Application: A.21-08-013 (consolidated)
Witness: Valerie A. Bille
Exhibit: SDG&E-08

PREPARED REBUTTAL TESTIMONY OF

VALERIE A. BILLE

SDG&E POSITION REGARDING SCOPING MEMO PHASE ONE QUESTIONS

ON BEHALF OF SAN DIEGO GAS & ELECTRIC COMPANY

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

FEBRUARY 14, 2022

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I. INTRODUCTION

Instead of focusing on the relevant question—should the CCM Adjustment Mechanism[1] be suspended for 2022 based upon the impacts of the COVID-19 pandemic and the Federal Reserve's significant actions to minimize the pandemic's economic impacts—intervenors[2] largely focus on irrelevant issues or time periods. But once these distractions are set aside, intervenors largely do not challenge—and in some cases support—the basic facts demonstrating that the CCM cannot function as intended, that the Utilities'[3] stock has underperformed the broader market, and that the pandemic-related conditions and government response was temporary and not applicable to 2022, warranting a suspension of the CCM.[4]

The Adjustment Mechanism is based solely on interest rates; it only provides an accurate measurement if changes in interest rates reflect changes in the cost of equity. But as James Coyne testifies, during the pandemic and corresponding CCM measurement period (October 1, 2020-September 30, 2021), interest rates and the cost of equity diverged. As S&P states, "long-

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[1] All definitions from Exhibit SDG&E-06 (Bille) apply to this testimony. *See* D.08-05-035 ("2008 Decision") at 15-16 (describing the Adjustment Mechanism). If any individual issue is not address in this rebuttal testimony it does not imply agreement by SDG&E with any argument, position, or proposal asserted by parties.

[2] The following intervenor parties offered testimony: California Advocates ("CalPA"); Environmental Defense Fund ("EDF"); Federal Executive Agencies ("FEA"); Protect Our Communities Foundation ("PCF"); The Utility Reform Network ("TURN"); United Consumers' Action Network ("UCAN"); and Wild Tree Foundation ("WTF")

[3] The "Utilities" or "California Utilities" collectively consist of the filing utilities, San Diego Gas & Electric Company ("SDG&E"), Pacific Gas and Electric Company ("PG&E"), and Southern California Edison Company ("SCE").

[4] *See* Assigned Commission's Scoping Memorandum and Ruling (December 24, 2021) ('Scoping Memo") at 7 ("Are there extraordinary circumstances that warrant a departure from the CCM in 2022?").

term bond yields have been artificially suppressed due to the Fed's unprecedented intervention in the capital markets."[5] The cost of equity, however, did not decrease—reflected in utilities' stock underperformance and increase in beta.[6]

As intervenors acknowledge, utility commissions nationwide have recognized that the cost of equity has not decreased in tandem with interest rates that were lowered by the Federal Reserve's actions.[7] This is reflected in the (at most) modest reduction in the national authorized ROE average. As even intervenors admit, the CCM would reduce the Utilities' ROE by far more than any minimal decline in nationwide authorized ROE during the pandemic.

Intervenors also largely acknowledge that utility stocks underperformed the broader market. And no intervenor seemingly challenges that the California Utilities' stocks have underperformed the S&P utility 500 and S&P 500.

Intervenors instead largely focus on irrelevant issues such as the Utilities' earnings and/or "regulatory mechanisms" for cost recovery. But even accepting the intervenors' arguments as true, this proves the very point. If intervenors acknowledge that SDG&E faces (at least) the same risks it did at the time of the 2019 Decision, that it has had strong earnings, and that it has certain regulatory protections for pandemic-related cost recovery, then there is no other explanation for why utilities generally, and the California Utilities specifically, stock price has underperformed throughout the pandemic and CCM measurement period but for the pandemic's material impact.

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[5] *See* S&P, The Big Picture: 2022 Electric, Natural Gas and Water Utilities Outlook (Oct 2021) ("S&P Oct. 2021") at 5.

[6] Prepared Rebuttal Testimony of James Coyne (Feb. 14, 2022) ("SDG&E-09 (Coyne)") at JMC-3.

[7] S&P Oct. 2021 at 5 ("Authorized returns have been somewhat resistant to the decline in interest rates.").

