Company:	San Diego Gas & Electric Company (U 902 M)
Proceeding:	Wildfire Interim Rate Relief Mechanism
Application:	A.21-07-XXX
Exhibit No.:	SDG&E-03

SAN DIEGO GAS & ELECTRIC COMPANY
PREPARED DIRECT TESTIMONY
OF CASEY BUTLER
(CASH FLOW IMPACTS)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

JULY 30, 2021

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PREPARED DIRECT TESTIMONY OF
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I. INTRODUCTION

My testimony describes the expected impacts to San Diego Gas & Electric Company ("SDG&E" or "Company") and its ratepayers in the event wildfire mitigation-related balances continue to be held in the Wildfire Mitigation Plan Memorandum Account ("WMPMA"), as well as the expected benefits that would occur if the Commission approves SDG&E's interim rate relief mechanism.

As described in the testimony of SDG&E witness Jonathan Woldemariam (Exhibit SDG&E-01), SDG&E is forecasting increases in its future WMPMA balances. If not recovered prior to SDG&E's next General Rate Case, Test Year 2024, those balances have the potential to be significant. In the meantime, SDG&E will continue to perform and make substantial expenditures for the wildfire mitigation work described in Mr. Woldemariam's testimony. But if SDG&E's proposed interim rate relief mechanism is approved, it would improve SDG&E's cash flow position, reduce debt costs that would otherwise be incurred, and foster the stability of SDG&E's credit ratings (to the benefit of SDG&E and its customers). Interim rate relief would also smooth rates and avoid rate shock because recovery of the WMPMA costs would be spread out. These impacts are described in greater detail in this testimony.

II. CAPITAL AND OPERATIONS AND MAINTENANCE ("O&M") COSTS

A. Direct Capital and O&M

Table 3-1 below summarizes the direct costs described in Mr. Woldemariam's testimony for wildfire mitigation.[1] SDG&E has provided direct cost estimates in its previously filed Wildfire Mitigation Plans ("WMP"). Because new rates associated with the next, Test Year 2024 General Rate Case will be effective as of January 1, 2024, SDG&E is providing forecasts through 2023 to demonstrate the potential magnitude of WMPMA balances. In addition, SDG&E includes forecasted costs to perform tree trimming activities in its WMPs. However, tree trimming activities are recorded to a different regulatory account, the Tree Trimming Balancing Account ("TTBA"). Given that the TTBA is separate and apart from the WMPMA, SDG&E is excluding costs and revenues recorded to the TTBA from the tables herein.

Table 3-1: Illustrative Direct Costs
(In Millions, 2020$)

	2019	2020	2021	2022	2023[2]	
	Actual	Actual	Forecast	Forecast	Proxy	Total
WMP Capital	$226.0	$384.0	$459.3	$486.1	$635.7	**$2,191.0**
WMP O&M (excluding TTBA)	$40.2	$117.2	$137.4	$134.0	$100.5	**$529.4**
Total Capital & O&M	**$266.2**	**$501.2**	**$596.7**	**$620.1**	**$736.2**	**$2,720.4**

The costs in Table 3-1 do not yet reflect the impact of loaders, escalation, allowance for funds used during construction ("AFUDC"), or capitalized property tax. These additional components are needed to convert the direct costs into revenue requirement. It is the revenue requirement, not direct costs, that is recorded to regulatory accounts and implemented in

1 Prepared Direct Testimony of Jonathan Woldemariam at Table 1-1. Figures may not be identical to Mr. Woldemariam's Table 1-1 due to rounding. References to "testimony" herein are to the prepared direct testimony served in support of this Application, unless otherwise indicated.

2 Represents proxy amounts.

customer rates. Thus, the balances recorded to the WMPMA and addressed in this Application are stated in terms of revenue requirement.

