Application: A.21-08-013 (consolidated)
Witness: James M. Coyne
Exhibit: SDG&E-07

PREPARED OPENING TESTIMONY OF
JAMES M. COYNE
EXTRAORDINARY CIRCUMSTANCES

ON BEHALF OF SAN DIEGO GAS & ELECTRIC COMPANY

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

JANUARY 18, 2022

TABLE OF CONTENTS

PREPARED OPENING TESTIMONY OF JAMES M. COYNE EXTRAORDINARY CIRCUMSTANCES

I. INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is James M. Coyne, and I am employed by Concentric Energy Advisors, Inc. ("Concentric") as a Senior Vice President.

Q. On whose behalf are you testifying?

A. I am submitting this testimony to the California Public Utilities Commission (the "Commission") on behalf San Diego Gas & Electric Company ("SDG&E" or the "Company"), which is a wholly-owned subsidiary of Sempra Energy.

Q. Have you previously provided testimony in this proceeding?

A. Yes, I provided Direct Testimony in August 2021. I have previously testified before the California Public Utilities Commission.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present evidence in response to two questions raised by Assigned Commissioner's December 24, 2021 Scoping Memorandum and Ruling ("Scoping Memo"). Specifically, the Scoping Memo directed parties to provide information on two questions for phase one of this proceeding:

1) Are there extraordinary circumstances that warrant a departure from the [Cost of Capital Mechanism] CCM for 2022?
2) If so, should the Commission leave the cost of capital components at pre-2022 levels for the year 2022, or open a second phase to consider alternative cost of capital proposals for the year 2022?[1]

[1] Scoping Memo at 7; *see id.* at 3.

My opening testimony addresses each question, in turn in Sections II and III, focusing particularly on whether exceptions circumstances exist to suspend the CCM. For the reasons described in those sections, the Commission should suspend the CCM and leave in place the already approved pre-2022 cost of capital components.

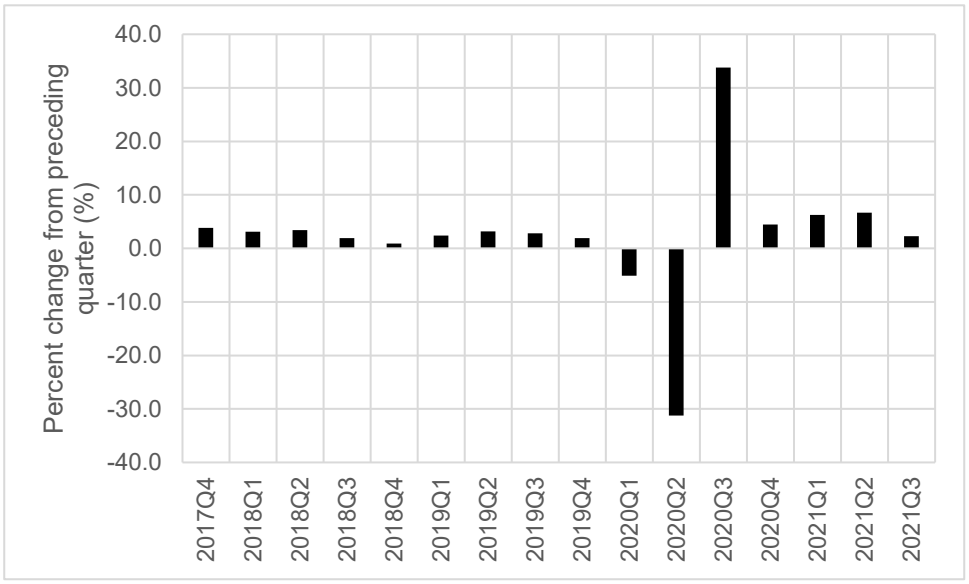
II. EXTRAORDINARY CIRCUMSTANCES

Q. Please describe the extraordinary circumstances that have affected capital market conditions.

A. Capital market conditions were significantly impacted in 2020 and 2021 by the economic impacts of the COVID-19 pandemic. Federal measures taken to contain the economic fallout from COVID-19 were extraordinary by any measure. As shown in Figure 1, according to the Bureau of Economic Analysis, real gross domestic product ("GDP") decreased at an annual rate of 5.1 percent in the first quarter of 2020 and at an unprecedented annual rate of 31.2 percent in the second quarter before rebounding in the third quarter at an annual rate of 33.8 percent. The fourth quarter of 2020 shows GDP expanded at an annual rate of 4.5 percent and that GDP continued to expand in 2021.[2]

[2] U.S. Bureau of Economic Analysis, Gross Domestic Product (Third Estimate), Corporate Profits (Revised Estimate), and GDP by Industry, Third Quarter 2021 (December 22, 2021) available at https://www.bea.gov/news/2021/gross-domestic-product-third-estimate-gdp-industry-and-corporate-profits-revised-3rd.

Figure 1: U.S. Real GDP Growth – 2017Q4-2021Q3[3]



In order to spare consumers and businesses from this sharp decline, the federal government took a series of unprecedented steps to stabilize financial markets. While utilities have traditionally been a "safe-haven" for investors, that has not been true during the COVID-19 pandemic. Capital market conditions changed dramatically in 2020 and 2021, resulting in greater risk for investors in both the broader equity market and utility stocks. As such, the effects of the COVID-19 pandemic, as well as the monetary and fiscal policy responses to the pandemic, represent an extraordinary circumstance.

Q. What steps did the Federal Reserve take to stabilize financial markets and support the economy in response to COVID-19?

