Application: A.22-04-012
Company: San Diego Gas & Electric Company (U 902 M)
Proceeding: 2023 Cost of Capital
Exhibit No.: SDG&E-06

PREPARED REBUTTAL 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**

August 22, 2022

TABLE OF CONTENTS

I. INTRODUCTION 1

II. SDG&E'S 10.55% ROE PROPOSAL IS SUPPORTED BY THE COMMISSION'S 2019 DECISION AND UNDERLYING FINANCIAL CONDITIONS SHOWING A HIGHER COST OF EQUITY 3

A. The Commission's Rationale in the 2019 Decision Applies Equally Today 3

1. SDG&E's Credit Ratings Largely Remain the Same 4

2. SDG&E Continues to Face Unique, Above-Average Risks Compared to Other Utilities Despite Effective Management 5

B. The National Authorized ROE Average Remains Largely the Same as in the 2019 Decision, with Expectations that it will Increase with Rising Interest Rates 10

C. Intervenors' Testimony Demonstrates That Underlying Financial Conditions Support a Higher ROE Than in 2019 13

1. Higher ROE Modeling and Rising Interest Rates Underscore the Increase in SDG&E's Cost of Equity 13

2. Higher Utility Betas and Utility Stock Market Underperformance Support an Increase in the Cost of Equity 16

III. CERTAIN INTERVENORS IGNORE THAT ROE IS A MARKET BASED CONCEPT AND THAT SDG&E'S ROE MUST BE SET CONSISTENT WITH THE ROE OF OTHER COMPANIES FACING COMMENSURATE RISKS TO ENSURE THAT SDG&E CAN INVEST IN SAFETY AND RELIABILITY 17

IV. SDG&E'S CAPITAL STRUCTURE PROPOSAL IS SUPPORTED BY CREDIT RATING AGENCIES COMPARED TO INTERVENORS' PROPOSAL TO INCREASE SDG&E'S FINANCIAL RISK 22

V. CONCLUSION 25

1
2
3
4
5
6

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

I. INTRODUCTION

7 The intervenors' testimony[1] confirms that the fundamental principles underlying the
8 Commission's 2019 Cost of Capital Decision ("D.") 19-12-056 ("2019 Decision")[2] remain in
9 place when the Commission set SDG&E's Return on Equity ("ROE") at 10.20%. Moreover, they
10 show that the cost of equity, driven principally by rising interest rates, has increased—
11 demonstrating why SDG&E's 10.55% ROE and overall cost of capital proposals should be
12 adopted—which do not result in a rate increase for most ratepayers.

13 Specifically, in setting SDG&E's ROE at 10.20% in its 2019 Decision, the Commission
14 concluded that SDG&E's ROE should be set at the upper end of the just and reasonable range
15 and observed approvingly that SDG&E's ROE was significantly higher than the nationwide
16 authorized electric utility ROE average. Since that Decision, SDG&E's credit ratings, risks, and
17 the national authorized ROE average all remain largely unchanged, supporting at least a similar
18 outcome.

19 Although SDG&E's credit rating was upgraded one notch by Moody's in 2021 to A3, it
20 remains the same from Fitch and S&P (BBB+) as in the 2019 Decision. SDG&E's rating from
21 all three credit rating agencies remains two notches below SDG&E's longstanding A-rating prior

---

[1] Intervenor testimony consists of Dr. Randall Woolridge for the Public Advocates Office of the California Public Utilities Commission ("CA"), Michael Gorman for the Energy Producers and Users Coalition, Indicated Shippers, and the Utility Reform Network ("EPUC/IS/TURN"); Dr. Richard McCann for the Environmental Defense Fund ("EDF"); Kevin O'Donnell for the Federal Executive Agencies ("FEA"); Mark Ellis for the Protect our Communities Foundation ("PCF"); Dr. Marlon Griffing and Richard Pavlovic for Utility Consumers' Action Network ("UCAN"); Alex Kronauer for Walmart, Inc., and Aaron Rothschild for Wild Tree Foundation ("WT").

[2] All definitions from the opening testimony are applied to this rebuttal testimony.

1 to downgrades in response to 2018 and 2019 wildfires in the state—despite SDG&E not being
2 the cause of a significant wildfire during that time and being repeatedly lauded by credit rating
3 agencies for its wildfire mitigation efforts.

4 While Assembly Bill ("AB") 1054 helped mitigate that credit ratings downslide,
5 SDG&E's ratings have not been restored. Instead, its unique risks—principally from wildfire and
6 wildfire liability from court-imposed inverse condemnation strict liability—remain largely the
7 same as at the time of the 2019 Decision. Because of this threat, S&P rates SDG&E as having
8 higher business risks than other comparable utilities. And equity analysts explicitly apply a
9 discount to Sempra (SDG&E's parent company's) stock.

10 Finally, as noted, the nationwide electric utility ROE average has likewise largely
11 remained stagnant since the 2019 Decision—at most declining by about 20 basis points. But that
12 decline has already stabilized. And as credit rating agencies and analysts state, they expect that
13 average to further increase with the ongoing rise in interest rates.

14 Moreover, as intervenors further recognize, the relevant financial data indicates a higher
15 cost of equity than existed at the time of the 2019 Decision. That includes higher ROE financial
16 modeling, higher interest rates, higher utility betas, and utility stock market underperformance—
17 including the further underperformance of Sempra and other California utilities relative to
18 utilities nationwide.

19 Yet despite the recognition of these underlying financial conditions by many intervenors,
20 certain parties propose setting SDG&E's ROE hundreds of basis points below the nationwide
21 authorized ROE average without any support. But as intervenors recognize, ROE is a market-
22 based concept. Setting ROE at what investors require based upon SDG&E's risks—such as the
23 Commission did in its 2019 Decision—benefits both the utility and its customers, ensuring that

SDG&E can make critical investments in wildfire mitigation and grid modernization for electrification; investments that the intervenors recognize are necessary.

Likewise, SDG&E's 54% common equity, 46% long-term debt authorized capital structure proposal is more consistent with the Company's longstanding capital structure, has been explicitly identified by Moody's as being credit supportive, and is consistent with the ongoing increase in the average authorized common equity ratio nationwide. In contrast, intervenors do not propose maintaining SDG&E's current authorized capital structure. Instead, they suggest increasing SDG&E's long-term debt—which would increase the Company's financial leverage, harm SDG&E's credit ratings, and require a higher ROE to counter that increase in risks.