Moreover, intervenors' focus on economic conditions returning to pre-pandemic levels in 2022 as the Federal Reserve tightens monetary policy and interest rates increase underscores that the conditions that existed during the Measurement Period that caused the Adjustment Mechanism to trigger were a temporary anomaly that no longer exist. Because the CCM cannot function as intended and the conditions that resulted in the CCM triggering are transitory and do not apply in 2022, the Commission should suspend the CCM Adjustment Mechanism and maintain SDG&E's current, already approved, cost of capital.

II. INTERVENORS' TESTIMONY SUPPORTS THAT THE ADJUSTMENT MECHANISM WOULD NOT ACCURATELY MEASURE CHANGES IN THE COST OF CAPITAL FOR 2022

The "purpose of the CCM is to relieve California utilities of the burden of annual full cost of capital applications and proceedings before the Commission."[8] It provides a simplified measure to assess changes in the cost of capital in interim years based upon changes in interest rates. As the Commission stated in adopting the CCM Adjustment Mechanism, the Mechanism's purpose is "to gauge changes in interest rates that also indicate changes in the equity costs of utilities."[9] But in creating the CCM Adjustment Mechanism, the Commission recognized that circumstances would exist where changes in interest rates would not accurately reflect changes in the cost of equity.[10]

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[8] UCAN (Pavlovic) at 5 (citing D.08-05-035 at 3).

[9] D.08-05-035 at 18, Finding of Fact ("FoF") 16.

[10] D.08-05-035 at 19, Conclusion of Law ("CoL") 6 (providing utilities the right to file an application upon an extraordinary event that "materially impacts [the utilities'] respective cost of capital and/or capital structure and impacts them differently than the overall markets."); Scoping Memo at 5 ("Do the financial impacts on the Utilities described in the applications, where they are largely attributed to the COVID-19 pandemic, constitute an extraordinary or catastrophic event that materially impacts their respective cost of capital and/or capital structure and impacts them differently than the overall financial markets?"(citation omitted)).

The Intervenors support that such circumstances exist here. Intervenors acknowledge that interest rates have not tracked the cost of equity, that utilities have underperformed the broader stock market, and that the conditions that existed during the CCM's measurement period were temporary and anomalous, supporting the CCM's suspension for 2022.

A. Intervenors Acknowledge That Interest Rates Have Not Tracked the Cost of Equity and that Utilities Have Underperformed the Stock Market

The CCM Adjustment Mechanism cannot provide an accurate measurement of the cost of capital for 2022 due to the COVID-19 pandemic and the Federal Reserve's resulting "unprecedented intervention in the capital markets" to "artificially suppress" interest rates.[11] As Mr. Coyne testifies, the CCM's premise that changes in interest rates reflected correlated changes in the cost of equity ceased to function. While interest rates were significantly lowered by the pandemic and federal government's extensive response, the cost of equity did not decrease in the same manner.[12] Notably, the last time that there was a divergence between interest rates and the cost of debt in 2009, the Commission granted a petition for modification based on that divergence.[13]

The Utilities were materially impacted and affected differently than the market generally—as demonstrated by an increase in utility betas from before the pandemic compared to during the pandemic[14] and the underperformance of utilities relative to the stock market

[11] S&P Oct 2021 at 5.

[12] *See* SDG&E-09 (Coyne) at JMC-2 and JMC-6.

[13] D.09-10-016 at 3. Dr. McCann's statement that "[n]o one can imagine that the utilities would request a suspension if the benchmark bond rate went *up* more than 100 basis points, triggering an increase in the authorized ROE", is thus incorrect because it already happened. EDF (McCann) at 7 (emphasis included).

[14] SDG&E-09 (Coyne) at JMC-3 – JMC-4 and JMC-10 – JMC-14.

generally.[15] The California Utilities even further underperformed the utility index. Sempra Energy's stock was down more than 20 percent below its pre-pandemic level on September 30, 2021 (compared to the S&P 500 being up 29% and the S&P Utilities 500 being down only 8% over that same period).[16]

Intervenors do not undercut these core facts. Mr. Gorman acknowledges that the "declines in short-term interest rates are a direct result of the Federal Reserve changing its monetary policy . . . to support U.S. economic activity, employment levels, and to influence inflationary pressures."[17] Although intervenors largely focus on how the beta measurement is conducted or what time period is used for measurement, utility betas still increased when comparing the same beta measurement from before the pandemic through the CCM measurement period at issue—even if February-April 2020 is removed.[18]

