Application: A.22-04-XXX
Company: San Diego Gas & Electric Company (U 902 M)
Proceeding: 2023 Cost of Capital
Exhibit No.: SDG&E-01

PREPARED DIRECT TESTIMONY OF

VALERIE A. BILLE - POLICY OVERVIEW

ON BEHALF OF

SAN DIEGO GAS & ELECTRIC COMPANY

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

April 20, 2022

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PREPARED DIRECT TESTIMONY OF VALERIE A. BILLE ON BEHALF OF SAN DIEGO GAS & ELECTRIC COMPANY

I. INTRODUCTION AND SUMMARY OF PROPOSALS

My testimony provides an overview of San Diego Gas & Electric Company's ("SDG&E" or "Company") test year ("TY") 2023 application for a newly authorized cost of capital ("COC") for SDG&E's California Public Utilities Commission ("Commission") operations. I also provide SDG&E's return on equity ("ROE") and rate of return ("ROR") proposals.

I am an officer for SDG&E. This Application applies to SDG&E's electric distribution, gas distribution and gas transmission businesses, together with the electric generation and the electric and natural gas procurement functions.[1] SDG&E's proposed ROE and overall ROR is consistent with financial modeling and capital market data demonstrating that the cost of equity for utilities, and SDG&E in particular, has increased as utilities' risks have increased, despite the decline in interest rates brought on by the federal government and Federal Reserve's actions to minimize the impacts from the COVID-19 pandemic. Yet although SDG&E's proposal reflects a fair cost of equity—particularly considering the Company's unique, above average risks including wildfire-related threats—and would help restore SDG&E's lowered credit ratings, it *does not* result in an increase in monthly costs for the average residential customer compared to SDG&E's current cost of capital and balances the interests of shareholders and ratepayers.

II. SDG&E'S PROPOSED RATE OF RETURN IS NECESSARY WHILE REFLECTING A DECREASE COMPARED TO SDG&E'S CURRENT COST OF CAPITAL

For 2023, SDG&E proposes the following cost of capital.

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[1] The return on electric transmission is not included since its governing regulatory agency is the Federal Energy Regulatory Commission ("FERC").

TABLE 1 – PROPOSED 2023 AUTHORIZED COST OF CAPITAL

Component	Capital Ratio	Cost	Weighted Cost
Long-Term Debt	46%	3.87%	1.78%
Preferred Stock	0%	0%	0%
Common Equity	54%	10.55%	5.70%
ROR	100%	N/A	7.48%

The Company's currently authorized cost of capital, as approved in D.19-012-056 (the "2019 Decision"), is shown below.

TABLE 2 – CURRENTLY AUTHORIZED COST OF CAPITAL

Component	Capital Ratio	Cost	Weighted Cost
Long-Term Debt	45.25%	4.59%	2.08%
Preferred Stock	2.75%	6.22%	0.17%
Common Equity	52.00%	10.2%	5.30%
ROR	100%	N/A	7.55%

If adopted, SDG&E's proposals will *decrease* the Company's currently authorized rate of return by 0.07% or seven basis points, which will result in an estimated $0.4 million (an electric reduction of $0.6 million electric with a $0.2 million gas increase) revenue requirement *decrease.*[2] This will not result in an increase in the monthly bill for most customers—including combined gas and electric residential customers.

2 SDG&E's revenue requirement impact is illustrative and will be updated as a result of the final outcome of this proceeding. In addition to the cost of capital components, the revenue requirement calculation reflects the adjustment associated with the equity rate base exclusion for wildfire mitigation capital expenditures required by Assembly Bill ("AB") 1054, as adopted by the Commission in Resolution E-5071.

SDG&E's requests are informed by the Company's actual capital structure, sound financial modeling, capital market data, and other qualitative and quantitative analyses from SDG&E and independent sources such as equity analysts, credit rating agencies, and state utility commissions' cost of capital authorizations. The Company's testimony supports its cost of capital proposals. While this testimony highlights the findings of the Company's witnesses, each witness sponsors the recommendations in their areas of responsibility.