II. SDG&E'S 10.55% ROE PROPOSAL IS SUPPORTED BY THE COMMISSION'S 2019 DECISION AND UNDERLYING FINANCIAL CONDITIONS SHOWING A HIGHER COST OF EQUITY

The basic conditions underlying the Commission's 2019 Decision setting SDG&E's ROE at 10.20%—namely SDG&E's credit ratings, risks, and nationwide authorized ROE average—remain in place today. In fact, financial metrics—principally rising interest rates—indicate a higher cost of equity for SDG&E now compared to at the time of the 2019 Decision, justifying SDG&E's ROE proposal of 10.55%.

A. The Commission's Rationale in the 2019 Decision Applies Equally Today

In setting SDG&E's ROE at 10.20% in the 2019 Decision, the Commission:

- "[C]onclude[d] that" SDG&E's "adopted ROE should be set at the upper end of the just and reasonable range;"
- Found that SDG&E's authorized ROE was "reasonably sufficient to assure confidence in the financial soundness of the utility and to maintain investment grade credit ratings while balancing the interests between shareholders and ratepayers;" and

- Observed approvingly that SDG&E's "10.20% authorized ROE is significantly higher than the 9.60% average ROEs granted to United States electric utilities during 2018."[3]

The Commission's rationale in the 2019 Decision remains equally applicable here. As intervenors largely recognize, SDG&E faces nearly the same credit ratings, the same (if not increased) risks, and a generally similar authorized ROE average for utilities nationwide.

1. SDG&E's Credit Ratings Largely Remain the Same

In the 2019 Decision, the Commission found that "SDG&E has an investment grade rating of BBB+ from S&P."[4] Although Moody's in March 2021 upgraded SDG&E's credit rating one notch to A3 based, in part, on "SDG&E's track record of effective wildfire risk mitigation practices,"[5] SDG&E's credit ratings from S&P and Fitch remain the same (BBB+) as they were at the time of the 2019 Decision.[6]

Those credit ratings from all three agencies remain two notches lower than SDG&E's longstanding A-credit rating as of 2018.[7] SDG&E's credit ratings were repeatedly downgraded in 2018 and early 2019 because of credit rating agencies' perception of California's increased risk from wildfires and wildfire liability related to inverse condemnation compared to utilities outside the state—despite SDG&E not being the cause of a significant wildfire since 2007 and the utility repeatedly being lauded for its wildfire mitigation efforts.[8] As discussed below,

---

[3] D.19-12-056 at 42-43 (citing S&P [RRA] Global Market Intelligence, July 22, 2019 at Table 1).

[4] D.19-12-056 at 51, FoF 32.

[5] Moody's, "Rating Action: Moody's upgrades San Diego Gas & Electric to A3 from Baa1; outlook stable," at 1 (Mar. 30, 2021) ("Moody's March 30, 2021").

[6] D.19-12-056 at 51, FoF 32 ("SDG&E has an investment grade rating of BBB+ from S&P"); *see generally* SDG&E-01 (Bille) at VAB-16.

[7] SDG&E-03 (Beer) at 8-10.

[8] SDG&E-01 (Bille) at VAB-11.

1 although AB 1054's passage (before the 2019 Decision) halted the slide in SDG&E's credit
2 ratings, it largely did not reverse those downgrades.

3 **2. SDG&E Continues to Face Unique, Above-Average Risks Compared**
4 **to Other Utilities Despite Effective Management**

5 Instead, rating agencies have not restored SDG&E's credit ratings because they and other
6 analysts continue to perceive SDG&E and other California electric utilities as facing ongoing,
7 heightened risks compared to non-California utilities—much as existed at the time of the 2019
8 Decision.[9] This is particularly true with regards to wildfire risks, stemming from a combination
9 of:

10 - The higher threat of wildfires in California;
11 - California courts' application of inverse condemnation strict liability for
12 any utility caused fire regardless of fault;[10] combined with
13 - Heightened investor concern that an electric utility will be less likely to
14 recover wildfire-related costs in California than they would in other
15 jurisdictions, such as at the Federal Energy Regulatory Commission
16 ("FERC"), for the same utility conduct.[11]

17 As noted, although AB 1054 helped somewhat mitigate those risks and halted the decline
18 in SDG&E's declining credit ratings, the law has not supported a restoration of those ratings
19 because it could not remove the state's high propensity for wildfires, did not remove inverse

[9] Although Dr. McCann opines that no utility witness specifies how any of the risks have changed significantly since the 2019 Decision, EDF (McCann) at 26, that is because the utilities likewise faced above average risks at the time of the 2019 Decision.

[10] Moody's, *San Diego Gas & Electric Company*, June 23, 2022 ("Moody's June 23, 2022") at 5 (under inverse condemnation, "utilities are strictly liable for damages from fires ignited by their equipment, regardless of fault or how reasonably the utilities acted").

[11] *See* Moody's June 23, 2022 at 1 ("Exposure to wildfire risk tempers SDG&E's credit quality."); S&P, *San Diego Gas & Electric Company*, July 29, 2022 ("S&P July 29, 2022") at 4 (incorporating a negative comparable ratings modifier into its rating on SDG&E and finding that "we view the threat of wildfires in [SDG&E's] service territory as high relative to that of its utility peers across North America").

condemnation, and remains untested. Regarding inverse condemnation, as Moody's states, by making SDG&E strictly liable regardless of how the utility acted, inverse condemnation heightens SDG&E's risk exposure because it increases the sheer number of fires that SDG&E could be responsible for; particularly problematic given the high propensity for wildfires in the state.[12]

Moreover, despite AB 1054 altering the prudency review standard for a utility-caused wildfire,[13] investors have ongoing concerns that a California utility will not receive cost recovery for the same conduct that would be found prudent in other jurisdictions, based on the Commission denying—and FERC granting—SDG&E recovery for the same conduct arising out of SDG&E's 2007 fires.[14] And as Moody's notes, the new AB 1054 standard remains untested.

Certain intervenors acknowledge this unique wildfire and wildfire liability risk. As Mr. O'Donnell testifies, "I understand and accept the fact that SDGE has a higher level of risk due to inverse condemnation and the ongoing threat of wildfires."[15] Mr. O'Donnell adds that there is

---

[12] Moody's June 23, 2022 at 4-5 (finding that inverse condemnation "heighten[s] the utilities' risk exposure to property damage").

[13] *Id.* at 5 (AB 1054 revised the prudency standard to be "in line with the recovery standards applied by the FERC").