Intervenors likewise largely do not challenge that the cost of equity diverged from interest rates.[19] And they generally recognize that, while the overall market increased, utilities underperformed the market during the Measurement Period:

- EDF (Dr. McCann)—"Since March 2020, share prices for utilities have not risen as much as the broader market indices;"[20]
- TURN (Ms. Dowdell)—"It is not surprising that utility P/Es have decreased relative to other sectors and the broader market;"[21]

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[15] *Id.* at JMC-6.

[16] *Id.*

[17] EPUC/IS (Gorman) at 17.

[18] SDG&E-09 (Coyne) at JMC-4, JMC-12.

[19] *See id.* at JMC-6.

[20] EDF (McCann) at 24.

[21] TURN (Dowdell) at 21.

- UCAN (Mr. Pavlovic)—"At best one can say that the continuing pandemic may have slowed the growth of utility stock prices;"[22]
- WTF (Mr. Rothschild)—Noting "electric utility stocks initially fell slightly more than the overall market (about 36% off their peak versus 34% for the S&P 500) and have lagged the market's recovery;"[23] and
- PCF (Mr. Ellis)—"stock returns of the US utility sector as a whole and of the California Utilities individually have not kept pace with the market average since the onset of the pandemic."[24]

Nor does any party contest that the California Utilities' stocks underperformed the S&P Utility 500, to say nothing of the S&P 500.[25]

B. Intervenors Acknowledge that Utility Commissions Nationwide Have Recognized the Divergence Between Interest Rates and the Cost of Equity and Have Not Reduced ROEs by as Much as the CCM Would

Intervenors further acknowledge that CCM would result in a far larger reduction in ROE than the, at most, modest decline in nationwide authorized ROEs during the pandemic, underscoring the divergence between interest rates and the cost of equity.[26] That is, state utility commissions have seemingly found that the reduction in interest rates brought about by the Federal Reserve's actions to minimize the pandemic's impacts do not reflect changes in the cost of equity—and have avoided reducing ROEs to correspond with the reduction in interest rates in the manner that the CCM Adjustment Mechanism would.[27] As S&P stated in October 2021:

> While authorized ROEs generally move directionally with Treasury Bond yields, over the past several years, state commissions have approved ROEs that contain a higher premium over Treasury bond yields than have historically prevailed. State utility commissions have recognized that long-term bond yields have been

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[22] UCAN (Pavlovic) at 13. The same is true for the Dow Jones Utility Average relative to the Dow Jones Industrial Average. *See* SDG&E-09 (Coyne) at JMC-7 – JMC-8 and Figure 1.

[23] WTF (Rothschild) at 27.

[24] PCF (Ellis) at 48.

[25] *See* SDGE-09 (Coyne) at JMC-6.

[26] *See, e.g.*, CalPa (Woolridge) at 11.

[27] *See generally* SDG&E-09 (Coyne) at JMC-15 – JMC-19.

> artificially suppressed due to the Fed's unprecedent intervention in the capital markets. As such, authorized returns have been somewhat resistant to the decline in interest rates, with the spread increasing as interest rates decline.[28]

This is reflected in the electric utilities' national authorized ROE data.[29] RRA recently stated that the "average ROEs authorized electric utilities was 9.41% in rate cases decided in the first nine months of 2021, in line with the 9.44% average for cases in full year 2020."[30]

Intervenors acknowledge this largely stagnant nature of national authorized ROE averages. As Mr. Griffing testifies, "later authorized ROEs are consistent with pre-pandemic authorized ROEs."[31] Mr. Gorman similarly avers that the average and median ROE for electric utilities has slightly *increased* between 2020 and 2021.[32] Intervenors alternatively compare the national authorized ROE average from 2019 to 2021,[33] with Mr. Gorman testifying that there

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[28] S&P Oct. 2021 at 5; *see also* EPUC/IS (Gorman) at 29 (citing the same S&P Report); RRA, Major Energy Rate Case Decisions – January-December 2021, at 2 (Feb. 10, 2022) (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").

[29] *See* D.19-12-056 at 42 (observing the prior year's (2018) RRA national average).