A. SDG&E's Capital Structure Proposal Balances the Company's Actual Capital Structure with Commission Precedent

Maritza Mekitarian and James Coyne's prepared direct testimonies support SDG&E's proposed capital structure of 54 percent common equity, 46 percent long-term debt, and zero percent preferred stock.[3] SDG&E's proposal better aligns SDG&E's authorized capital structure with its nearly decade-long actual capital structure of 56 percent common equity, 44 percent long-term debt, and zero percent preferred equity.[4] By having an actual capital structure with a higher common equity ratio than its authorized one, SDG&E's investors are supporting the Company's credit ratings—providing a benefit to ratepayers through lower borrowing costs—without receiving a return on their investment. If SDG&E reduced its actual common equity ratio to its currently authorized one it would harm its credit ratings, resulting in higher costs for ratepayers.[5]

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[3] Prepared Direct Testimony of Maritz Mekitarian – Authorized Capital Structure on Behalf of SDG&E (April 20, 2022) ("SDG&E-02 (Mekitarian)") at MM-5; Prepared Direct Testimony of James M. Coyne – Return of Equity on Behalf of SDG&E (April 20, 2022) ("SDG&E-04 (Coyne)") at JMC-66 – JMC-67.

[4] *See* D.12-12-034 at 11 (setting SDG&E's capital structure to reflect its actual capital structure).

[5] *See* SDG&E-02 (Mekitarian) at MM-9 (credit rating agencies assess SDG&E financial risks based upon the Company's actual capital structure); SDG&E-04 (Coyne) at 67.

SDG&E's proposed capital structure also reasonably removes the fictious preferred equity layer from the Company's authorized capital structure that lacks any relationship to SDG&E's actual management of the Company. Preferred stock is no longer an advantageous method for a utility operating company to raise capital. SDG&E has not issued preferred stock since 1993, redeemed all outstanding shares of preferred stock in 2013, and does not plan to issue this type of financing.[6]

SDG&E's proposed capital structure thus better rewards the Company for the judicious management of its capital structure by moving SDG&E's authorized capital structure closer to its actual one—instead of continuing with a fictious authorized capital structure that includes preferred equity that the Company does not have. The proposal would validate SDG&E's prudent business decision to maintain a higher actual equity ratio to manage the Company's above average risks from operating in California; helping counterbalance the fact that SDG&E's credit ratings remain at least two notches below the A rating that SDG&E held prior to 2019 from all three credit rating agencies due to the Company's unique, above average risks, including from wildfire-related threats. And it would be consistent with prior Commission precedent that based SDG&E's authorized capital structure on its actual one.[7]

The proposal also provides a prudent counter to help SDG&E manage increased financial risks. SDG&E is having to finance costs subject to cost recovery—including those in balancing and memorandum accounts—for longer terms, with more expensive long-term financing. As of the end of February 2022 SDG&E's undercollected balances are $720 million; compared to a

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[6] SDG&E-02 (Mekitarian) at MM-9.

[7] *See, e.g.*, D.12-12-034 at 11.

historical average closer to $300-$400 million. And this risk of carrying large balances for long periods may continue to grow.

For example, a recent proposed decision would deny SDG&E interim rate relief for wildfire mitigation costs contained in a memorandum account, leaving SDG&E potentially responsible for carrying hundreds of millions in additional wildfire mitigation expenses for years.[8] Moody's has stated that it could again downgrade SDG&E's credit rating if SDG&E falls to a 20 percent funds from operations to total debt ratio.[9] If the proposed decision is adopted, and the requirements on SDG&E to carry large costs in balancing and memorandum accounts for years before recovery continue to grow, the Company debt ratio will increase, impairing SDG&E's credit ratings.

SDG&E's proposed capital structure would help counterbalance those risks, instead supporting further upgrades to SDG&E's credit ratings. In fact, as S&P recently added, despite ongoing wildfire risks, the ratings agency could raise SDG&E's rating if SDG&E's "financial measures are consistently above the upgrade threshold."[10]

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8 A.21-07-017, Proposed Decision Denying SDG&E's Application for Interim Rate Relief (March 15, 2022) at 6. On April 18, 2022, a Revised Proposed Decision was issued that would likewise deny SDG&E interim rate relief.

9 Moody's, Rating Action: Moody's upgrades San Diego Gas & Electric to A3 from Baa1; outlook stable, (Mar. 30, 2021) ("Moody's Mar. 30, 2021), available at https://www.moodys.com/research/Moodys-upgrades-San-Diego-Gas-Electric-to-A3-from-Baa1--PR_443599.