[14] *Id.* Contrary to Dr. McCann's claim, it is thus not simply the case that inverse condemnation is a problem that investors only "discover[ed] recently." EDF (McCann) at 23-24. Instead, it was the combination of inverse condemnation combined with the Commission in 2017 denying SDG&E cost recovery for its 2007 wildfires when FERC allowed cost recovery for the same conduct that caused investor concern with the impact of wildfire liability in California and began the downgrade in credit ratings. *See* Moody's June 23, 2022 at 5.

[15] FEA (O'Donnell) at 66.

"'still [a] substantial and increasing risk of wildfires in California,'"[16] and "that wildfire and [inverse] condemnation risk is unique to California."[17]

Other intervenors try to minimize this risk by asserting that it is of the utility's own making.[18] For example, Dr. McCann alleges that for "risks to be appropriately 'priced in' to a utility's ROE it must meet two criteria: (1) the risk must be borne by shareholders, and (2) the risk must not be the result of the mismanagement of the company."[19] But that is precisely the case for SDG&E with regards to wildfire risk. As noted, Moody's and S&P have repeatedly lauded SDG&E for its "'effective wildfire risk mitigation practices,'"[20] with S&P calling SDG&E a "leader in wildfire prevention"[21]—consistent with "'efficient and economical management.'"[22]

Yet as noted, SDG&E's credit ratings were downgraded several notches due to the overall risk of wildfires and inverse condemnation in the state despite those efforts.[23] Nor is SDG&E's risks fully captured by its credit rating.[24] In fact, S&P incorporates a "negative comparable ratings modifier" on SDG&E, reflecting its determination that SDG&E's "business

---

[16] *Id.* at 49 (quoting Ratings Action; Moody's changes Edison and Southern California Edison outlooks to positive; affirms ratings (May 16, 2022)).

[17] FEA (O'Donnell) at 82; *id.* at 73 ("Sempra is still somewhat in the shadow of inverse condemnation").

[18] EDF (McCann) at 4.

[19] *Id.* at 14.

[20] EPUC/IS/TURN (Gorman) at VIII-3 (quoting Moody's March 30, 2021 at 1).

[21] S&P July 29, 2022 at 2.

[22] WT (Rothschild) at 89 (quoting *Bluefield Co. v. Pub. Serv. Comm'n*, 262 U.S. 679, 692 (1923)).

[23] Moody's June 23, 2022 at 1 (SDG&E's "[e]xposure to wildfire risk tempers SDG&E's credit quality" despite "effective wildfire mitigation practices.").

[24] *See* UCAN (Pavlovic) at 6 (arguing that SDG&E's risks are accounted for in the Company's credit ratings); EPUC/IS/TURN (Gorman) at VIII-55 (same).

1 risk profile is at the lower end of the excellent range" relative to other comparable utilities, based
2 on SDG&E's "higher wildfire threat compared to utility peers across North America."[25]
3 Nor, as certain intervenors claim, is SDG&E's wildfire threat only recognized by credit
4 rating agencies.[26] Instead, Sempra's stock is explicitly discounted despite SDG&E's "superior
5 wildfire mitigation protocols"[27]—reflecting "lingering risks related to [California's] inverse
6 condemnation policy and highly politicized regulatory environment."[28]
7 And contrary to certain intervenors' claims,[29] SDG&E's above-average risk is likewise
8 reflected in stock market performance. Sempra and the other California electric utilities have
9 underperformed both the broader market and utilities nationwide since the 2019 Decision.[30] As
10 discussed further below, as Mr. Rothschild recognizes, since January 1, 2020, the S&P Utility
11 500 has underperformed the S&P 500, with utility stocks up less than 26% while the S&P 500 is
12 up more than 30%.[31] But as Mr. Coyne details, Sempra and the other California utilities have
13 even further underperformed the broader utility index.[32]

---

[25] S&P, "Sempra Energy Unsecured Debt Rating Lowered To 'BBB'; Outlook on Subsidiary SDG&E Revised to Stable" (May 12, 2021) at 2; *accord* S&P July 29, 2022 at 2, 3.

[26] *Contra* EDF (McCann) at 26 (arguing that SDG&E is relying upon the "three major credit rating companies" for risk assessment).

[27] Evercore ISI, "Sempra Energy" (Jun. 29, 2021), at 2.

[28] Wells Fargo, Equity Research, Sempre Energy Analysis (SRE), SRE: Analyst Day Previews CapEx Upside in Texas (Jun. 29, 2021), at 3; *see* Evercore ISI, "Sempra Energy" (Aug. 4, 2022) at 2 (assigning a discount "due to wildfire liability issues associated with inverse condemnation"); UBS "Sempra" (Aug. 4, 2022) at 4 (noting risks include "uncertainty surrounding wildfire-related cost recovery").

[29] *See* EDF (McCann) at 4.

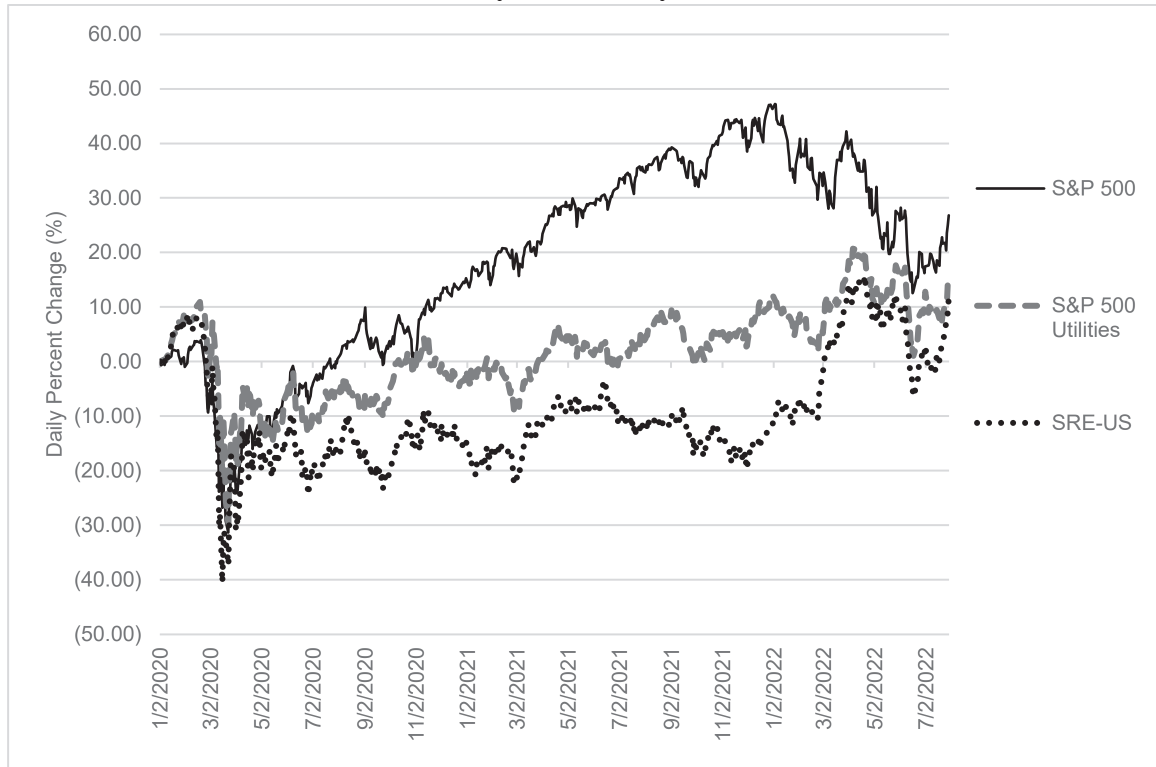
[30] SDG&E-08 (Coyne) at JMC-17.