A. In response to the economic effects of COVID-19, the Federal Reserve decreased the federal funds rate twice in March 2020, resulting in a target range of 0.00 percent to 0.25 percent (which has remained in effect to the present), and announced plans to increase its holdings of both Treasury and mortgage-backed securities. From December 2020 through November

[3] *Id.*

2021, the Federal Reserve purchased at least $80 billion per month of Treasury securities and at least $40 billion per month of mortgage-backed securities to support the flow of credit to households and businesses during the pandemic.[4] In addition, on March 23, 2020, the Federal Reserve began expansive programs to support credit to large employers, including the Primary Market Corporate Credit Facility ("PMCCF") to provide liquidity for new issuances of corporate bonds, and the Secondary Market Corporate Credit Facility ("SMCCF") to provide liquidity for outstanding corporate debt issuances. Further, the Federal Reserve supported the flow of credit to consumers and businesses through the Term Asset-Backed Securities Loan Facility ("TALF").[5]

These "quantitative easing" programs allowed the Federal Reserve to purchase government bonds and corporate bonds from banks. The banks then received cash from the Federal Reserve, which resulted in an expansion of the money supply. This increase in the money supply kept short-term interest rates low and increased the ability of banks to lend to consumers and businesses. Investors in longer term bonds also responded, which affected the entire duration of the bond yield curve, from very near-term rates to 30-year yields. As shown in Figure 2, the programs enacted by the Federal Reserve resulted in an unprecedented expansion of the money supply as measured by M2.[6] That expansion was far greater than the increase following the Federal Reserve's response to the Great Recession of

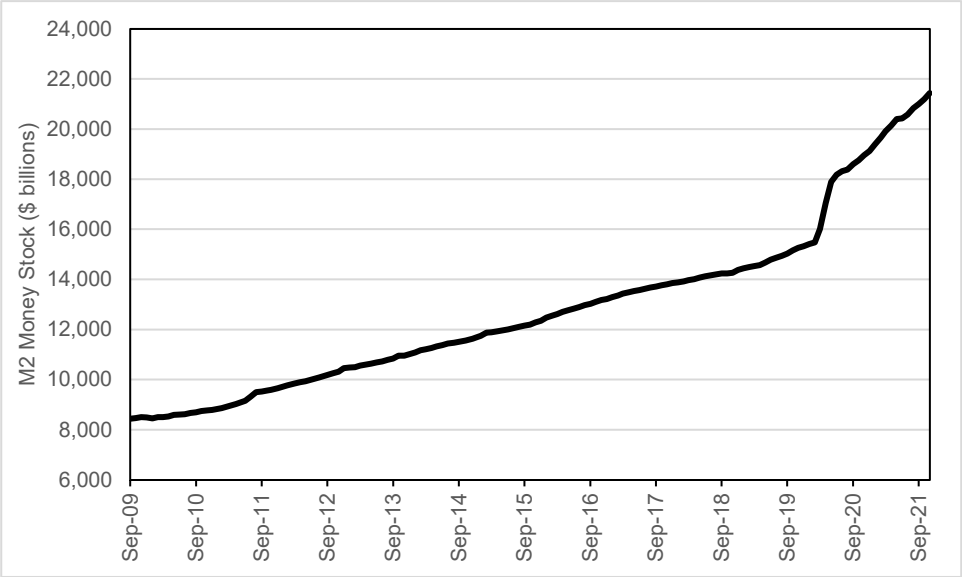
[4] CNBC, Fed will aggressively dial back its bond buying, sees three rate hikes next year (December 15, 2020), available at https://www.cnbc.com/2021/12/15/fed-will-aggressively-dial-back-its-monthly-bond-buying-sees-three-rate-hikes-next-year.html.

[5] Federal Reserve Board Press Release, Federal Reserve announces extensive new measures to support the economy (March 23, 2020), available at https://www.federalreserve.gov/newsevents/pressreleases/monetary20200323b.htm.

[6] M2 is defined by the Federal Reserve as follows: M2 includes a broader set of financial assets held principally by households. M2 consists of M1 plus: (1) savings deposits (which include money market deposit accounts, or MMDAs); (2) small-denomination time deposits (time deposits in amounts of less than $100,000); and (3) balances in retail money market mutual funds (MMMFs).

2008/2009. This demonstrates the level of intervention that was necessary to provide some stability to capital markets amidst the extraordinary circumstances associated with COVID-19.

Figure 2: M2 Money Stock – September 2009 – November 2021[7]



Q. Please summarize the fiscal policy response from the U.S. Congress.

A. In addition to the Federal Reserve's response, the U.S. Congress passed approximately $4.5 trillion in fiscal stimulus programs. On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act was signed into law, providing a large fiscal stimulus package aimed at mitigating the economic effects of the coronavirus. In March 2021, the U.S. Congress approved additional fiscal stimulus of $1.9 trillion in response to the ongoing economic effects of COVID-19. The extraordinary measures taken by the Federal Reserve and U.S. Congress to support the economy and stabilize financial markets have distorted bond markets (deliberately driving government and corporate yields lower) and equity markets (creating upward pressure on valuations and downward pressure on yields for dividend

[7] FRED, Economic Data, Source: Board of Governors of the Federal Reserve System (US), M2 Money Stock [M2] (January 12, 2022), available at https://fred.stlouisfed.org/series/M2SL.

paying companies such as utilities). In March 2020, for the first time on record, the yield on a 10-year treasury bond dropped below 1.0 percent,[8] and remained below 1.0 percent for the remainder of 2020.[9] The 10-year treasury bond yield remained low throughout 2021, beginning the year below 1.0 percent, ending the year at 1.52 percent with an average of 1.45 percent.[10] Before the onset of COVID-19, the 10-year Treasury yield had had reached levels as low as 1.45 percent on only two occasions: July 24-25, 2012 and July 5-11, 2016. Moreover, these fiscal stimulus programs have increased inflationary pressures, as evidenced in the sharp run-up in inflation and corresponding upward spike in bond yields since late November 2021.