[30] S&P, RRA, Focus Notes (Jan. 10, 2022) at 9. RRA, Major Energy Rate Case Decisions – January-December 2021, at 2 (Feb. 10, 2022) (showing the all-electric ROE average for 2021 as 9.38%). Concededly, certain intervenors offer slightly different 2021 averages based upon modifying what electric utilities are included. *Compare* PCF (Ellis) at 48, Figure 17, (citing S&P Global Market Intelligence, 2021 nationwide authorized average of 9.43%) *with* CalPA (Woolridge) at 11 (asserting a 2021 average of 9.38%); EPUC/IS (Gorman) at 26 (asserting a 2021 average of 9.39%). Notably, in the 2019 Decision, the Commission seemingly relied upon the "all cases" electric average from 2018. D.19-12-056 at 42.

[31] *See, e.g.*, UCAN (Griffing) at 14.

[32] EPUC/IS (Gorman) at 27, Table 8. *See* SDG&E-09 (Coyne) at JMC-16.

[33] *See* PCF (Ellis) at 46 (asserting a 26-basis point reduction between August 2019 to the end of 2021).

was a 25-point basis point decline (from 9.64% to 9.39%) over this two-year period[34](it was 9.60% in 2018, the year cited in the Commission's 2019 Decision).[35]

Yet even if there has been a modest decline in national authorized ROEs during the pandemic, that decline is far smaller than the nearly 60-basis point change that would result from the CCM Adjustment Mechanism. The CCM would reduce the California Utilities' ROEs to within about 20 basis points of the 2021 national authorized ROE average[36]—without anything about that average, the cost of equity, or the Utilities' risk profile justifying such a sudden change.[37] Although Ms. Dowdell asserts that the Utilities' current ROEs are as "much as 86 bps higher" than the 2020 ROE average of 9.44% (for SDG&E it is 76 basis points),[38] this differential already existed in 2021 and remains consistent with the Commission's 2019 Decision, where the Commission set the Utilities' ROEs by as much as 70 basis points higher than the 2018 national authorized ROE average.[39]

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[34] EPUC/IS (Gorman) at 26 (asserting that the electric industry authorized ROE was 9.64% in 2019 and 9.39% in 2021); *see* TURN (Dowdell) at 13 n.60 (stating that the "[a]verage 2019 ROE was 9.65"); RRA Regulatory Focus Major Rate Case Decisions Jan-Dec 2020 (providing an all-electric 2019 average of 9.66%).

[35] Contrary to Mr. Ellis's claim (PCF (Ellis) at 47), SDG&E has identified the modest decline in authorized all electric ROE since the Commission's 2019 Decision. *See* SDG&E-06 (Bille) at VAB-19.

[36] *See* Woolridge at 13 (identifying that the CCM Adjustment Mechanism would reduce the Utilities' ROE by 50-60 bps, moving those ROEs within 20-30 bps of the 2021 authorized ROE average); O'Donnell at 12 (recognizing that the Utilities' risks have not lessened since the 2019 Decision); Gorman at 31 (citing the ongoing concerns with wildfire-related issues) (citing Moody's Credit Opinion for SCE (Dec. 27, 2021)).

[37] Moreover, as Mr. Coyne testifies, in the 37 instances where a utility filed multiple rate cases between 2019 and 2021, in 70 percent of those cases the authorized ROE was either unchanged or increased, with the maximum reduction being only 32 basis points. *See* SDG&E-09 (Coyne) at JMC-17 – JMC-18 and Figure 4.

[38] TURN (Dowdell) at 4.

[39] D.19-12-056 at 43 (observing that it was that it was setting the approved ROEs "significantly higher than the 9.60% average ROEs granted to United States electric utilities during 2018." (citation omitted).).

By contrast, as noted, implementing the CCM Adjustment Mechanism would move the Utilities' ROE placement much closer to the nationwide authorized average than the Commission approved in the 2019 Decision. While several intervenors focus on the fact that the ROEs for SDG&E and PG&E (but not SCE) resulting from the CCM Adjustment Mechanism would still be at the very bottom of the "just and reasonable" ranges established by the Commission its 2019 Decision,[40] such a placement would be contrary to the Commission's findings in that Decision that the Utilities' authorized ROEs should be at the "'upper end of the just and reasonable ranges'"[41] Credit rating agencies have found that—given the California Utilities' wildfire-related risks—that the Utilities having authorized ROEs above the industry average have been credit supportive.[42] The CCM Adjustment Mechanism would largely remove that support.[43] Implementing the CCM would thus be inconsistent with, as intervenors acknowledge, other utility commissions' recognitions that the artificial reduction in interest rates does not reflect corresponding changes in ROE.