10 S&P, *How are California's Wildfire Risks Affecting Utility Credit Quality* (Jun. 3, 2021) ("S&P, June 3, 2021") at 10, available at https://www.spglobal.com/ratings/en/research/articles/210603-credit-faq-how-are-california-s-wildfire-risks-affecting-utility-credit-quality-11954953. *See* D.19-12-056 at 6 (Commission must ensure that the cost of capital and capital structure is sufficient to maintain reasonable credit ratings); D.12-12-034 at 8-9 ("as long-term debt ratios are increased, credit ratings tend to be downgraded which results in increased financial risks for common equity holders, thereby requiring greater returns on common equity.").

Yet SDG&E is not proposing that its authorized capital structure mirror its actual capital structure. Instead, consistent with D.19-12-056 (the "2019 Decision"), SDG&E's proposal strikes a reasonable balance by replacing the Company's preferred equity layer with an increase in both common equity and long-term debt.[11] As Mr. Coyne finds, SDG&E's proposed 54 percent common equity ratio is well within the range—and just over the mean—of actual common equity ratios held by operating companies in Mr. Coyne's proxy group.[12]

B. SDG&E Supports the Continuation of the CCM, in Conjunction with a Utility's Right to File an Application, With Three Technical Modifications

As provided in the Prepared Direct Testimony of Patrick Billings, SDG&E supports that the CCM, combined with SDG&E's right to file an application in lieu of the CCM when applicable as provided in D.08-05-035,[13] be continued for a new three-year cycle from 2023-2025. The CCM streamlines the cost of capital process by measuring the cost of capital in interim years between applications based solely on changes in interest rates—on the premise that changes in interest rates can "indicate changes in the equity costs of utilities"[14] to "maintain fair and reasonable" ROEs.[15] A CCM based upon this framework remains suitable for many economic circumstances, while appropriately providing SDG&E and other utilities the right to file a cost of capital application in lieu of the CCM when appropriate.

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[11] D.19-12-056 at 11 (not adopting SDG&E's actual capital structure as its authorized because the Company did not request an "increase in long-term debt").

[12] SDG&E-04 (Coyne) at JMC-66 – JMC-67.

[13] D.08-05-035 at 19, Conclusion of Law 6 ("The utilities have a right to file a cost of capital application outside of the CCM process upon an extraordinary or catastrophic event that materially impacts their respective cost of capital and/or capital structure and impacts them differently than the overall financial markets.").

[14] D.08-03-035 at 18, Finding of Fact 16.

[15] *Id.* at 3.

SDG&E does request three clarifications to the CCM process to address situations that SDG&E has faced during the current cost of capital cycle:

- Indicate what index applies to each utility after a cost of capital decision;
- Specify what Moody's utility bond index applies when a utility has split credit ratings; and
- Provide that a utility can switch to a different Moody's bond index within a CCM cycle if its credit ratings change.[16]

III. SDG&E'S ROE SHOULD BE SET AT 10.55 PERCENT TO APPROPRIATELY REFLECT THE COST OF EQUITY AND SDG&E'S ABOVE-AVERAGE RISKS, WHILE GENERALLY NOT RESULTING IN A RATE INCREASE

I provide SDG&E's ROE recommendation and the bases for that proposal, which is supported by the prepared direct testimony of Mr. Coyne, Ms. Mekitarian, and Ari Beer. SDG&E proposes an eminently supportable ROE of 10.55 percent, given Mr. Coyne's quantitative analysis showing an ROE range of 10.40-11.40 percent, and the above-average risks that SDG&E faces relative to the proxy group—while resulting in an overall rate of return decrease that does not raise costs for the average customer.

To invest in the wires, poles, and substations needed to deliver clean, safe, and reliable electricity and/or natural gas to customers, SDG&E raises funds by either issuing debt or selling equity. Both methods have costs. The company pays interest to debt creditors on borrowed funds. Or it pays a portion of its profits or dividends to equity investors, *i.e.*, shareholders. These costs are known as the cost of capital.