Q. Are conditions expected to stabilize in the near-term?

A. The economy remains in a tenuous recovery phase of the business cycle. As such, capital market conditions continue to be unstable with expectations for interest rates and inflation to increase. Inflation is currently at its highest level in approximately 40 years and interest rates have recently increased from historic low-levels observed at the onset of the pandemic. The year-over-year ("YOY") change in the Consumer Price Index ("CPI") published by the Bureau of Labor Statistics has increased steadily in 2021 rising from 1.37 percent in January 2021 to 7.0 percent in December 2021. This change in the CPI in December 2021 is the largest 12-month increase since 1982.[11] Goldman Sachs forecasts consumer price inflation excluding food and energy costs to still be above 4 percent when the Federal Reserve ends

---

[8] FRED, Economic Data, Source: Board of Governors of the Federal Reserve System (US), available at https://fred.stlouisfed.org/series/DGS10.

[9] U.S. Department of the Treasury, available at https://www.treasury.gov/resource-center/data-chart-center/interest-rates/pages/TextView.aspx?data=yieldYear&year=2020.

[10] *Id.*

[11] CNBC, Inflation rises 7% over the past year, highest since 1982 (January 12, 2022), available at https://www.cnbc.com/2022/01/12/cpi-december-2021-.html.

their tapering of bond purchases in 2022.[12] And respondents to the recent CNBC Fed Survey, indicated the CPI is expected to rise 3.5 percent in 2022, which is an increase from the September Survey of 3.00 percent.[13] Adding uncertainty to the economic outlook, the current expectation is that the Federal Reserve will raise the federal funds rate three quarter-point increases in 2022, followed by three increases in 2023 and two in 2024.[14] Further, in December 2021, the Federal Reserve decided to reduce the pace of its quantitative easing policy, by reducing its net asset purchases to from $120 billion to $60 billion in January 2022.[15] This means that the historic low interest rate environment during the CCM's measurement period of October 2020 to September 2021 will likely not be applicable in 2022. Not only were circumstances extraordinary during the measurement period, but they are also expected to be transitory.

While these expansive monetary and fiscal programs provided for some price stability, as shown in Figure 3, the Chicago Board Options Exchange ("CBOE") Volatility Index ("VIX") has remained above long-term historical levels, indicating stock investors remain anxious about the economy. The VIX reached 82.69 on March 16, 2020 in response to the pandemic. As a point of comparison, the VIX last traded above 80 in November 2008 during the financial crisis and Great Recession of 2008/09. The VIX has continued to reach levels as high as 37.00 and averaged 19.69 in 2021. This is higher than the long-term

[12] Bloomberg.com, Goldman Now Sees Fed Hiking Rates in July as Inflation Lingers (October 30, 2021), available at https://www.bloomberg.com/news/articles/2021-10-30/goldman-now-sees-fed-hiking-rates-in-july-as-inflation-lingers.

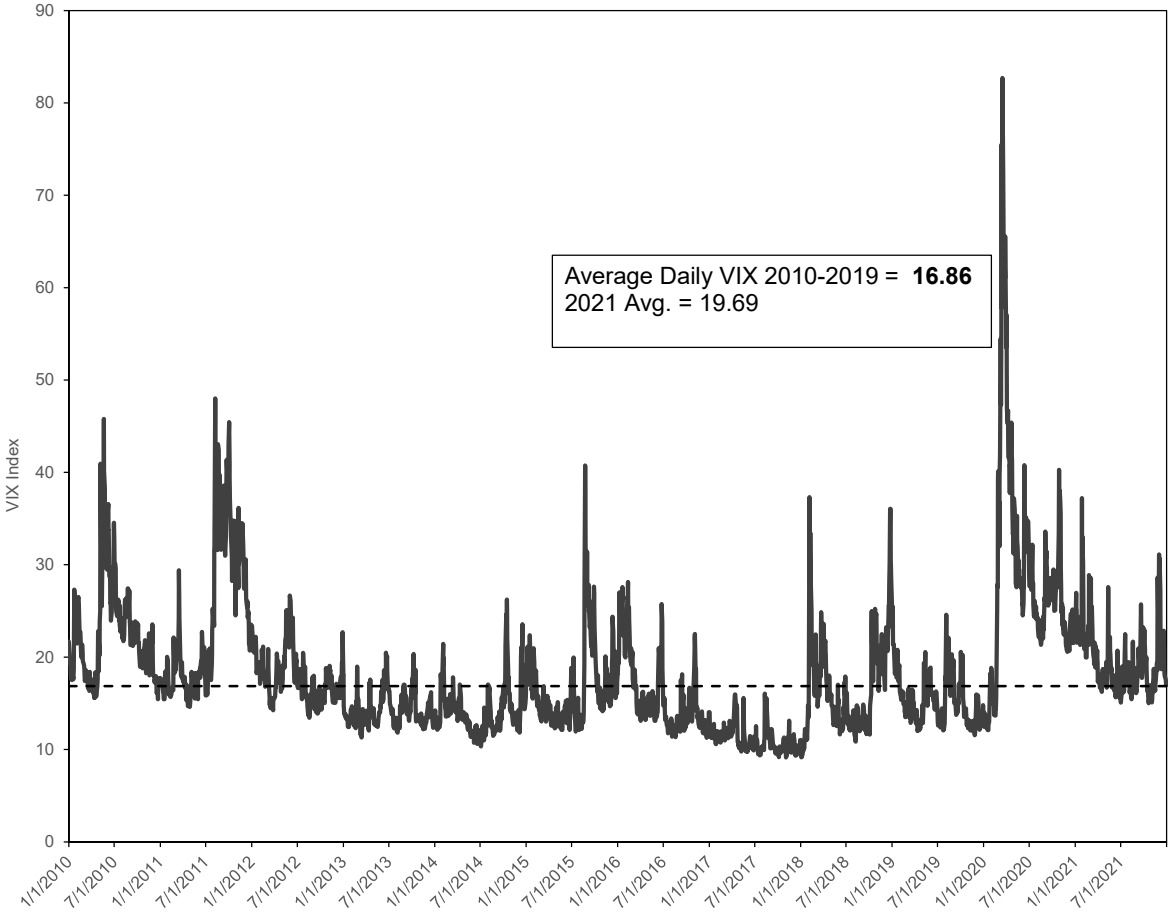
[13] CNBC, Investors Expect a Faster Pace for Fed Rate Hikes, CNBC Survey Shows (November 2, 2021), available at https://www.cnbc.com/2021/11/02/investors-expect-a-faster-pace-for-fed-rate-hikes-cnbc-survey-shows.html.