[31] WT (Rothschild) at 13 (electric utility stocks "up a little less than the overall market between the last California cost of capital proceeding and today"); *see also* EPUC/IS/TURN (Gorman) at II-10 ("During the COVID-19 pandemic the utilities underperformed relative to the overall market").

[32] SDG&E-08 (Coyne) at JMC-22 – JMC-23.

1
2

Relative Performance of Utilities and the S&P 500, January 2020 – July 2022[33]



3
4
5 Mr. O'Donnell likewise notes that inverse condemnation has resulted in an 100-130 basis
6 point difference in dividend yields between Southern California Edison and the comparison
7 group.[34] And the focus on SDG&E's unique wildfire risks does not even account for the other
8 elevated threats that investors perceive, such as the "lengthy and controversial process to extend
9 SDG&E's electric and natural gas franchise agreements with the City of San Diego."[35]
10 As such, contrary to the unsubstantiated arguments from some intervenors,[36] analysts
11 believe SDG&E faces the same unique, elevated risks compared to non-California utilities that

---

33 *Id.* at JMC-18, Figure 5.

34 FEA (O'Donnell) at 61.

35 Moody's June 23, 2022 at 6.

36 *See, e.g.*, UCAN (Pavlovic) at 7.

1 the utility faced at the time of the 2019 Decision—and that inverse condemnation offsets the
2 more constructive aspects of California's regulatory regime.[37] One of those credit supportive
3 features to help respond to this heightened wildfire risks has been authorized ROEs that are
4 above the national average.[38] While Mr. O'Donnell cites effective utility efforts to reduce
5 wildfire risks,[39] that is the whole point. Such above-average risks require adequate investment to
6 reduce the risk of wildfire and Public Safety Power Shutoff ("PSPS") events to support safety
7 and reliability.

8
9
10
B. The National Authorized ROE Average Remains Largely the Same as in the 2019 Decision, with Expectations that it will Increase with Rising Interest Rates

11 Finally, intervenors recognize that the national authorized ROE average is largely similar
12 to the average observed in the 2019 Decision.[40] Specifically, as noted, in setting SDG&E's ROE
13 at 10.20%, the Commission in the 2019 Decision identified the 2018 all-electric utility average
14 as compiled by Regulatory Research Associates ("RRA"), a unit of S&P, as 9.60%.[41] By

---

[37] SDG&E-05-C, RRA Report (Dec. 14, 2020) at 2 (California's "unique" and "significant" wildfire and wildfire liability risks are somewhat offset by the other aspects of California's regulatory structure that are "relatively constructive for investors").

[38] SDG&E-05-C, RRA Report (Dec. 14, 2020) at 2 ("By contrast, the more traditional aspects of the California regulatory paradigm are relatively constructive for investors . . . [e]quity return authorizations . . . *have been above the industry averages when established*."). (emphasis added); S&P, Ratings Direct: PG&E Corp (May 20, 2021) ("We view the regulatory framework in California to be generally credit supportive" including because the state features "authorizations of return on equity that is above the industry average.").

[39] *See* FEA (O'Donnell) at 49, 51.

[40] *See* EPUC/IS/TURN (Gorman) at II-1 (arguing that the nationwide authorized electric utility ROE average has ranged between 9.35%-9.78% between 2014-2022).

[41] D.19-12-056 at 42-43 (citing S&P [RRA] Global Market Intelligence, July 22, 2019 at Table 1).

comparison, for the first half of 2022, RRA has found the nationwide authorized electric utility average to be 9.39%—a slight increase from 9.38% in 2021.[42]

Some intervenor witnesses found slightly higher averages, with Mr. Ellis opining that the average is 9.50% for 2021,[43] and Mr. Kronauer determining a 9.60% average between 2019-2022 for vertically integrated utilities and 9.46 percent overall for electric utilities.[44] Other intervenors attempt to cherry-pick numbers rather than apply RRA's all electric average, preventing an apples-to-apples comparison to the Commission's 2019 Decision, which relied upon the all-electric figure.[45]

Regardless, the data all demonstrates that the nationwide authorized ROE average for electric utilities has been largely stagnant. At most, it has moderately declined by 21 basis points from 2018 to present[46]—despite the significant decline in interest rates in 2020-2021 driven by the Federal Reserve's efforts to minimize the economic fallout from the Covid-19 pandemic—as state utility commissions "recognized that long-term bond yields have been artificially suppressed due to the Fed[eral Reserve's] unprecedent intervention in the capital markets."[47] As

---

[42] RRA, Major Energy Rate Case Decisions in the US—January-June 2022 (July 27, 2022) ("RRA July 27, 2022") at 3, Table 1; *see also* RRA, Major Rate Case Decision—January-December 2020 (finding the all-electric average as 9.66% for 2019 and 9.44% for 2020).

[43] PCF (Ellis) at 14 (citation omitted).

[44] Walmart (Kronauer) at 8. Contrary to Mr. Kronauer's seeming suggestion, *id.* at 10, SDG&E is a vertically integrated utility because it owns generation resources.

