test years. The seven-year average also serves to normalize the year-to-year variability in utility spending. Finally, this method eliminates the need for the Commission to conduct a line-by-line review of forecasted 2017 and 2018 capital spending while balancing the interests of both ratepayers and shareholders.

Capital additions by major plant category for each year are escalated to PTY dollars based on Global Insight indices, as described in the testimony of Scott Wilder. For example, the recorded (2010 through 2013) and forecasted (2014 through 2016) additions would be escalated to 2016 dollars and then averaged. To determine the capital additions for 2017 and 2018, the seven-year average capital addition is escalated using the above-mentioned Global Insight Indices. This established method accounts for inflation specific to the type of plant additions SDG&E will be making during the post-test year periods.

As more fully described in my workpapers, a weighting factor is applied to the plant additions to determine the weighted average plant additions included in the rate base for the post-test years. Incremental net depreciation, amortization, and deferred taxes are also calculated using TY ratios in order to determine the weighted average rate base for each PTY. The resulting 2017 and 2018 capital-related revenue requirements associated with the methodology described above yield:

($ in millions)	2017	2018
Capital–Related Revenue Requirement	$76.1	$76.1

In August 2014, the Commission issued its final decision authorizing PG&E's general rate case revenue requirement for 2014-2016[8] and adopted a consistent methodology to determine capital-related PTY revenue requirements as the one described above. More specifically, the decision adopts base year capital additions using a seven-year average with the seventh year being the test year (2008-2014 for PG&E, 2010 through 2016 for SDG&E). As explained in the decision, "Use of a more recent seven-year period offers a more robust forecast relative to TURN's proposal based on the 2005-2011 period."[9] Also consistent with SDG&E's proposal, the decision escalates the seven-year average using Global Insights indices and rejects

[8] D.14-08-032.
[9] D.14-08-032, p. 659.

the use of CPI-U as proposed by TURN. The Commission explains that "although the CPI may reasonably measure price inflation faced by consumers, it does not measure price escalation for goods and services procured by an energy utility."[10]

IV. Z-FACTOR MECHANISM

SDG&E proposes to keep in place the current Z-factor process for the 2016-2018 PTY term. The Z-factor mechanism uses a series of eight criteria[11] outlined in D.94-06-011 to identify exogenous cost changes that qualify for rate adjustments prior to the next GRC test year. If all eight criteria are met, the Z-factor mechanism allows for rate adjustments for only the portion of the Z-factor costs not already contained in SDG&E's annual revenue requirement and only for costs that exceed a $5 million deductible per event. SDG&E proposes no changes to the current identification of Z-factors.

SDG&E proposes to continue the "Z-factor memorandum account" procedure. In the case of a potential Z-factor event, SDG&E will notify the Commission's Executive Director of the event by letter, providing all relevant and available information about the event, and will activate the Z-factor Memorandum Account for potential entries. Following this notification, SDG&E would have the option to file an application for a revenue requirement supplement if the Z-factor event exceeds the $5 million per event deductible.

V. REGULATORY FILINGS

Currently, SDG&E updates PTY revenue requirements through an annual advice letter filing. SDG&E proposes to continue this process of implementing PTY revenue requirement adjustments annually after the test year through an advice letter process. Consistent with current treatment, SDG&E will make an annual PTY advice letter filing on or before November 1 (beginning November 1, 2016) to update the authorized revenue requirements, according to the adopted PTY ratemaking mechanism. The resulting customer rate adjustments to recover the updated revenue requirement would be effective the following January 1. The advice letter will contain all calculations necessary to update the revenue requirement for the subsequent year.

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[10] D.14-08-032, p. 659.

[11] In D.05-03-023 (SDG&E/SoCalGas 2004 COS Phase II decision), mimeo at 78 (Ordering Paragraph No. 2 authorizing SDG&E and SoCalGas to file for rate adjustments using the mechanism described in the Settlement Agreement) and p. 12 of Appendix C (Settlement Agreement). The eliminated criteria provided that the costs and events are not part of the rate update mechanism.

VI. CONCLUSION

SDG&E's proposal is a fair and reasonable mechanism to provide the foundation for financial stability in the post-test years. This proposal accounts for the major cost drivers impacting the Company, which allows SDG&E to provide safe and reliable service to its customers, comply with regulations, and manage its operations as prudent financial stewards.

This concludes my revised prepared direct testimony.

VII. WITNESS QUALIFICATIONS

My name is Sandra K. Hrna. I am employed by SDG&E as Director of Supply Management & Supplier Diversity. My business address is 8330 Century Park Court, San Diego, California 92123. I have been employed by SDG&E and Sempra Energy since 2001. In addition to my current position, I have held various Accounting and Finance positions within the organization, including Director of Capital and Business Optimization, Assistant Treasurer and Director of Financial Analysis & Regulatory Accounts, Director of Business Planning, Budgets & Claims and Director of Compliance & Accounts Payable.

I received my Bachelors of Business Administration – Accounting from The University of Texas at Austin in 1991. I also received a Masters in Professional Accounting – Tax from the University of Texas at Austin in 1991.

I have previously testified before this Commission.