[14] Federal Reserve, Summary of Economic Projections (December 15, 2021), available at https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20211215.pdf.

[15] Federal Reserve, Press Release (December 15, 2021), available at https://www.federalreserve.gov/monetarypolicy/files/monetary20211215a1.pdf.

average of 16.86 from 2010-2019. This indicates that equity market volatility levels have settled but continue to remain above the historical mean.

Figure 3: CBOE VIX – January 2010 – December 2021[16]



Q. Has the cost of equity for utility companies been affected by these circumstances?

A. Yes. The cost of equity for regulated utility companies has been affected by the dramatic shifts in market conditions during 2020, the economic recovery in 2021, and the expectations for 2022. In fact, utility company stocks have traded more in-line with the broader market since February 2020 when the COVID-19 pandemic became a concern in financial markets. This higher correlation is reflected in the Beta coefficients, which are the

[16] Source: Bloomberg Professional.

measure of risk in the capital asset pricing model ("CAPM"), where 1.0 is the market average and where higher betas translate to greater risk and higher required equity returns. Beta coefficients have increased substantially between January 2020 and June 2021 for the utility companies used in my cost of capital analysis, and this shift has been sustained through December 2021. Figure 4 presents the average Value Line and Bloomberg Beta coefficients for a representative Utility Peer Group[17] and Sempra Energy over this period. Higher Beta coefficients for utilities signal an increase in relative risk, and therefore a higher return to justify taking on those risks. These higher Beta coefficients reflect direct market evidence of a significant increase in cost of equity for utilities (as measured with the CAPM model). Investors have not viewed the utilities sector as a safe-haven during the capital market conditions associated with COVID-19, and even though bond yields have declined, the cost of equity has increased. Under these circumstances, the CCM cannot be expected to produce reliable results.

Figure 4: Beta Coefficients for Proxy Group and Sempra Energy

	January 2020	**June 2021**	**December 2021**
Utility Peer Group Average			
Value Line Beta	0.56	0.88	0.89
Bloomberg Beta	0.532	0.891	0.884
Sempra Energy			
Value Line Beta	0.70	0.95	1.00
Bloomberg Beta	0.633	0.924	0.926

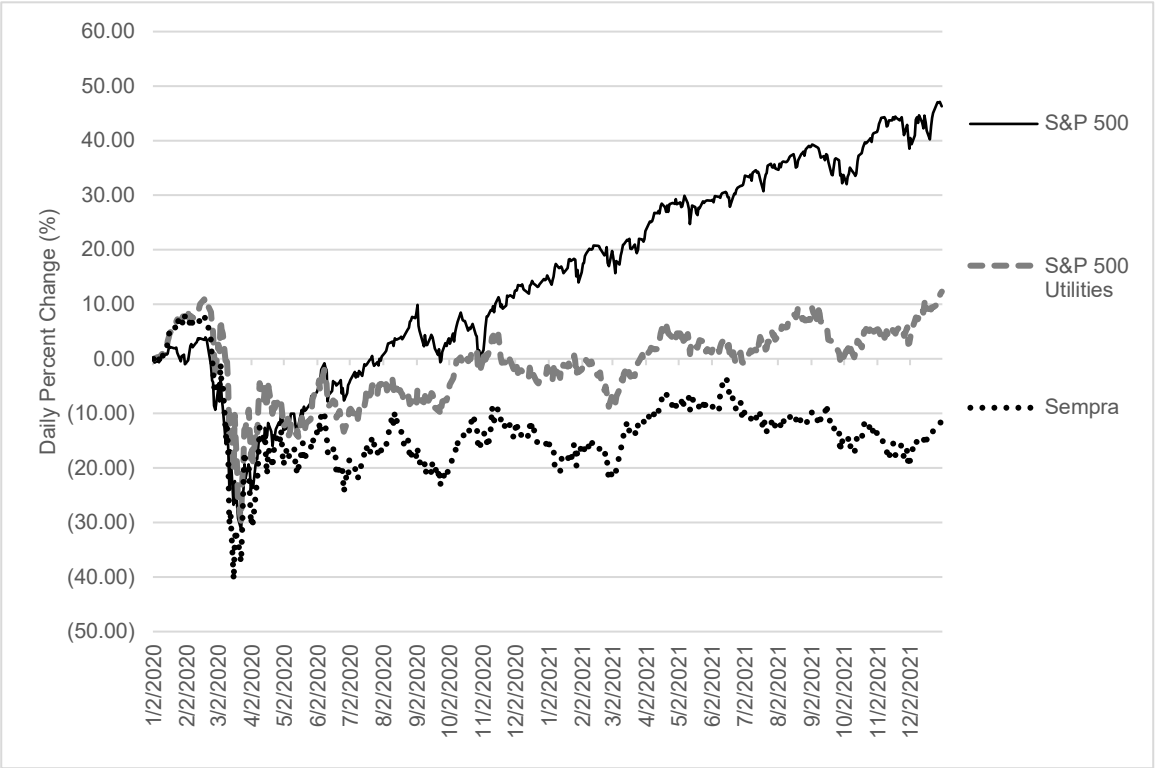
[17] The representative "Utility Peer Group" was selected to include companies that possess a set of business and operating characteristics similar to SDG&E's electric and gas utility operations.