B. Total Capital and O&M

Table 3-2 below summarizes the total, fully loaded capital and operations and maintenance ("O&M") amounts SDG&E forecasts at this time, which will form the basis of what SDG&E records to the WMPMA. The capital costs include escalation, overhead loaders, AFUDC, and capitalized property tax. Please note that the amounts in Table 3-2 exclude cost recorded to the TTBA.

Table 3-2: Illustrative Total Capital and O&M[3]
(In Millions, includes escalation, overheads, AFUDC, and capitalized property tax)

	2019	2020	2021	2022	2023[4]	
	Actual	Actual	Forecast	Forecast	Proxy	Total
WMP Capital	$223.3	$416.5	$552.8	$606.3	$760.7	**$2,559.5**
WMP O&M (excluding TTBA)	$43.4	$128.1	$149.6	$149.1	$113.7	**$583.9**
Total Capital & O&M	**$266.7**	**$544.5**	**$702.4**	**$755.3**	**$874.4**	**$3,143.4**

III. REVENUE REQUIREMENT

The revenue requirement consists of the total O&M and capital costs stated above, as well as capital-related costs - SDG&E's return on investment, federal and state income taxes, and property taxes.[5] Table 3-3 below illustrates the forecasted revenue requirement for SDG&E's WMP, excluding the TTBA.

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3 For the years 2019-2023, excludes removal costs for existing assets of $256 million and $84 million for FERC portion of Common Plant; not part of basis for calculating revenue requirement; includes adjustments made to true-up to activities recorded in the WMPMA through March 2021.

4 Represents proxy amounts.

5 The revenue requirement components and the rate base calculations are computed based on the same standard, Commission-approved methodology used in the 2019 GRC and other incremental applications.

Table 3-3: Illustrative Forecasted Revenue Requirement Summary
(In Millions)

	2019	2020	2021	2022	2023	Total
CPUC WMP Revenue Requirement (excluding TTBA)	$44.4	$140.6	$224.0	$307.4	$356.6	$1,073.0

As described in Mr. Woldemariam's testimony, the above revenue requirement is based on recorded costs for 2019 through fourth quarter 2020 (*i.e.*, December 2020), forecasted costs for 2021 and 2022 from our 2021 WMP Update Filing,[6] and 2023 from the 2021 Risk Assessment and Mitigation Phase ("RAMP") Report Filing. These forecasted revenue requirements illustrate the potential balances in the WMPMA until rates associated with SDG&E's next GRC (Test Year 2024) are effective. SDG&E will determine the actual capital and O&M costs associated with the WMP as it is completed and will calculate the actual revenue requirements on a monthly basis to be recorded to the WMPMA.

While the amounts in Table 3-3 above illustrate the revenue requirement for SDG&E's WMP (excluding the TTBA), as explained in Mr. Dalton's testimony (Exhibit SDG&E-02), this interim rate relief request pertains only to those amounts incremental to those previously authorized in SDG&E's 2019 General Rate Case and does not include costs recorded to other regulatory accounts (*e.g.,* the TTBA, Fire Risk Mitigation Memorandum Account). Additionally, pursuant to Assembly Bill ("AB") 1054,[7] SDG&E will exclude its portion of wildfire mitigation capital expenditures from equity rate base as adopted by the Commission in Resolution E-5071. But as described by Mr. Dalton, the AB 1054 equity exclusion reduces SDG&E's base margin and does not directly reduce the balances in the WMPMA. Accordingly,

[6] On July 15, 2021, the Commission approved SDG&E's 2021 WMP at its Business Meeting.

[7] AB 1054 added Section 8386.3(e) to the Public Utilities Code.

the AB 1054 equity exclusion is being implemented outside of this Application and is, therefore, not reflected in the tables herein.

Table 3-4 below presents the incremental revenue requirement after deducting the amounts previously authorized and stated exclusions.