Capital markets are competitive. Investors will only choose to invest with SDG&E to fund critical projects for wildfire mitigation, grid modernization for electrification, and clean

16 Prepared Direct Testimony of Patrick Billings – Cost of Capital Mechanism on Behalf of SDG&E (April 20, 2022) at PB-8.

energy policies if SDG&E presents a reasonable return on those investments relative to the Company's risks. As the Commission has repeatedly found, SDG&E's return on its rate base must thus be set at a level that is comparable to the return for other businesses with corresponding risks.[17] As Mr. Coyne likewise testifies, setting an ROE that "fairly represents the true cost of equity balances the interest of both ratepayers as well as shareholders."[18]

If ROE is set too low it harms both groups, impairing "the financial health and integrity of the utility [such] that they are unable to make the investments they need to maintain the safety, integrity, and reliability of the system—such as through wildfire mitigation—in addition to meeting important public policy goals."[19] When a utility's return is set too low relative to its risks, investors will invest in other companies that have the same return with lower risk profiles[20]—preventing adequate investments in needed areas like wildfire mitigation or grid modernization.

For instance, a March 24, 2022 California State Auditor report found that potentially billions in further investments will be needed to underground lines or cover conductors to mitigate wildfires and minimize power shutoffs.[21] S&P likewise recently stated that, "[s]tate

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17 D.19-12-056 at 15-16 (citing *Federal Power Com. v. Hope Natural Gas Co.,* 320 U.S. 591, 601 (1944); *Bluefield Co. v. Pub. Serv. Comm'n*, 262 U.S. 679, 692 (1923)).

18 SDG&E-04 (Coyne) at JMC-10.

19 *Id.*

20 SDG&E-04 (Coyne) at JMC-9 – JMC-10; *see* D.19-12-056 at 16 (the Commission "attempt[s] to set the ROE at a level of return commensurate with market returns on investments having corresponding risks and adequate to enable a utility to attract investors," ensuring a return that is "reasonably sufficient to ensure confidence in the financial soundness of the utility, and adequate, under efficient management, to maintain and support its credit and to enable it to raise the money necessary for the proper discharge of its public duties.").

21 Auditor of the State of California, *Electrical System Safety California's Oversight of the Efforts by Investor-Owned Utilities to Mitigate the Risk of Wildfires Needs Improvement* (March 24, 2022) at 30, available at http://auditor.ca.gov/reports/2021-117/index.html#ref2 (finding that replacing the

regulatory support, including in the form of adequate returns on equity, to ensure ongoing capital attraction in the utility sector will be instrumental" as the "industry strengthens the grid against climate change and other risks."[22] And electrification can increase load growth, spreading the cost of needed investments across more customers and lessening rate impacts.

It cannot both be determined that these large investments are essential and then not provide the means to sufficiently finance those investments. While SDG&E is always concerned with affordability—and has proposed concrete steps to address affordability concerns[23]—affordability goals cannot be implemented in a cribbed way that prevents SDG&E's obtaining necessary capital for critical investments. Such a policy would harm customers through underinvestment and the inability to achieve state goals.

And it can lead to increased financial leverage and/or credit rating downgrades, raising costs for customers.[24] As the Commission has recognized, a strong investment grade credit rating—which is based on the soundness of the Company as an investment—benefits both the utility and ratepayers.[25] The riskier that SDGE is considered as an investment, the more expensive it is for the Company to raise capital—because it has to compensate bond and stock holders for that increased risk—through higher interest rates, a higher return on equity or, most

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nearly 40,000 miles of bare lines in areas of elevated and extreme fire risk would be $28 billion); *see* Prepared Direct Testimony of Ari Beer – Company Risk on Behalf of SDG&E (April 20, 2022) at AB-23.

22 S&P, The Big Picture: 2022 Electric, Natural Gas and Water Utilities Outlook (October 2021) ("S&P Oct. 2021 Report") at 3, available at https://www.spglobal.com/marketintelligence/en/news-insights/blog/the-big-picture-2022-electric-natural-gas-and-water-utilities-outlook.

23 R.18-07-006, Order Instituting Rulemaking to Establish a Framework and Processes for Assessing the Affordability of Utility Service (July 12, 2018).

24 *See* D.19-12-056 at 16 (finding that ROR must be set at a level to "maintain and support" a utility's credit rating).

25 D.12-12-034 at 7-8.

likely, both.[26] Ratepayers ultimately bear these costs. For example, the fact that SDG&E's credit ratings remain at least two notches below the A rating that SDG&E possessed through 2018 through no fault of its own but instead stemming from the increased risk environment in California results in higher costs for both SDG&E and its customers. SDG&E's proposal can help restore those ratings.