[45] *See, e.g.*, EPUC/IS/TURN (Gorman) at II-2, Figure 1 (excluding limited riders); UCAN (Griffing) at 43 (only including fully litigated cases in his authorized ROE average).

[46] *See* CA (Woolridge) at 20 ("authorized electric ROEs declined by about 20 basis points" between 2018 and 2021).

[47] S&P, The Big Picture: 2022 Electric, Natural Gas and Water Utilities Outlook (Oct 2021) ("S&P Oct. 2021") at 5; *see also* RRA, July 27, 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.").

1 Mr. Kronauer thus points out,[48] SDG&E request remains within the upper end of the range of
2 authorized ROEs, consistent with the Commission's 2019 Decision setting SDG&E's ROE at the
3 upper end of the just and reasonable range.[49]

4 And, as discussed further below, the current authorized national average largely does not
5 capture the ongoing rise in interest rates. As Mr. Rothschild testifies, "[h]igher interest rates, all
6 else equal, generally indicate a higher cost of equity for electric utility companies because fixed
7 income investments become relatively more attractive when they start paying a higher rate."[50]
8 RRA finds that, with interest rates now on the rise, "the average authorized returns for full year
9 2022 and 2023 may edge higher."[51] S&P likewise adds that it expects ROEs may increase as
10 interest rates rise.[52]

11 As RRA states, however, this will take some time to influence the national average, given
12 regulatory lag.[53] Mr. Coyne thus states a comparison with authorized returns must account for
13 interest rate levels when those ROEs were set and adjust for current and/or projected rates.[54] As
14 such, considering that SDG&E's faces similar credit ratings, risks, and national authorized ROE
15 environment—one that is likely to feature increasing authorized ROEs with rising interest

---

[48] Walmart (Kronauer) at 9 (noting that an authorized ROE was set above SDG&E's 10.55% ROE request).

[49] Contrary to Dr. McCann's claim, FERC's initial order setting PG&E's ROE at 9.26% was for March 2017-March 2018, so it is not a "current perspective." EDF (McCann) at 41); *see* 178 FERC ⁋ 61,175. PG&E's currently authorized FERC-jurisdictional ROE is 10.30%, as approved by FERC in 173 FERC ⁋ 61,281.

[50] WT (Rothschild) at 26.

[51] RRA July 27, 2022 at 7; *accord id.* at 4 ("Authorized returns may edge slightly higher going forward as the U.S. Federal Reserve continues efforts to tamp down soaring inflation via a series of interest rate hikes, the first of which was announced in March.").

[52] S&P Oct. 2021 at 5.

[53] RRA July 27, 2022 at 6.

[54] SDG&E-08 (Coyne) at JMC-9.

rates—the Commission's findings in the 2019 Decision that supported SDG&E being granted a 10.20% ROE remain equally applicable today. No factors or findings from Commission precedent support a reduction in ROE.

C. Intervenors' Testimony Demonstrates That Underlying Financial Conditions Support a Higher ROE Than in 2019

Moreover, as intervenors' testimony confirms, the underlying economic and financial fundamentals today indicate a higher cost of equity for SDG&E now than at the time of the 2019 Decision, supporting SDG&E's 10.55% ROE request.[55] Specifically compared to 2019, intervenors observe:

- Higher financial modeling results;
- Higher interest rates;
- Higher utility betas; and
- Utilities stock underperformance, with further California utility underperformance.[56]]

1. Higher ROE Modeling and Rising Interest Rates Underscore the Increase in SDG&E's Cost of Equity

As Mr. Coyne explains, SDG&E's ROE recommendation is more than fair and appropriate, given his modeling range.[57] Although Mr. Coyne demonstrates the flaws with intervenors' modeling, witnesses that submitted ROE analysis for the same intervenor in both

---

[55] UCAN (Griffing) at 8 ("the rate of return should reflect the condition of the capital markets in which SDG&E will have to compete with other firms for funding.").

[56] *See* WT (Rothschild) at 23 and 31 (also observing an increase in volatility and credit spreads).

[57] SDG&E-08 (Coyne) at JMC-60.

1 2019 and in this proceeding largely all directionally have an increase in their ROE range today

2 compared to 2019.[58]

Party	2019 ROE Range	2022 ROE Range
EPUC/IS/TURN (Gorman)	8.50-9.00%[59]	9.20-9.80%[60]
UCAN (Griffing)	8.74%-9.71%[61]	9.39%-9.84%[62]
FEA (O'Donnell)	5.5%-10.25%[63]	6.25%-10.25%[64]

3
4 This increase in modeling outcomes is consistent with rising interest rates. As noted,

5 intervenors overwhelmingly recognize that interest rates are increasing and will continue to rise,

6 given ongoing, heightened inflation. Specifically, as intervenors detail, the Federal Reserve

7 increased the federal funds rate (which impacts all other interest rates) by 25 basis points in

8 March, 50 basis points in May, 75 basis points in June, and another 75 basis points in July for a

9 target range of 2.25-2.50 percent.[65] And as Mr. Gorman added, the Federal Reserve stated that it

10 will continue increasing the federal funds rate until the Federal Reserve achieves its target 2.0%

---

58 In contrast to the Scoping Memo's explicit instruction, Scoping Memo at 3, Dr. McCann recommends a "blended" ROE consisting of a different gas and electric ROE. It should be rejected.

59 A.19-04-014, *et al.* EPUC/IS/TURN-01 (Gorman) at VIII-37.

60 EPUC/IS/TURN (Gorman) at VIII-39.

61 A.19-04-014, *et al.*, UCAN-PCF-01 (Griffing) at 46. Dr. Griffing testified for both UCAN and PCF in A.19-04-014.

62 UCAN (Griffing) at 42.

63 A.19-04-014, *et. al*, FEA-01 (O'Donnell) at 64.

64 FEA (O'Donnell) at 72.

65 *See* CA (Woolridge) at 15; *accord* SDG&E-08 (Coyne) at JMC-15.