Table 3-4 Illustrative Incremental Forecasted Revenue Requirement Summary
(In Millions)

	2019	2020	2021	2022[8]	2023[9]	Total
CPUC WMP Revenue Requirement (excluding TTBA)	$44.4	$140.6	$224.0	$307.4	$356.6	$1,073.0
WMP GRC Revenue Requirement	($23.6)	($68.5)	($76.4)	($82.4)	($88.4)	($339.3)
Incremental WMP Revenue Requirement	**$20.8**	**$72.1**	**$147.6**	**$225.0**	**$268.2**	**$733.7**
Regulatory Interest[10]	$0.0	$0.2	$0.2	$0.4	$0.8	$1.6
Total Incremental WMP Revenue Requirement	**$20.8**	**$72.3**	**$147.8**	**$225.4**	**$269.0**	**$735.3**

The forecasts shown in Table 3-4 are illustrative and are being provided to demonstrate what the WMPMA could potentially be. As discussed in Mr. Dalton's testimony, SDG&E's proposed interim rate relief mechanism would implement 50% of the WMPMA balances at the time of the annual regulatory account update filing. Accordingly, the WMPMA balances presented in Table 3-4 are subject to change prior to being implemented in rates.

IV. IMPACTS OF INTERIM RATE RELIEF TO SDG&E AND ITS CUSTOMERS

As described in Mr. Woldemariam's testimony, SDG&E anticipates significant investment to continue to mitigate the wildfire risk. When the Wildfire Mitigation Plan was

8 Amounts shown for 2022 and 2023 are consistent with Application 17-10-007/008, SDG&E's Petition for Modification of Test Year 2019 General Rate Case Decision 19-09-051 (April 9, 2020).

9 *Id.*

10 Based on SDG&E's average regulatory interest rate (Commercial Paper Rate) of 0.13% over the period June 2020 – May 2021.

created via Senate Bill ("SB") 901, it was originally established that the work undertook by electric utilities, such as SDG&E, to minimize wildfire would be annually submitted and approved as part of the Wildfire Mitigation Plan process, but the costs would be recovered through General Rate Cases. Thus, the Legislature and Commission expected that SDG&E would expend funds on wildfire mitigation activities without the ability to include such funds in rates until after approval in the GRC. AB 1054 then revised the mandates put forth in SB 901 to, among other things, require the Wildfire Mitigation Plans to cover a three-year period.[11] AB 1054 also provided that cost recovery would occur either in the GRC or through a separate application filed by the utility at the conclusion of the time period covered by the Plan.[12] But even after the modifications enacted in AB 1054, there remains a disconnect and the potential for regulatory lag between expending substantial costs on wildfire mitigation activities and the timing of cost recovery.

Absent an interim mechanism to implement costs associated with the WMP in rates, SDG&E will be accumulating and carrying substantial costs on its financial statements related to these wildfire mitigation efforts, as demonstrated above in Table 3-4. This accumulation increases the size of the overall balance so that when the balance is approved for cost recovery in a GRC, it would be a large, lump-sum increase for customers resulting in potential rate shock. By contrast, SDG&E's proposal in this Application will smooth rates by annually implementing 50% of the balances in the WMPMA. Additionally, SDG&E's proposal would promote intergenerational equity, ensuring that the same customers who benefit from the investments in wildfire mitigation will pay for those investments at the time they are made.

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[11] P.U. Code Section 8386(b).

[12] *Id.* at Section 8386.4(b)(2).