To determine a reasonable return on equity for SDG&E, Mr. Coyne applied the results of four ROE-models (DCF, CAPM, Risk Premium, and Expected Earnings) to a proxy group of 20 investment-grade, dividend-paying electric utilities to establish an ROE range.[27] He found a reasonable range for the proxy group to be 10.40-11.40 percent—before taking SDG&E's risks into account. As Mr. Coyne details, interest rates have been driven to extremely low levels since March 2020 by the COVID-19 pandemic and the federal government and the Federal Reserve's response to increase the money supply and lower interest rates to minimize the pandemic's economic impacts.[28] Yet despite that decline in interest rates, the cost of equity for utilities has increased over this same period based on the perceived increase in utility risk, reflected by:

- Utilities' direct stock market underperformance (and further underperformance of the California utilities) relative to the overall stock market;
- Utility betas (which is a measure of risk relative to the market) increasing relative to the market; and
- State utility commissions nationwide holding utility ROEs largely stagnant despite the significant decline in interest rates, underscoring that utility commissions have recognized that artificially suppressed interest rates due

[26] *See* D.03-12-035 at 42 ("the cost of investment grade debt is considerably less . . . the lower cost of a utility's debt translates into lower rates, all else being equal." (citation omitted)).

[27] SDG&E-04 (Coyne) at JMC-3 – JMC-4 and JMC-30 – JMC-31.

[28] SDG&E-04 (Coyne) at JMC-5.

> to the Federal Reserve's actions do not reflect corresponding decreases in the cost of equity.[29]

For example, from the onset of the pandemic in mid-February 2020 through February 28, 2022, the S&P 500 increased 31.04 percent, while the S&P 500 Utilities Index declined 3.42 percent and Sempra Energy's stock price declined 8.97 percent.

Messrs. Coyne and Beer then detail SDG&E's above-average risks compared to the proxy group. As both Mr. Coyne and Mr. Beer discuss, a significant, unique risk that SDG&E faces is California's high propensity for wildfires and accompanying wildfire liability regime. As noted, SDG&E in 2018-2019 experienced multiple credit rating downgrades due to catastrophic wildfires in the State—despite SDG&E being repeatedly lauded as a "global leader in wildfire prevention" and not being the cause of a significant wildfire ignition since 2007.[30] Although Moody's recently upgraded SDG&E's credit rating to A3 based, in part, on "SDG&E's track record of effective wildfire risk mitigation practices,"[31] as discussed, SDG&E's ratings remain at least two notches below the A-credit rating that SDG&E had in 2018 from all three credit rating agencies.

Although AB 1054's revisions to the state's prudency standard and establishment of a wildfire fund with a cap on expenses meaningfully reduces risks, it does not eliminate them.[32] This is reflected in the fact that SDG&E has had the same BBB+ rating from S&P and Fitch since the winter of 2019. Instead, S&P continues to find that, "[d]espite SDG&E's leadership role in wildfire prevention, we assess the company at the lower end of the range for excellent

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29 *Id.* at JMC-22.

30 S&P, June 3, 2021 at 8.

31 Moody's, Mar. 30, 2021 at 1.

32 S&P, *San Diego Gas & Electric Co*. (July 9, 2021) at 6.

business risk profile category" reflecting "the company's higher wildfire threat compared to utility peers across North America."[33] This is because SDG&E and other California electric utilities continue to face significant risks from the increased likelihood of catastrophic wildfires, inverse condemnation, and the risk of a potential lack of recovery of costs associated with a catastrophic wildfire.[34]

AB 1054 cannot reduce the sheer increased risk of wildfires in California. As S&P states, "California's environment remains highly prone to catastrophic wildfires, continuing to pressure utility credit quality."[35] The increased duration of wildfire season and the higher frequency of wildfire-prone conditions has increased the opportunities for a utility's equipment to be involved in an ignition, expanding the risks both for the utility bearing costs and/or not obtaining cost recovery.

SDG&E's post AB 1054 above-average wildfire risks also stems from ongoing concerns regarding the state's legal regime for utility wildfire liability—inverse condemnation's strict liability combined with lingering doubts regarding a utility's ability to obtain cost recovery following SDG&E being permitted cost recovery by FERC but denied cost recovery by the

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33 S&P, *Sempra Energy Unsecured Debt Rating Lowered To 'BBB'; Outlook On Subsidiary SDG&E Revised To Stable* (May 12, 2021) at 2.

34 S&P, June 3, 2021 at 2-3; *accord* S&P, Regulatory Research Associates ("RRA"), *California Regulatory Review* (Dec. 14, 2020) ("RRA Dec. 14, 2020") at 1-2.