APPENDIX A – POST TEST YEAR ESCALATION EXAMPLES

SAN DIEGO GAS & ELECTRIC
Exemplary Calculation of 2017 and 2018 Revenue Requirements Assuming No Z-Factor Adjustment
For Illustrative Purposes Only

Line No.	Description	($ in Millions) Rev Req*	Escalation
1	**2016 Total Revenue Requirement**	**$ 1,905.4**	
2	Less: 2016 Misc. Revenues	$ 19.2	
3	Less: 2016 Capital Related Costs (Depreciation, Taxes, Return)	$ 1,110.8	
4	Less: 2016 Medical Expense	$ 27.2	
5	Less: 2016 Franchise & Uncollectible	$ 63.6	
6	2016 Escalatable O&M Margin	$ 684.6	
7	2017 O&M Escalation Rate %	*2.58%*	
8	2017 O&M Escalation $ (L6 * L7)	$ 17.6	$ 17.6
9	2017 Medical Escalation Rate %	*7.80%*	
10	2017 Medical Escalation $ (L4 * L9)	$ 2.1	$ 2.1
11	2017 Capital Related Costs (Depreciation, Taxes, Return)	$ 76.1	$ 76.1
12	2017 O&M Margin (L6 + L8)	$ 702.3	
13	2017 Medical Expense (L4 + L10)	$ 29.4	
14	2017 Capital Related Costs (as Proposed) (L3 + L11)	$ 1,186.9	
15	2017 Misc. Revenue (L2)	$ 19.2	
16	2017 FF&U	$ 64.3	$ 0.7
17	**2017 Revenue Requirement (Sum of Lines 12 through 16)**	**$ 2,002.0**	**$ 96.6**
18	Less: 2017 Misc. Revenues	$ 19.2	
19	Less: 2017 Capital Related Costs (Depreciation, Taxes, Return)	$ 1,186.9	
20	Less: 2017 Medical Expense	$ 29.4	
21	Less: 2017 Franchise & Uncollectible	$ 64.3	
22	2017 Escalatable O&M Margin	$ 702.3	
23	2018 O&M Escalation Rate %	*2.46%*	
24	2018 O&M Escalation $ (L22 * L23)	$ 17.3	$ 17.3
25	2018 Medical Escalation Rate %	*7.80%*	
26	2018 Medical Escalation $ (L20 * L25)	$ 2.3	$ 2.3
27	2018 Capital Related Costs (Depreciation, Taxes, Return)	$ 76.1	$ 76.1
28	2018 O&M Margin (L22 + L24)	$ 719.6	
29	2018 Medical Expense (L20 + L26)	$ 31.6	
30	2018 Capital Related Costs (L19 + L27)	$ 1,263.0	
31	2018 Misc. Revenue (L18)	$ 19.2	
32	2018 FF&U	$ 64.9	$ 0.7
33	**2018 Revenue Requirement (Sum of lines 28 through 32)**	**$ 2,098.3**	**$ 96.3**

***** *Differences due to rounding.*

APPENDIX B – GLOSSARY OF TERMS

Commission	California Public Utilities Commission
CPI	Consumer Price Index
DRA	Division of Ratepayer Advocates
GRC	General Rate Case
O&M	Operations and Maintenance
PG&E	Pacific Gas and Electric Company
PTY	Post-Test Year
SCE	Southern California Edison Company
SDG&E	San Diego Gas & Electric Company
SoCalGas	Southern California Gas Company
TY	Test Year

SDG&E 2016 GRC Testimony Revision Log – March 2015

Exhibit	Witness	Page	Line	Revision Detail
SDGE-37	Sandra K. Hrna	Cover	N/A	Changed “A.14-11-XXX” to “A.14-11-003”
SDGE-37	Sandra K. Hrna	Cover	N/A	Changed “SDG&E-37” to “SDG&E-37-R”
SDGE-37	Sandra K. Hrna	Cover	N/A	Changed “NOVEMBER 2014” to “MARCH 2015”
SDGE-37	Sandra K. Hrna	SKH-i	N/A	Changed “SDG&E-01” to “SDG&E-01-R”
SDGE-37	Sandra K. Hrna	SKH-ii	N/A	Changed “$96.4 million (5.04 percent)” to “$96.6 million (5.07 percent)”
SDGE-37	Sandra K. Hrna	SKH-ii	N/A	Changed “$95.9 million (4.78 percent)” to “$96.3 million (4.81 percent)”
SDGE-37	Sandra K. Hrna	SKH-1	10	Changed “SDG&E-01” to “SDG&E-01-R”
SDGE-37	Sandra K. Hrna	SKH-1	19	Changed “$96.4 million (5.04 percent)” to “$96.6 million (5.07 percent)”
SDGE-37	Sandra K. Hrna	SKH-1	20	Changed “$95.9 million (4.78 percent)” to “$96.3 million (4.81 percent)”
SDGE-37	Sandra K. Hrna	SKH-3	8	Changed “show” to “shown”
SDGE-37	Sandra K. Hrna	SKH-3	8-9	Changed “$75.9” to “$76.1”
SDGE-37	Sandra K. Hrna	SKH-3	8-9	Changed “6.81%” to “6.85%”
SDGE-37	Sandra K. Hrna	SKH-3	8-9	Changed “$75.5” to “$76.1”
SDGE-37	Sandra K. Hrna	SKH-3	8-9	Changed “6.35%” to “6.41%”
SDGE-37	Sandra K. Hrna	SKH-3	8-9	Changed “$20.1” to “$20.0”
SDGE-37	Sandra K. Hrna	SKH-3	8-9	Changed “$22.7” to “$22.6”
SDGE-37	Sandra K. Hrna	SKH-3	8-9	Changed “$55.8” to “$56.1”
SDGE-37	Sandra K. Hrna	SKH-3	8-9	Changed “$52.8” to “$53.5”
SDGE-37	Sandra K. Hrna	SKH-4	19-20	Changed “$17.7” to “$17.6”
SDGE-37	Sandra K. Hrna	SKH-6	19-20	Changed “$75.9” to “$76.1”
SDGE-37	Sandra K. Hrna	SKH-6	19-20	Changed “$75.5” to “$76.1”
SDGE-37	Sandra K. Hrna	SKH-A-1	N/A	Replaced Exemplary Calculation Table
SDGE-37	Sandra K. Hrna	SKH-A-3	N/A	Added 2016 GRC Testimony Revision Log Table