1 inflation rate.[66] As Mr. Coyne details, this results in a Federal Reserve target range of 3.25-3.50
2 percent by the end of 2022.[67] And it indicates that ongoing rate increases into 2023 are likely.
3 The Federal Reserve's actions have already significantly raised interest rates. As Mr.
4 Rothchild testifies, the interest rate on 30-year Treasury bonds has increased from 2.44% at the
5 time that SDG&E filed its application to around 3.14%.[68] And that does not even account for the
6 fact that the current 30-year Treasury yield was below two percent one year ago and around two
7 percent on January 1, 2022[69]—demonstrating why RRA expects the nationwide authorized ROE
8 average to increase from its moderate decline in 2020-2021 during a period of extremely low
9 interest rates due to the Federal Reserve's unprecedented actions to respond to the pandemic.
10 The result, as intervenors recognize, is that interest rates are now higher than they were at
11 the time of the 2019 Decision.[70] As noted, Mr. Rothschild testifies that the 30-year Treasury
12 yield is at 3.14%[71]—compared to Mr. Woolridge's statement that the 30-year Treasury was
13 around 2.25% at the time of the 2019 Decision.[72] In other words, 30-year Treasury rates are
14 nearly 100 basis points higher now than when the Commission set SDG&E's ROE at 10.20%.[73]

---

[66] EPUC/IS/TURN (Gorman) at III-1.

[67] SDG&E-08 (Coyne) at JMC-15.

[68] WT (Rothchild) at 31, 131; *accord* SDG&E-08 (Coyne) at JMC-15 (the 30-year Treasury yield closed out February at 2.17%, when Mr. Coyne conducted his direct testimony analysis, and was 3.05% as of July 22, 2022).

[69] CNBC, U.S. 30 Year Treasury, available at https://www.cnbc.com/quotes/US30Y

[70] *See, e.g.*, CA (Woolridge) at 12-13; FEA (O'Donnell) at 6 ("Long-term interest rates have increased slightly since this Commission's" 2019 Decision).

[71] WT (Rothschild) at 31.

[72] CA (Woolridge) at 12-13 and Figure 1.

[73] *See* WT (Rothschild) at 26 (discussing how an increase in interest rates generally indicates an increase in the cost of equity); *see also* SDG&E-08 (Coyne) at JMC-9 ("interest rates have now increased by 86 to 143 basis points since SDGE&'s ROE of 10.20 percent was authorized in December 2019").

1 2. **Higher Utility Betas and Utility Stock Market Underperformance**
2 **Support an Increase in the Cost of Equity**

3 Intervenors likewise generally recognize that utility betas (including for Sempra) are
4 higher than during the 2019 Decision.

5 **Beta Coefficients for Proxy Group and Sempra Energy**[74]

	January 2020	**February 2022**	**July 2022**
Proxy Group Average			
Value Line Beta	0.56	0.88	0.86
Bloomberg Beta	0.532	0.873	0.854
Sempra Energy			
Value Line Beta	0.70	0.95	0.95
Bloomberg Beta	0.633	0.912	0.899

6
7 As Mr. Coyne states, utility betas "remain near 0.85, which is substantially higher than at
8 any time in the last 20 years, except during the financial crisis" of 2008-2009.[75] As Mr. Gorman
9 testifies, an "increase in betas suggests that utility companies' investment risks are increasing
10 relative to the overall general marketplace."[76] Again, as ROE must be set commensurate with
11 risk, an increase in utility risk suggests an increase in the cost of equity.[77]

12 Similarly, as noted, utilities have underperformed the broader market since the 2019
13 Decision.[78] As with heightened betas, stock market underperformance indicates a higher cost of

74 SDG&E-08 (Coyne) at JMC-18, Figure 6.

75 *Id.* at JMC-13.

76 EPUC/IS/TURN (Gorman) at VIII-34; *id.* at VIII-38 (acknowledging currently elevated betas).

77 *See* Coyne SDG&E-08 at JMC-47.

78 *See id.* at JMC-22 – JMC-23.

equity for utilities.[79] Although certain intervenors focus on utility stock market performance in the last two months or since the war in Ukraine began,[80] the relevant time frame for comparison should be to the last cost of capital decision, as that provides a relevant anchor to compare conditions now compared to what they were when SDG&E's current 10.20% ROE was authorized.

And that comparison shows that investors have required a higher cost of equity for utilities. Nor do intervenors' arguments regarding recent utility stock market performance negate that the California utilities' stock is discounted and underperforming relative to utilities nationwide, as evidenced by a comparison to the S&P Utility 500. As such, underlying financial conditions show an increase in SDG&E's cost of equity relative to 2019, supporting SDG&E's 10.55% ROE request.

III. CERTAIN INTERVENORS IGNORE THAT ROE IS A MARKET BASED CONCEPT AND THAT SDG&E'S ROE MUST BE SET CONSISTENT WITH THE ROE OF OTHER COMPANIES FACING COMMENSURATE RISKS TO ENSURE THAT SDG&E CAN INVEST IN SAFETY AND RELIABILITY

Despite the straightforward evidence that the framework underlying the 2019 Decision remains the same and that SDG&E's cost of equity has increased since that Decision, certain intervenors seek to place SDG&E and the other California utilities' ROEs as much as 100-400 basis points below the national average[81]—by ignoring the fact that SDG&E and other California utilities must compete against utilities outside the state for capital while facing above-average risks. In so doing, intervenors do not offer any evidence that SDG&E's risk profile is

---

[79] *Id.*

[80] *See, e.g.*, CA (Woolridge) at 17.

[81] *See* SDG&E-08 (Coyne) at JMC-7 – JMC-8 ("At the outset, one must question analyses producing results that are more than 370 basis points below any return authorized for any electric utility in at least 40 years").

meaningfully lower than the average electric utility to support such a significant below-average ROE.[82]

Yet as numerous intervenors recognize—and as the Commission has repeatedly applied based upon Supreme Court precedent—ROE is a market-based concept.[83] It is based upon the return on investment that investors require.[84] As Mr. Gorman testifies, "the market sets the required rate of return for assuming the risk of an investment."[85]

Critically, ROE must be set commensurate with risks.[86] As Dr. Griffing states, investors have "many opportunities from which to choose in the financial markets."[87] So for a company to attract capital, its ROE must "at least equal the expected rate of return for the best alternative opportunity with similar risk.[88]

Otherwise, investors will invest in other companies that have the same return for less risk. Intervenors thus largely recognize, as the Commission has found,[89] that setting ROE based upon

---

82 SDG&E-08 (Coyne) at JMC-8 – JMC-9.

83 CA (Woolridge) at 3 ("Thus, the appropriate ROE for a regulated utility requires determining the market-based cost of capital."); UCAN (Griffing) at 7 (must identify the "required equity return based on the market's value of a utility's stock.").