Customers also benefit from reduced interest expense. The forecasted WMP amounts are equal to the incremental revenue requirement forecasted in Table 3-4 above, and the projected under-collected balance of these costs will be nearly $750 million by the end of 2023.[13] To put this figure into context, SDG&E's annual average long-term debt issuance is approximately $600 million for the years 2017 through 2020. The forecasted WMP-related incremental revenue requirement alone significantly exceeds the historical annual cash flow needs determined by SDG&E to support all other operational activities. SDG&E typically funds its operational shortfalls through commercial paper. But given the substantial amount of these under-collected costs, SDG&E plans to leverage long-term debt markets instead. In other words, if SDG&E is not able to recover these costs in a timely fashion, such as through the proposed interim mechanism, SDG&E anticipates it will issue long-term debt to offset its under-collected wildfire mitigation balances. As previously noted, the funding needs to offset the under-collected WMP balances surpasses the entirety of SDG&E's typical annual debt issuance to carry the under-collected wildfire mitigation costs by the end of 2023. This results in incremental annual interest expense that would be borne by SDG&E ratepayers. These financing costs can be reduced through interim rate relief.

Based on the foregoing, SDG&E's proposed interim mechanism will help smooth rates by implementing a smaller portion of wildfire mitigation-related costs in rates on an annual basis, subject to refund and a reasonableness review, rather than increasing rates by the entire, cumulative balance (from 2019 through 2023) at once. Further, as noted, the proposed interim rate relief mechanism avoids SDG&E potentially issuing debt to fund the large, under-collected WMPMA balances thus avoiding ratepayers paying additional debt-related expenses. As

[13] *See* Table 3-4: Incremental Forecasted Revenue Requirement Summary.

described in Mr. Dalton's testimony, SDG&E and Southern California Gas Company submitted to the Commission, a request for interim rate relief of our Pipeline Safety Enhancement Program ("PSEP") costs.[14] The Commission, in their decision approving an interim mechanism for certain PSEP-related costs, stated that interim relief of these program costs "reasonably balances the objective of mitigating sharp rate increases with the need for Commission review of utility costs prior to collection from ratepayers."[15] The same principle applies here.

V. OTHER POTENTIAL IMPACTS

There are other impacts that SDG&E may experience from carrying the accumulation of wildfire-related balances on its financial statements. Financial risk – a function of the amount of debt in a utility's capital structure – creates uncertainty arising from increased reliance on debt financing and the associated fixed obligation payments required of debt. As the Commission has previously recognized, financial risk increases with debt leverage.[16] A rising debt-equity ratio implies that a company has growing fixed obligations to holders of securities that have a priority claim to cash flows. As that obligation increases, more cash flows must be committed to these payments, thus increasing risk to the company's debt holders. Furthermore, the larger the cash flows committed to fixed obligation payments, the greater the financial risk exposure to the common stockholders, as they are entitled only to cash flows available after all debt obligations are satisfied. As noted above, SDG&E is forecasting that it would issue additional long-term debt to fund the WMPMA balance, thus increasing financial risk and potentially impacting SDG&E's actual capital structure.

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[14] D.16-08-003.

[15] *Id.,* Findings of Fact 4, at 13.

[16] *See* D.12-12-034 at 5.

The major credit rating agencies likewise commonly employ several key metrics to quantify financial risk. The primary metric those agencies use is funds from operations ("FFO") as a percent of total debt. Together with their assessment of business risk and regulatory framework, the major credit rating agencies use these financial metrics to determine the credit ratings they assign to each issuer of debt. The FFO-to-Total Debt ratio is a key indicator of creditworthiness as it measures how much debt a company could retire with annual cash from operations, where a higher proportional figure indicates a stronger ability to retire debt, and thus lower financial risk.

In the most recent Moody's Investor Service Credit Opinion[17] of SDG&E, Moody's states that "A downgrade of SDG&E's ratings is possible upon a deterioration in its credit metrics such that its ratio of CFO [Cash Flow from Operations] pre-W/C [Working Capital] to debt falls below 20% for a sustained period of time..."[18] SDG&E's inability to timely recover the WMP-related expenditures has the dual impact of not only increasing the amount of debt but also weakening the CFO pre-W/C (or FFO) metric due to the additional interest expense which reduces cash flow from operations. Using Moody's most recent credit opinion[19] as a basis to calculate the pro forma impact of carrying the additional debt and added interest expense, Table 3-5 below illustrates the credit dilutive impact based on the rating agency's last full calendar year for SDG&E's FFO/debt metric.