35 S&P, June 3, 2021 at 1; *accord* Moody's Investors Service, *San Diego Gas & Electric Company, Update to credit analysis following upgrade to A3* (May 10, 2021) ("Moody's May 10, 2021") at 5.

Commission in 2017 for the same conduct in SDG&E's 2007-caused wildfires.[36] As RRA noted, inverse condemnation remains in place.[37]

And rating agencies have repeatedly expressed uncertainty and concerns about AB 1054's implementation; particularly whether the new prudence review standard will be applied in a manner that continues to make it more difficult to achieve cost recovery compared to the "industry norm" for prudence review, such as applied by FERC.[38] As S&P has stated, if AB 1054 is not implemented "in a credit-supportive manner then much of the new law's credit-supportive elements related to the revised standards of a utility's reasonable conduct could potentially be negligible."[39] Ongoing uncertainty likewise remains regarding how the Office of Energy Infrastructure Safety will implement the safety certification review process upon which many of the law's benefits depend.

As such, RRA continues to find that California's "unique" and "significant" wildfire and wildfire liability risks offset the "relatively constructive" aspects of California's regulatory

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36 *See* Moody's May 10, 2021 at 6 (noting that it is "important" that AB 1054 revised the state's prudency standard for wildfire cost recovery to be in line with FERC's because, "in the case of SDG&E's 2007 wildfires, while the CPUC denied recovery, the FERC ruled that SDG&E acted prudently and allowed the recovery of the wildfire costs.").

37 RRA Dec. 14, 2020 at 1 (noting that AB 1054 "does nothing to alter the inverse condemnation policy, thus a substantial portion of the risk for PG&E and other utilities in the state remains").

38 SDG&E-04 (Coyne) at JMC-53; *see SDG&E*, 146 FERC ¶ 63,017, P 60 (FERC's finding that SDG&E was prudent on the same conduct and granted recovery, determining that even if SDG&E's presumption of prudence was not dispositive, the recovery of SDG&E's wildfire costs was valid because SDG&E would likely be held responsible for such costs under inverse condemnation regardless of fault); Moody's May 10, 2021 at 6 (noting that it is "important" that AB 1054 revised the state's prudency standard for wildfire cost recovery to be in line with FERC's because, "in the case of SDG&E's 2007 wildfires, while the CPUC denied recovery, the FERC ruled that SDG&E acted prudently and allowed the recovery of the wildfire costs.").

39 S&P, June 3, 2021 at 6; *accord* Moody's May 10, 2021 at 2 (citing a credit challenge as an "[e]xecution risk in the CPUC's implementation of the new prudency standards included in the wildfire legislation.").

regime.[40] S&P similarly recently stated that "because we view the likelihood of a change to California's interpretation of inverse condemnation as remote, and favorable climate change patterns are also unlikely to emerge for a state with a long history of drought conditions, we are unlikely to raise ratings for utilities with meaningful wildfire-related risks in the near term."[41] This means that SDG&E's credit ratings remain significantly below their pre-2019 levels based upon credit rating agencies' assessment of the heightened, ongoing risks.

This ongoing risk is also reflected in investor analysts explicitly pricing Sempra and other California electric utility holding companies' stock with a "discount"—despite SDG&E's "superior wildfire mitigation protocols"[42]—reflecting "lingering risks related to CA's inverse condemnation policy and highly politicized regulatory environment."[43] And it is reflected in the fact that wildfire insurance premiums continue to rise and/or insurers continue to exit the market, placing a quantifiable price to that higher risk.

As noted, SDG&E also faces increased risks from carrying a larger amount of costs that remain subject to cost recovery—including those in balancing and memorandum accounts—for longer periods of time, with more expensive long-term financing. Although memorandum accounts preserve the ability to recover costs, they do not protect against the risks that those costs will be disallowed when spending decisions on matters such as wildfire mitigation must be made before Commission authorization. Similarly, the PD denying SDG&E's application for interim rate relief noted approvingly that the Commission could "smooth out" rate increases by

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40 *See* RRA Dec. 14, 2020 at 2.