Q. How have utilities performed relative to the broader equity market since the onset of COVID-19?

A. While the overall market has surpassed its pre-pandemic levels, the same is not true with regard to the utility sector. The S&P Utilities sector was one of the worst performing market sectors in 2020, declining by 7.49 percent from the mid-February peak as compared to a 12.57 percent increase for the S&P 500. The only market sectors that underperformed utilities in 2020 were real estate (down 8.30 percent) and energy (down 26.31 percent). At end of year, seven of the other eight market sectors were above their mid-February 2020 levels, led by technology (up 28.09 percent), consumer discretionary (up 22.92 percent), and materials (up 22.26 percent).[18] Figure 5 compares the year-to-date daily performance of the S&P 500 stock market index and the S&P Utilities Index as of December 31, 2021. Performance is shown as the percentage gain from the last trading day of the previous year. As Figure 5 shows, the S&P 500 has largely recovered as it now exceeds its pre-COVID-19 levels. However, the S&P Utilities Index significantly lags the broader market compared to pre-pandemic levels, and Sempra Energy's stock price was more than 20 percent below its pre-pandemic level on September 30, 2021 (the end of the measurement period) and more than 10 percent below its pre-pandemic level on December 31, 2021. A decline in stock price indicates that investors are treating the sector with greater caution as they sort through the implications of the shifting economic environment on utilities. Just as an increase in Beta signals an increase in the cost of equity in the CAPM model, a decline in stock price indicates an increase in the cost of equity in the Discounted Cash Flow ("DCF") model. These are consistent messages from the market data and drive higher estimates of the cost of equity than those considered by the Commission in 2019.

[18] Comparison from February 19, 2020 through December 31, 2020.

Figure 5: Relative Performance of Utilities and the S&P 500, January 2020 – December 2021[19]



As such, following the extraordinary circumstances associated with COVID-19, the monetary and fiscal policy responses, and economic recovery, the utility industry increasing cost of equity diverged from declining interest rates, rendering the CCM adjustment mechanism inappropriate under these circumstances..

III. COST OF EQUITY RELATIVE TO PRE-2022 LEVELS

Q. Please describe the CCM and how it applies to the Company.

A. The CCM was adopted in the 2008 Decision ("D.") 08-03-035 for SDG&E (and California's other major utilities) to provide two methods to assess SDG&E's cost of capital in years that the Company is not required to file a cost of capital application—the adjustment mechanism and a utility's right to file in extraordinary circumstances, as discussed below. It was

[19] Source: S&P Capital IQ Pro.

subsequently continued in D.13-03-015 and D.19-12-056 and is currently in effect for SDG&E. Under the CCM's adjustment mechanism, the mechanism can automatically adjust cost of capital components based on changes in utility bond rates under the assumption that interest rate changes are positively correlated with changes in the cost of equity.

The CCM benchmark rate for SDG&E under the adjustment mechanism is the basis of comparison to determine if future measurement periods "trigger" the CCM. The trigger occurs if the change in the average Moody's Baa utility bond index (the index that applies to SDG&E based on its credit ratings at the time D.19-12-056 was issued) relative to the adjustment mechanism's benchmark is larger than plus or minus 1.00 percent. If a change of more than 1.00 percent occurs and the adjustment mechanism applies, SDG&E's authorized ROE is adjusted upward or downward by one half of the difference between the CCM benchmark and the twelve-month average determined during the CCM period, measured from October through September of each calendar year. While the CCM tracks broad movements in the capital markets by monitoring utility debt yields, extraordinary events can materially impact the cost of equity in ways not reflected in average utility bond yields. In that case, the CCM alternatively provides utilities the right to file a cost of capital application to have a full cost of capital assessment for that year.

Q. Is the CCM's adjustment mechanism an appropriate measure of the cost of capital for 2022 given the extraordinary circumstances associated with COVID-19 that you have described?