C. Intervenors Acknowledge That the Temporary Nature of the Economic Conditions That Existed During the CCM Measurement Period No Longer Exist, Further Supporting Suspension

Finally, intervenors' repeated recognition that the economic conditions that existed during the Measurement Period resulting from the pandemic and the Federal Reserve's extensive

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[40] *See* EPUC/IS (Gorman) at 6; TURN (Dowdell) at 13.

[41] TURN (Dowdell) at 13 (quoting D.19-12-056 at 40-41).

[42] *See* EPUC/IS (Gorman) at 31 (citing S&P Global Ratings, Ratings Direct: PG&E Corp (May. 20, 2021); RRA, California Regulatory Review (Dec. 14, 2020) at 1-2 (discussing how above-average rate of returns help counteract the increased risk of wildfires, inverse condemnation, and uncertain cost recovery in California).

[43] S&P, North America Regulated Utilities' Negative Outlook Could See Modest Improvement (Jan. 10, 2021) at 3 (noting that a primary ongoing threat to utility credit quality is weaker than expected rate cases).

response were temporary and are diminishing further support suspending the CCM, the Mechanism would not provide an accurate measurement for 2022.[44] Indeed, intervenors spend much of their testimony emphasizing how current market conditions do not reflect those during the pandemic and the CCM measurement period at issue—asserting that the economic impacts of the pandemic "largely abated" during 2021,[45] and that economic activity from the fourth-quarter 2021 to the present is "on par with pre-pandemic" levels.[46]

Intervenors repeatedly assert that utilities' increase in beta was "transient,"[47] as was utilities' stock underperformance relative to the market and the divergence between interest rates and the cost of equity. As Mr. Gorman states, "[m]ore recent beta estimates suggest that as economy has recovered, and has observable risk premiums between Treasury and utility bonds as a return to more normal levels, and also measures of beta have returned to more normal levels."[48] Several intervenors notably focus on the S&P Utility 500's performance through the second half of 2021 and early 2022 (ignoring much of the CCM's measurement period and incorporating data from after the applicable period),[49] arguing that, "as of January 20, 2022, the gap between the S&P 500 Index and S&P Utilities Index has substantially closed."[50]

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44 *See* SDG&E-09 (Coyne) at JMC-6 and JMC-20 – JMC-21.

45 EPUC/IS (Gorman) at 10.

46 EDF (McCann) at 9.

47 TURN (Dowdell) at 20.

48 EPUC/IS (Gorman) at 33.

49 *See, e.g.*, *id.* at 15, figure 1 (providing data from June 30, 2021 through January 16, 2022); WTF (Rothschild) at 30 and chart 8 (focusing on his proxy group's performance from July 1, 2021 through December 30, 2021).

50 PCF (Ellis) at 53. Notably, Sempra's stock price remains below its February 21, 2020 pre-pandemic levels.

Likewise, intervenors largely agree that the Federal Reserve is now withdrawing its expansive intervention in the market, "allow[ing] short-term interest rates to increase in 2022."[51] Specifically, as intervenors indicate, the Federal Reserve curtailed quantitative easing beginning in November 2021[52] and is expected to raise the federal funds rate at least three times in 2022, with the first rate increase expected in March.[53] As of February 14, 2022, the 10-year Treasury was already above two percent before *any* Federal Reserve rate increases[54]—it averaged 1.28% for the Measurement Period.[55] According to Mr. Gorman, this interest rate increase is expected to continue, with investors expecting the 10-Year Treasury to average around two percent in 2022.[56]

Yet intervenors' focus on economic conditions such as utility stock underperformance or increased utility betas during the pandemic being abnormal, temporary, and no longer existing only underscores why the CCM should be suspended. For example, the fact that the S&P utility 500 is now better tracking the broader market indicates that it *was not* doing so during the pandemic and CCM measurement period.