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[17] Moody's Investors Service Credit Opinion, *San Diego Gas & Electric Company* (May 10, 2021) ("Moody's Credit Opinion").

[18] Moody's Credit Opinion at 3.

[19] *Id.* at 10.

Table 3-5: Pro Forma Financial Impact
(In Millions)

Metric	2020 Actual[20]	Without Interim Rate Relief
FFO	**$1,537**	**$1,517**
Debt	**$6,434**	**$7,168**
FFO/debt	**23.9%**	**21.2%**

This calculation was based on layering in the additional debt and corresponding interest expense predicated on SDG&E's forecasted WMP-related under-collections through 2023, to the last full calendar year FFO/debt as published by Moody's.[21] The calculation assumes interest expense at SDG&E's CPUC authorized long-term debt cost of 4.59%.

Without a mechanism for interim rate relief, the pro forma FFO/debt of 21.2% nearly reaches Moody's minimum threshold of 20.0% for SDG&E to maintain its current A3 rating. A weakening of SDG&E's financial position could result in Moody's downgrading the Company's current Outlook from Stable, and if sustained over a longer-term, that could put downward pressure on SDG&E's credit metrics from Moody's and the other rating agencies. Weakened credit metrics could result in higher borrowing costs that would be reflected in higher customer bills. Adopting the proposed interim rate relief mechanism would avoid such impacts.

Implementing interim rate relief would also serve to enhance the rating agencies' perception of California's regulatory framework, which in conjunction with the ability to recover costs and earn returns, comprises 50% of Moody's credit rating methodology. The significance of the regulatory environment and timely rate relief to a company's overall credit rating is also consistent with how the other two major credit rating agencies, S&P and Fitch, evaluates

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[20] Represents SDG&E's published 2020 FFO/debt per Moody's Credit Opinion at 10.

[21] *See* Moody's Credit Opinion.

regulated utilities. The Commission has recognized that "maintain[ing] investment-grade creditworthiness" is an "important component[s] of the Hope and Bluefield decisions."[22]

VI. CONCLUSION

SDG&E's proposed interim mechanism appropriately balances the Company's and ratepayers' interests by benefiting both. Without interim rate relief, SDG&E will accumulate and carry substantial costs on its financial statements which could lead to potential rate shock to ratepayers once these costs are approved. In addition, these costs will have the effect of increasing SDG&E's financial risk and could impact the Company's actual capital structure to the detriment of ratepayers. Lastly, SDG&E's credit rating and the overall regulatory framework could be viewed in a more negative light without approval of interim rate relief given the carrying forward of substantial under-collections.

This concludes my prepared direct testimony.

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[22] D.12-12-034 at 37 (alteration in original).

VII. STATEMENT OF QUALIFICATIONS

My name is Casey W. Butler. My business address is 8330 Century Park Court, San Diego, California 92123. I am employed by SDG&E as a Manager in Financial & Business Planning. I am responsible for managing the operating cost and capital budgets for SDG&E. I have held this position since July of 2020. Prior to this position, I was the Financial and Strategic Analysis Manager at SDG&E for nearly two years. In that position, I was responsible for overseeing the financial analysis and development of revenue requirements for SDG&E projects and programs. I have been employed by SDG&E and/or Sempra Energy since January 2006. In addition to the positions that I have listed above, I have served as a Project Controls Manager at Sempra Energy, Business Planning Manager in SDG&E's Major Projects Budgets and Accounting group, a Principal Business Analyst on SDG&E's Sunrise Powerlink Project, and a Principal Business Analyst in SDG&E's Financial Planning organization. In addition, I have also been a lead planner for multiple SDG&E General Rate Case applications.

I received a Bachelor of Science Degree in Accounting from Bentley University in May of 1998.

I have previously testified before this Commission.