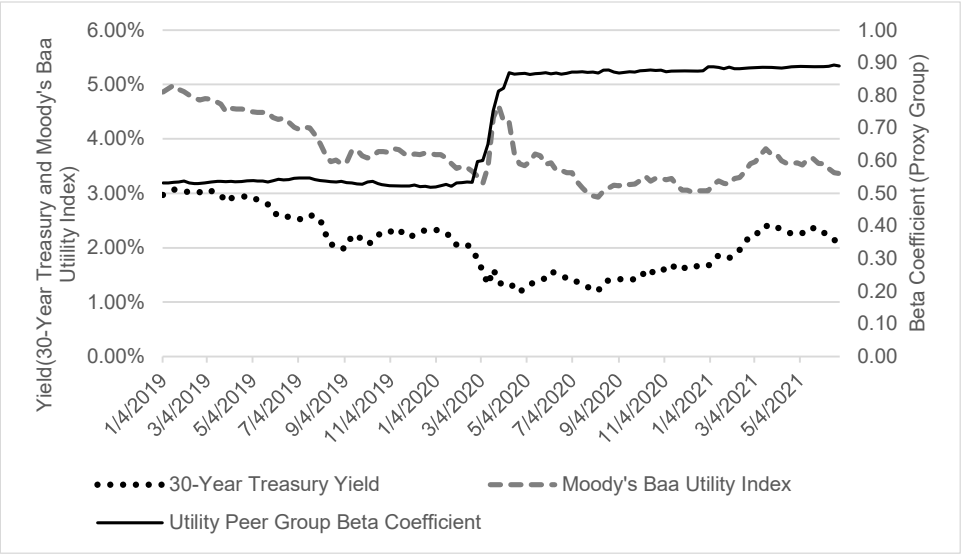
A. No, it is not. As I have described, debt and equity markets have diverged over the course of the pandemic. The CCM adjustment mechanism is an unreliable measure of the cost of equity capital in these market conditions. Further, the Federal Reserve's planned actions in

2022 to significantly increase interest rates in response to economic growth and inflation indicate just how transitory the artificially low interest rates were during the CCM measurement period.

Q. Are there other ways of viewing the divergence in debt and equity market responses to the economic effects of COVID-19?

A. Yes. As described above, the Federal Reserve and U.S. Congress took extraordinary measures to support the economy and stabilize financial markets. But in doing so they drove down interest rates, particularly during the CCM period at issue, as evidenced in the Moody's Baa utility bond index dropping to historically low levels at the beginning of the CCM measurement period in the fall of 2020 and early 2021. Conversely, heightened volatility in equity markets overall, and significantly higher Beta coefficients in the utility industry drove the cost of equity higher. As shown in Figure 6, the risk of equity investments in utility companies has increased since the onset of the COVID-19 pandemic even as interest rates declined.

Figure 6: Cost of Debt and Utility Beta Coefficients, January 2019-November 2021[20]



Under these circumstances, the Moody's utility bond index is not a reliable indicator of the cost of equity for California's utilities, given the degree to which interest rates were influenced by temporary Federal Reserve policies designed to mitigate the impact of the pandemic. As described above, these actions by the Federal Reserve are temporary as the FOMC expects to raise the federal funds rate three times in 2022, and taper its quantitative easing program by reducing its net asset purchases January 2022. As such, Federal Reserve policies in response to the pandemic and the associated capital market conditions that existed in the CCM measurement period will not continue in 2022.

Q. Why would the CCM adjustment mechanism not result in a fair ROE for SDG&E?

A. SDG&E's current ROE of 10.20 percent was authorized in December 2019. While interest rates on government and corporate bonds declined to historically low levels in 2020, they have since rebounded and are projected to increase as fiscal and monetary stimulus programs continue to unwind. Further, the CCM measurement period from October 1, 2020

[20] Source: Bloomberg Professional. Beta coefficients are based on 5-years of weekly returns relative to the S&P 500.

through September 30, 2021 is disconnected from the capital market conditions anticipated for 2022 as the Federal Reserve begins to unwind its policies developed in response to the pandemic. Simultaneously, other measures such as Beta coefficients and declining stock valuations, indicate that equity investors required during the CCM's measurement period (and continue to require now) a higher rate of return from utility investments. This is in opposition to the CCM adjustment mechanism, which is based on an assumed direct relationship between the cost of equity and the Moody's utility bond index that would decrease the cost of equity to 9.62 percent. The CCM adjustment mechanism cannot serve as a reasonable approximation of SDG&E's cost of capital under these circumstances. This is particularly true because of the temporary nature of the monetary and fiscal policies responses to the pandemic, as those actions in 2020 and 2021 do not accurately reflect the cost of equity for 2022, given economic growth, inflation, and the Federal Reserve's increasingly tightening monetary policy.

Q. Are there factors specific to SDG&E's risk profile that suggest that the Company's risk profile is different from most other utilities in the United States?

A. Yes, there are several factors that have a direct bearing on SDG&E's risk profile in relation to other utilities. Those risk factors include: (1) the Company's exposure to Wildfire Risks; (2) the Company's substantial capital expenditure program; (3) California's clean energy mandates; and (4) regulatory risk relative to other jurisdictions.

Q. Please describe the risks that the California utilities face due to the wildfires.

A. Wildfires present unique risks to the California investor-owned utilities for two main reasons. First, wildfires have become more frequent and larger in magnitude over time, creating more opportunities for a utility's equipment to be involved in an ignition. Second, each time a California utility's equipment is involved in the ignition of a fire that creates

economic damages, that utility may face enormous uninsured, and potentially unrecoverable, liabilities.

Under California state law, a legal standard known as inverse condemnation applies when utility equipment is a cause of a wildfire ignition. This doctrine makes utilities strictly liable for liability damages caused by their own facilities, regardless of negligence and other causes. These liabilities may include homeowner insurance claims, uninsured property damage claims, business interruptions, agricultural damages, emotional harm, personal injuries, and other losses.