84 *See* D.19-12-056 at 15-16 (citing *Federal Power Com. v. Hope Nat'l Gas Co.,* 320 U.S. 591, 601 (1944); *Bluefield*, 262 U.S. at 692); *see also* FEA (O'Donnell) at 14 ("Since every equity investor faces a risk-return tradeoff, the issue of risk is an important element in determining the fair rate of return for a utility."); *see also* WT (Rothschild) at 50 (citing applicable legal standards).

85 EPUC/IS/TURN (Gorman) at VIII-54.

86 D.19-12-056 at 16.

87 UCAN (Griffing) at 9.

88 *Id.* at 10; *accord* FEA (O'Donnell) at 14 ("Regulatory law and policy recognize that utilities compete with other firms in the market for investor capital.").

89 *See* D.19-12-056 at 43 (finding that setting SDG&E's ROE at 10.20% balanced shareholder and ratepayer interests).

current market conditions "balances investor and consumer interests,"[90] supporting both affordability and adequate investment that benefits ratepayers. If ROE is set below that market-required comparative return to accomplish other goals it "harms both investors and ratepayers,"[91] jeopardizing "adequate service" for customers.[92]

Certain intervenors' focus on SDG&E's overall rates and affordability[93]—a distinct concept from SDG&E's rate of return, which is a market-based concept based upon investor expectations—is thus misplaced. SDG&E is always concerned with affordability and ratepayer interests. Notably, the Company's cost of capital proposals, including a ROE of 10.55%, would generally not result in a rate increase for most ratepayers.

But as discussed, having an ROE that reflects the market-required return needed to ensure adequate investment based upon SDG&E's risks compared to other utilities (and other investments more generally) is critical to supporting both utility and ratepayer interests, ensuring adequate service, reliability, and investment. Rates should be addressed in an overall, holistic manner—not by targeting the rate of return in this limited-scoped cost of capital proceeding separate from all the other factors that impact overall rates. Attempting to set the rate of return solely on this basis could result in deleterious consequences, such as inadequate investment and credit rating downgrades.

Ensuring adequate investment is particularly important in California to combat wildfire risks and to support grid modernization for clean energy and electrification. As credit rating

---

[90] UCAN (Griffing) at 8.

[91] WT (Rothschild) at 18 (citation omitted).

[92] FEA (O'Donnell) at 14; *see* WT (Rothschild) at 18 (if ROE is set too low "the Utilities will not be able to access the capital needed to provide safe and reliable service.").

[93] *See, e.g.*, EPUC/IS/TURN (Gorman) at IV-8; PCF (Ellis) at 22; EDF (McCann) at 15.

agencies and analysts such as RRA recognize, "the authorization of adequate returns to ensure ongoing capital attraction in the utility sector will be instrumental as the industry shifts away from fossil fuels to renewables and storage and invests in strengthening the nation's power grid against climate and other risks."[94] Indeed, even Dr. McCann agrees that "electrification will necessitate a major new investment in capital expenditures."[95]

Similarly, RRA stated that wildfire mitigation investments such as the undergrounding of utility power lines in California benefits customers.[96] The Commission likewise found that "[w]e expect PG&E to ramp up its system hardening and other projects."[97] And AB 1054's legislative directive mandates that California electric utilities "must invest in hardening of the state's electrical infrastructure and vegetation management to reduce the risk of catastrophic wildfire."[98]

As noted, some intervenors recognize that credit rating agencies have touted the utilities' extensive investments in wildfire mitigation programs to increase safety and reliability. But such efforts require sufficient investment to counter those above-average wildfire risks.

Yet certain intervenors ignore that ROE is a market-based concept, and that SDG&E is competing with other potential investments—including utilities nationwide—for capital. They

---

[94] RRA July 27, 2022 at 4 ("Energy utilities are investing in infrastructure to modernize transmission and distribution systems, build new natural gas, solar and wind generation, and deploy new technologies to accommodate the expansion of electric vehicles, battery storage and advanced metering infrastructure that facilitate the transition toward decarbonization"); S&P Oct. 2021 at 3 ("[s]tate 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.").

[95] UCAN (McCann) at 8.

[96] RRA State Regulatory Evaluations—Energy (May 30, 2022) at 6.

[97] D.20-12-005 at 121.

[98] AB 1054 (2019), Section 2(a-b), Legislative Findings.

instead focus on things like "book value."[99] But as other intervenors note, the "earned return on book equity is an entirely different concept from the cost of equity, which should be market based."[100] As Dr. Woolridge quotes Dr. Roger Morin, "'[i]nvestors can only purchase new shares of common stock at current market prices and not at book value.'"[101]

As such, as Dr. Griffing testifies, "return calculated on an enterprises' common-equity book value does not reflect a return available on an enterprise of corresponding risk."[102] Even if Mr. Ellis's statement—without evidence—that "[s]ubstantial, robust evidence suggests that authorized ROEs for nearly all US utilities exceed their cost of equity,"[103] is true (and Mr. Coyne demonstrates that it is not[104]), it is beside the point. If SDG&E's ROEs were reduced to its purported book value—or otherwise below the national authorized ROE average for whatever reason—while no other utilities nationwide have their ROE similarly reduced (and in fact while the nationwide authorized ROE average is likely increasing, given rising interest rates), investors will flock to other utilities that offer a higher return while facing lower risks than those possessed by SDG&E.

And the Commission has never authorized ROE based upon book value. So the concept should not be given any weight. In sum, the fundamental principles that informed setting

---

[99] *See, e.g.*, UCAN (McCann) at 7; PCF (Ellis) at 16.

[100] PCF (Rothschild) at 135.

[101] CA (Woolridge) at 109 (quoting Roger Morin, *New Regulatory Finance* (2006) at 293); *accord* UCAN (Griffing) at 52 (investors must pay market value).

[102] UCAN (Griffing) at 52.

[103] PCF (Ellis) at 13; *cf.* UCAN (Griffing) at 52 n.74 ("market value typically exceeds book value.").

[104] *See* SDG&E-08 (Coyne) at JMC-24 (demonstrating that market-to-book ratios for utilities have "increased not because authorized returns were higher than the true cost of equity, but because interest rates on government bonds have steadily declined for the past four decades. Low interest rates are favorable for capital-intensive industries such as utilities, while increasing interest rates are not.").

SDG&E's ROE well above the nationwide authorized average in the 2019 Decision remain in place, necessitating a return that is commensurate with SDG&E's above-average risks.