41 S&P, June 3, 2021 at 10.

42 Evercore ISI, *Sempra Energy* (Jun. 29, 2021) at 2.

43 Wells Fargo, Equity Research, *Sempre Energy Analysis (SRE), SRE: Analyst Day Previews CapEx Upside in Texas* (Jun. 29, 2021) at 3.

adopting "an extended amortization period to mitigate the rate impacts on SDG&E's customers when the amounts found reasonable are added to the utility's authorized revenue requirement."[44]

Such an approach puts the burden entirely on SDG&E to bear the risk of financing larger balances for longer periods to achieve broader policy goals. As Moody's has stated, its current credit rating assumes a "constructive" regulatory relationship. The need to finance long-term balances with the potential for delayed or denied cost recovery implicate Moody's findings that an increase in debt or a deterioration in regulatory support could result in a ratings downgrade.[45]

Moody's and other credit rating agencies have similarly identified additional unique risks for SDG&E, including:

- "[H]igh political risk and public scrutiny in both San Diego and the state of California,"[46] with the potential for a ratings downgrade if there is a "deterioration in regulatory support or increase in regulatory contentiousness" including from PSPS events;[47]
- Credit challenges from SDG&E's "[m]aterial capital investment program that will "require incremental debt;"[48] and
- The "significant demands that are placed on the California utilities amid many ambitious public policy initiatives."[49]

SDG&E's above-average risk is also reflected in Sempra Energy's beta, which is higher than the average for Mr. Coyne's proxy group.[50] Based on these qualitative and quantitative analyses of SDG&E's risks, Mr. Coyne states that it would be reasonable for SDG&E's ROE to

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44 A.21-07-017, PD at 17.

45 Moody's May 10, 2021 at 3, 9.

46 *Id.* at 2, 5.

47 *Id.* at 3.

48 *Id.* at 2.

49 *Id.* at 10.

50 SDG&E-04 (Coyne) at JMC-17 – JMC-18, Figure 4.

be "at the top of the range."[51] Similarly, in its 2019 Decision, the Commission, after "considering the evidence on market conditions, trends, creditworthiness, interest rate forecasts, quantitative financial models, additional risk factors including business risk," "conclude[d] that" SDG&E's "adopted ROE should be set at the upper end of the just and reasonable range."[52] It approvingly found that, in setting SDG&E's ROE at 10.20 percent, that a "10.20% authorized ROE is significantly higher than the 9.60% average ROEs granted to United States electric utilities during 2018."[53]

SDG&E's credit ratings remain largely the same as in the 2019 Decision,[54] while its risks have increased, as evidenced by (among other things) an increased beta, supporting the Company remaining at the upper end of the just and reasonable range. SDG&E's proposal also remains consistent with the relationship that the Commission set in 2019 between SDG&E's ROE and the nationwide electric utility authorized ROE average. That nationwide average has only (at most) moderately declined since the Commission's 2019 Decision—despite the decline in interest rates due to the Federal Reserve's unprecedented intervention to lower interest rates to mitigate the economic impacts of the COVID-19 pandemic.

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[51] *Id.* at JMC-68.

[52] D.19-12-056 at 40-41.

[53] *Id*. at 42-43 (citing S&P [RRA] Global Market Intelligence, July 22, 2019 at Table 1).

[54] *See* D.19-12-056 at 51, Finding of Fact 32 ("SDG&E has an investment grade rating of BBB+ from S&P.").

As Mr. Coyne testifies, since the Commission's 2019 Decision, authorized ROEs have remained generally consistent,[55] with the 12-month average authorized ROE remaining within "9.47 percent to 9.71 percent for electric utilities."[56] As S&P has added:

> While authorized ROEs generally move directionally with Treasury Bond yields, over the past several years, state commissions have approved ROEs that contain a higher premium over Treasury bond yields than have historically prevailed. State utility commissions have recognized that long-term bond yields have been artificially suppressed due to the Fed's unprecedent intervention in the capital markets. As such, authorized returns have been somewhat resistant to the decline in interest rates, with the spread increasing as interest rates decline.[57]

SDG&E's proposal is also consistent with the fact that credit rating agencies have found that SDG&E and other California utilities' possessing current authorized ROEs that are "above the industry average" is credit supportive.[58] As RRA recently noted, California's "recent [ROE] authorizations have been above the industry averages when established," helping offset the unique, significant risks that SDG&E and other California electric utilities face from inverse condemnation.[59] Even at SDG&E's current ROE, Sempra Energy's beta has significantly increased, its stock has underperformed both the S&P 500 and S&P Utility 500, and investor analysts, as noted, have explicitly priced Sempra's stock at a "discount."