Q. What unique risks remain after the passage of SB 901 and AB 1054?

A. Assembly Bill 1054 ("AB 1054") was signed into law by Governor Newsom on July 12, 2019, creating a Wildfire Fund to mitigate the effects of wildfire liabilities on utilities. There are several significant wildfire risks remaining after the enactment of AB 1054 that do not apply to utilities outside California. Principal among these are the following:

- The legal standard known as inverse condemnation was unchanged by AB 1054. Under this doctrine, utilities remain strictly liable when their equipment is the cause of a wildfire ignition, regardless of whether the utility acted reasonably and showed no negligence. So even though AB 1054 may cap the utilities' ultimate liability, this is a unique risk in California. Credit rating agencies continue to recognize this doctrine as a credit constraint,[21] and equity analysts continue to apply a discount to Sempra's stock price based on inverse condemnation's continuation.[22]
- There is no precedent for the CPUC operating under the revised prudence standard or other regulatory aspects articulated in AB 1054. The impact on the CPUC's determination of prudence is uncharted water with the potential for significant impact on shareholders. The risk reducing effect of the adoption of the "industry norm" for

[21] *See, e.g.*, Fitch Ratings, Fitch Affirms San Diego Gas & Electric's IDR at 'BBB+; Outlook Revised to Stable (July 17, 2019) at 1; *see also* RRA, California Regulatory Review (Dec. 14, 2020) at 2 (noting that AB 1054 "does nothing to alter the inverse condemnation policy, thus a substantial risk for PG&E and other utilities in the state remains.").

[22] *See* Wells Fargo, *Sempra Energy* at 3 (June 29, 2021) (stating that the discount applied to California electric utilities reflects "lingering risks related to CA's inverse condemnation policy and highly politicized regulatory environment, partially offset by a highly supportive 5-year rate plan and separately, constructive FERC regulation.").

prudence depends on how the CPUC implements the standard for utilities operating under the Wildfire Fund. For example, if the CPUC were to adopt a view that it only takes minimal evidence to overcome the presumption of prudence and shift the burden of proof, then the risk reducing effect is minimal. The only relevant precedent of a CPUC prudence review is the Commission's 2017 100 percent imprudence finding regarding SDG&E's 2007 wildfires, further increasing uncertainty. Moody's noted that it could again downgrade SDG&E's credit rating if there is an "unsupportive application of the new prudency standard."[23]

- There are ongoing concerns about the Wildfire Fund's durability. The Fund was created by a combination of State and utility funding totaling $21 billion. Governor Newsome's Strike Force retained an energy advisory firm, Filsinger Energy Partners, ("Filsinger") to measure the probability of exhausting the Wildfire Fund. Filsinger estimated various probabilities for the Fund's exhaustion, ranging from 0.1% to 21.9% by the year 2035, depending on the likelihood of the CPUC finding the utility to be imprudent (Filsinger's estimated that the amount of prudence findings would range from 25% to 75%). This assumed a median wildfire loss of $7 billion per year based upon the experience of the previous five years.[24] If the Fund is exhausted, the risk reducing benefits of the imprudence liability cap and liquidity supported by the Fund are negated. Although the fund's liquidity is not an immediate concern, it is a risk that weighs down SDG&E's current credit ratings.[25]

- Under AB 1054, a utility's insurance coverage is subject to a recommendation of "reasonable insurance coverage" by the Fund Administrator. If the Administrator should recommend a lower insurance level, and if adopted by the CPUC, the utility's shareholders would be subject to greater risk.

- The imprudence liability cap, which is approximately $950 million for SDG&E, can also be nullified by the Wildfire Fund Administrator if the Administrator concludes that the utility has acted in a manner that constitutes "conscious or willful disregard of the rights and safety of others"[26] or if a utility does not possess a safety certificate.

Lastly, it must be recognized that the magnitude of wildfire risk is unique to California.

Post AB 1054, the state's utilities still bear more risk than their industry peers. As a result,

---

[23] Moody's, Ratings Action: Moody's upgrades San Diego Gas & Electric to A3 from Baa1; outlook stable (March 30, 2021) at 2.

[24] California Wildfire Fund Durability Analysis, Filsinger Energy Partners, June 26, 2019, pp. 2 - 3, assuming a 20% cap, as ultimately adopted; *see also* Moody's, *Rating Action: Moody's affirms San Diego Gas & Electric's ratings; changes outlook to positive from negative*, dated July 29, 2019 at 1 (referencing Filsinger analysis).

[25] S&P, How are California's Wildfire Risks Affecting Utility Credit Quality (Jun. 3, 2021); Moody's Investors Service, San Diego Gas & Electric Company, Update to credit analysis following upgrade to A3 (May 10, 2021).

[26] AB 1054, Chapter 3. Operations of the Fund, (3)(A).

the combination of risk-reducing elements of the legislation and these remaining uncertainties following implementation cannot be measured within a standard industry peer group. Thinking about this from an investor's perspective, with all other risks being equal, why would an investor choose to invest in a California utility company without a premium for bearing that additional risk?

Q. Please discuss SDG&E's capital spending program.

A. The Company plans a major capital investment program over the 2021-2025 period, totaling $9.45 billion, which will result in an unprecedented increase in the Company's invested plant. As with any utility facing substantial capital expenditure requirements, the Company's risk profile is affected in two significant and related ways: (1) the heightened level of investment increases the risk of under recovery or delayed recovery of the invested capital; and (2) an inadequate return would put downward pressure on key credit metrics. The absolute level of investment required will put significant pressure on the Company's ability to raise capital, and the terms will have lasting impacts for the Company's customers.