IV. SDG&E'S CAPITAL STRUCTURE PROPOSAL IS SUPPORTED BY CREDIT RATING AGENCIES COMPARED TO INTERVENORS' PROPOSAL TO INCREASE SDG&E'S FINANCIAL RISK

As discussed further by Maritza Mekitarian,[105] SDG&E's capital structure proposal is consistent with (in fact, below) SDG&E's longstanding actual capital structure and should be adopted, as the Commission has done in prior cost of capital decisions.[106] Certain intervenors seemingly recognize that "as the amount of debt in the capital structure increases, its financial risk increases and the risk of the utility, as perceived by equity investors also increases."[107] The Commission has likewise found that "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."[108]

Yet intervenors want to increase SDG&E's authorized capital structure leverage by moving SDG&E's authorized preferred equity layer solely into long-term debt. Far from being credit supportive, simply increasing SDG&E's long-term debt in this manner would harm SDG&E's credit metrics—which could increase costs for ratepayers through higher borrowing costs, the need for a higher ROE, or both—and increase the Company's risks. SDG&E's strong creditworthiness allows the Company's balance sheet to support increased customer undercollections and continued investments in approved wildfire mitigation programs without interim cost recovery without yet harming SDG&E's credit standing, providing multiple

---

[105] SDG&E-07 (Mekitarian) at MM-8.

[106] D.12-12-034 at 11.

[107] CA (Woolridge) at 29; *accord* FEA (O'Donnell) at 54 (a lower debt level lowers the risk of default).

[108] D.12-12-034 at 8-9.

1 ratepayer benefits. Intervenors' proposal is also seemingly inconsistent with the Commission's
2 indication in the 2019 Decision to pair any increase in long-term debt with an increase in
3 common equity to maintain a desired level of credit support.[109]
4 Mr. Gorman's statement that SDG&E's authorized capital structure from the 2019
5 Decision "has been adequate to support the Company's financial integrity, credit standing and
6 access to capital"[110] is not accurate, as credit rating agencies assess SDG&E's capital structure
7 based upon its actual capital structure, not its authorized one. And in fact, Moody's recently
8 found that an increase in SDG&E's "allowed equity layer to 54% (as requested) would be credit
9 supportive because it would contribute to stronger credit metrics."[111]
10 Equally important, intervenors are not proposing that SDG&E maintain the same
11 authorized capital structure for the 2019 Decision. They offer no support that their proposal to
12 increase SDG&E's financial risk will similarly support SDG&E's financial integrity and credit
13 standing. Instead, it will increase SDG&E's risks, requiring a higher equity return to compensate.
14 Moreover, as RRA states, authorized "equity ratios have generally increased over the last
15 several years."[112] The average equity ratio authorized in electric utility cases was 50.06% for
16 2021—compared with 49.02% for 2018, the year relied upon by the Commission in the 2019

[109] *See* D.19-12-056 at 11.

[110] EPUC/IS/TURN (Gorman) at VIII-4.

[111] Moody's June 23, 2022 at 8; *id.* at 9 ("As mentioned earlier, CPUC's authorization to increase the utility's allowed equity layer would help its credit metrics.").

[112] RRA July 27, 2022 at 7.

1 Decision.[113] Messrs. O'Donnell and Gorman find that the average for 2021 was even higher, at
2 51.0%,[114] and 51.53%,[115] respectively.
3 In other words, applying RRA's common equity ratio average, in setting SDG&E's
4 common equity ratio at 52% in the 2019 Decision, the Commission set SDG&E's common
5 equity ratio three percent above the national average for 2018. SDG&E's proposal here is now
6 less than four percent above the 2021 national average; largely maintaining SDG&E's capital
7 structure position relative to utilities nationwide.[116] Leaving SDG&E's common equity ratio at
8 52% would thus move SDG&E's common equity ratio closer to the national average than it was
9 at the time of the 2019 Decision[117]—failing to sustain SDG&E's capital structure relative to
10 other utilities despite SDG&E's above-average risks.
11 And intervenors' proposals would be even worse, increasing SDG&E's financial leverage
12 while state utility commissions nationwide are increasing utility common equity ratios.[118] For

---

[113] *Id.*

[114] FEA (O'Donnell) at 65.

[115] EPUC/IS/TURN (Gorman) at II-3, Table 2.

[116] *See* SDG&E-08 (Coyne) at JMC-52 (finding that SDG&E's common equity proposal is within the common equity proposals for the operating companies within Mr. Coyne's proxy group).

[117] *See* SDG&E-02 (Mekitarian) at MM-20.

[118] UCAN appears to be the only party opposed to SDG&E's proposed Cost of Capital Mechanism ("CCM") clarifications. UCAN (Pavlovic) at 11-12, Mr. Pavlovic seems principally focused on SDG&E's request to provide a method to potentially change the applicable index during a measurement period if there is a credit ratings change. *Id.* at 12. This is likely because SDG&E's request for specification as to what index and rate applies each cycle is largely clerical in nature. *See* SDG&E-05 (Billings) at PB-9. But contrary to Mr. Pavlovic's suggestion, SDG&E's requested CCM clarifications are beneficial to both the utility and ratepayers. It applies equally if a utility's credit rating is upgraded or downgraded. SDG&E's proposals simply minimizes uncertainty, providing clarification as to what benchmark and index should apply when a utility has split credit ratings, or how a utility should handle a credit rating change. *Id.* at 7-8. Similarly, far from Mr. O'Donnell's suggestion that the Commission should not "set[] aside its own order in Decision 08-03-035," FEA (O'Donnell) at 103, SDG&E has followed and applied D.08-03-035 since it was issued and advocates to continue following that decision here.

1 example, Mr. O'Donnell states that he "understand[s] and accept[s] the fact that SDGE has a
2 higher level of risk due to inverse condemnation and the ongoing threat of wildfires."[119] But then
3 he perplexingly responds to that by proposing to increase SDG&E's authorized debt from its
4 currently authorized level.[120] In no instance should SDG&E's capital structure be lowered
5 beyond its currently authorized level such that it would increase SDG&E's financial leverage.

6 **V. CONCLUSION**

7 Based upon the Commission's findings in the 2019 Decision remaining equally
8 applicable to SDG&E and the increase in the cost of equity, principally through the ongoing rise
9 in interest rates, the Commission should adopt SDG&E's 10.55% ROE and capital structure
10 requests.

11 This concludes my prepared rebuttal testimony.

---

[119] FEA (O'Donnell) at 66.

[120] *Id.* at 67.