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[55] SDG&E-04 (Coyne) at JMC-22.

[56] *Id.* at JMC-22 – JMC-23 and Figure 6. *Compare* D.19-12-056 at 43 (comparing SDG&E's 10.20% authorized ROE to the 9.60% authorized average ROE in 2018), *with* RRA, *Major Energy Rate Case Decisions – January-December 2021* (February 10, 2022) ("RRA February 10, 2022") at 3 (observing a 9.38% ROE all electric average, with a 9.53% authorized average for vertically integrated utilities).

[57] S&P Oct. 2021 Report at 5; *see also* RRA February 10, 2022 at 6 ("the gap between authorized ROEs and interest rates widened somewhat over this period, largely as a result of regulators' often-unstated understanding that the drop in interest rates caused by Federal Reserve intervention was unusual.").

[58] S&P, Ratings Direct: *PG&E Corp*. (May 20, 2021).

[59] RRA Dec. 14, 2020 at 2.

Moreover, interest rates are quickly increasing in response to the Federal Reserve raising rates, increased inflation (the consumer price index rose by 7.9 percent through February, the fastest growth in annual inflation in over 40 years), and the war in Ukraine, among other reasons.[60] As Mr. Coyne testifies, the Federal Reserve has reversed its pandemic-induced unprecedented intervention to keep interest rates low as economic conditions return to pre-pandemic levels and the country faces sustained inflation.[61] In November 2021, the Federal Reserve began curtailing "quantitative easing."[62]

And on March 16, 2022, it announced a 25-basis point increase in the federal funds rate, from 0-.25% to .25%-.50%—its first increase in the federal funds rate (which impacts all other interest rates) since reducing that rate to zero in March 2020—while projecting six more rate hikes this year.[63] S&P has found that, going forward, it expects ROEs may increase as interest rates rise.[64] SDG&E's increasing cost of debt further reflects this trend. Considering this fast-changing economic environment, SDG&E's ROE proposal of 10.55 percent is certainly reasonable—particularly when, combined with the Company's capital structure proposal, it does not increase monthly costs for the average residential customer.

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[60] SDG&E-04 (Coyne) at JMC-5.

[61] *Id.*; *see* New York Times, *A Fed Governor says the latest inflation data reaffirms the case for big rate increase* (April 13, 2022), available at https://www.nytimes.com/2022/04/13/business/economy/fed-inflation-rate-increases-waller.html.

[62] *See* CNBC, *Fed will aggressively dial back its bond buying, sees three rate hikes next year* (December 15, 2021), available at https://www.cnbc.com/2021/12/15/fed-will-aggressively-dial-back-its-monthly-bond-buying-sees-three-rate-hikes-next-year.html.

[63] Federal Reserve Gov, *Federal Reserve issues FOMC statement* (March 16, 2022) available at https://www.federalreserve.gov/newsevents/pressreleases/monetary20220316a.htm.

[64] S&P Oct. 2021 Report at 5.

IV. CONCLUSION

SDG&E's proposed capital structure, ROE, and overall ROR is consistent with financial modeling, relevant capital market data, SDG&E's increased risks (as reflected by higher beta), and an increasing interest rate environment. It will help counter SDG&E's risks from, among other things, wildfire concerns, a heightened political environment, and the need to finance larger amounts of costs for longer periods—enabling the Company to raise the significant amount of investment required to help meet the State's ambitious climate change and other environmental goals, mitigate wildfire risks, maintain safe, reliable, and affordable service, and reduce borrowing costs to customers through helping SDG&E return to the longstanding A credit rating. And SDG&E's proposed ROE is consistent with the Commission's findings in its 2019 Decision—all while not raising costs on most customers—including combined gas and electric customers.

V. WITNESS QUALIFICATIONS

My name is Valerie Bille. I am Vice President, Chief Accounting Officer, Controller, and Treasurer for SDG&E. My business address is 8330 Century Park Court, San Diego, California 92123.

In my current position, I am responsible for overseeing the financial planning and budgeting, financial reporting, treasury management, and accounting for SDG&E. I assumed my current position in August 2020. Prior to this, I have served in roles of increasing responsibility at Sempra Energy and SDG&E since November 2014.

I received a Bachelor of Science in Business Administration from California State University, San Marcos in 2000. I am a Certified Public Accountant. I began my career with Deloitte & Touche.

I have previously testified before the Commission.