Q. Please describe the environmental mandates that will be required by SDG&E to achieve California's clean energy goals.

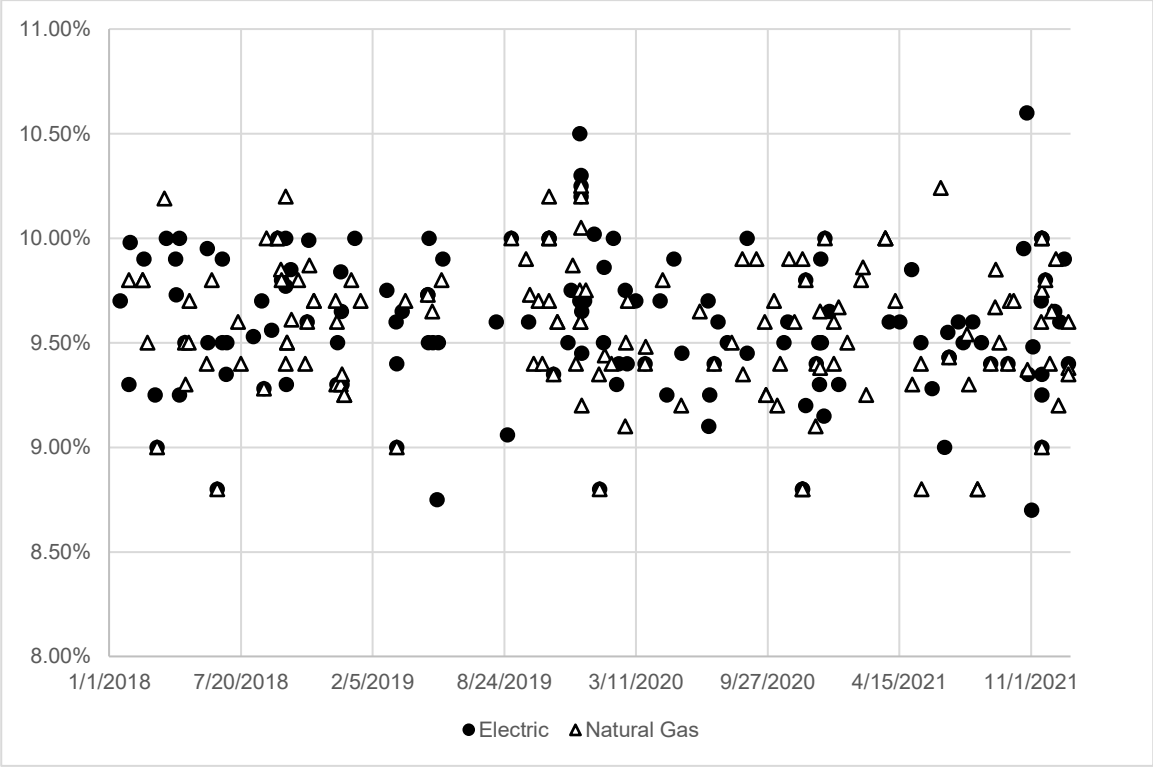
A. Senate Bill 100 ("SB 100") requires each California electric utility, including SDG&E, to procure 50 percent of its annual electric energy requirements from renewable energy sources by 2026, and 60 percent by 2030. In addition, SB 100 creates the policy of meeting all of California's retail electricity supply with a mix of Renewable Portfolio Standard ("RPS") Program-eligible and zero-carbon resources by 2045.[27]

[27] Sempra Energy, 2020 SEC Form 10-K (February 27, 2020) at 43.

Q. How do these risk factors relate to SDG&E's cost of equity?

A. SDG&E's risk profile is above the average risk of most utilities in the United States. Therefore, it would be reasonable for SDG&E's ROE to be set at the top of the range of authorized returns. Figure 7 below, demonstrates that authorized returns for utilities have been consistent in the periods preceding, and subsequent to the CCM measurement period. As such, the CCM adjustment mechanism's decrease to SDG&E's return would be inconsistent with the trends in authorized returns and would not reflect SDG&E's above average industry risk.

Figure 7: Authorized ROEs 2018-2021



An ROE at the Company's currently authorized level would continue to provide a return that is at the top end of the range of recently authorized returns, and consistent with SD&GE's risk profile.

IV. CONCLUSION

Q. How has the CCM been affected by capital market conditions?

A. Capital market conditions were significantly impacted in 2020 and 2021 due to the extraordinary circumstances of the economic impacts of the COVID-19 pandemic. The CCM is based on a direct relationship between the cost of equity and the Moody's utility bond index. However, the Moody's utility bond index, which is a measure of debt yields, is an unreliable measure of the cost of equity under these unique circumstances. Measures taken to contain COVID-19 resulted in different impacts on debt markets and equity markets. Debt yields were driven lower by an aggressive and unprecedented level of federal government action designed to support the economy. The low interest rate environment has been directly attributable to temporary steps the Federal Reserve has taken to contain the economic effects of COVID-19, including reducing the federal funds rates and taking additional measures to support the U.S. economy and provide liquidity and stability in financial markets. Equity investors, responding to increased levels of risk and market volatility, required higher returns. Given the uncertainty and volatility that have characterized capital markets since February 2020, the increase in relative risk to the utility industry (as measured by Beta) compared to the broader market, and the pressures cited by S&P on utility credit quality, it is reasonable that equity investors would require a higher ROE to compensate them for the additional risk associated with owning common stock.

So debt and equity returns have moved in opposite directions, particularly for utilities. Because the cost of equity for utilities has not tracked the cost of debt, the CCM adjustment mechanism cannot be expected to produce a reliable result under the capital market conditions which prevailed during the CCM measurement period. Moreover, those actions were temporary; the Federal Reserve's plan to increase interest rates demonstrates

that the CCM would not provide an accurate cost of capital for 2022. Therefore, the cost of capital should not be adjusted according to the CCM adjustment mechanism methodology. The CCM should be suspended for 2022.

Q. Does this conclude your opening testimony?

A. Yes, it does.

JMC-1

COYNE RESUME