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[51] EPUC/IS (Gorman) at 17.

[52] *See* UCAN Response to SDG&E DR 1 (Griffing), Response 6 ("Q: Does Dr. Griffing agree that the Federal Reserve has already begun tapering its monthly purchase of bonds (i.e., reducing the amount of bonds it is buying month) under its 'quantitative easing' program that it began in response to the COVID-19 pandemic? If not, please explain in detail why this is incorrect. A: Dr. Griffing agrees that the Federal Open Market Committee of the Federal Reserve began reducing its monthly purchases of Treasury securities and mortgage-backed securities in November 2021 (citation omitted), Appendix A, VAB-A-6.

[53] Rothschild at 31 (citation omitted); *see generally* SDG&E-09 (Coyne) at JMC-20 – JMC-21.

[54] https://www.cnbc.com/quotes/US10Y.

[55] SDG&E-09 (Coyne) at JMC-2.

[56] EPUC/IS (Gorman) at 22 (citing *Blue Chip Financial Forecasts*, January 1, 2022); *see also* WTF Response to PG&E DR No. 4, Q 13 Response ("If inflation increases, interest rates will likely rise as well. This occurs because lenders will demand higher interest rates as compensation for the decrease in purchasing power of the money they are paid in the future."), Appendix A, VAB-A-10.

Nor would the CCM accurately reflect "*current* market conditions and investors' *current* expectations for 2022."[57] As S&P states, it "expects ROEs may increase" as interest rates rise.[58] Regardless of the absolute amount of increase in interest rates, the low interest rate environment that existed during the Measurement Period is not indicative of 2022.

In sum, as the Federal Reserve reduces its monetary intervention, the fact that economic conditions have stabilized, the relationship between the cost of equity and interest rates is normalizing, and utility stock performance is now more consistent with the broader market all indicate that the conditions during the pandemic and CCM measurement period were anomalous and reflected temporary conditions do not provide an accurate measurement of the forward-looking cost of capital for 2022. As Dr. McCann states, ROE should not be set based upon "short-term spikes and dips."[59]

III. INTERVENORS' FOCUS ON UNRELATED MATTERS DOES NOT SUPPORT IMPLEMENTING THE CCM

Largely agreeing that the cost of equity has not tracked interest rates, that utility stocks have underperformed the broader market, and that the conditions during the CCM measurement period were temporary and do not reflect circumstances in 2022, intervenors instead focus on issues unrelated to the question of whether the pandemic and government response was an extraordinary event that materially impacted the Utilities' "*cost of capital* and … [affected the Utilities] differently than the overall financial markets."[60] Such attempts to distract from the relevant issue should be ignored.

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[57] WTF (Ellis) at 44.

[58] EPUC/IS (Gorman) at 29 (citing S&P Oct. 2021, Report at 5).

[59] EDF (McCann) at 24.

[60] Scoping Memo at 5 (citation omitted) (emphasis added).

For example, intervenors repeatedly emphasize that the cost of debt has declined[61] and that utilities can access capital markets.[62] Yet Utilities have readily acknowledged that interest rates have declined—that is why the CCM Adjustment Mechanism would have triggered. But this issue is distinct from the cost of equity. And the issue is at what cost the Utilities can access the capital markets, not whether they can do so.

Similarly, a focus on whether and how the COVID-19 pandemic impacted SDG&E and the other Utilities' operations—such as Sempra's 2020 Form 10-K disclosure[63]—is separate from the impact on the Utilities' cost of equity and whether the CCM Adjustment Mechanism accurately reflects changes in the cost of equity. Moreover, as Sempra added in that 10-K, it was "conducting business with substantial modifications," and that "emergency customer protections . . . have resulted in a reduction in payments received from our customers and an increase in uncollectible accounts."[64]

Intervenors likewise concentrate on the Utilities' rates, earnings,[65] decoupling, or regulatory mechanisms; particularly the deferral of uncollectible expenses resulting from

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[61] *See* CalPa (Woolridge) at 5-6 (discussing Utilities' raising capital through debt); EPUC/IS (Gorman) at 6, 29-30 (same); FEA (O'Donnell) at 9 (same); UCAN (Pavlovic) at 22 (same).

[62] *See* TURN (Dowdell) at 12.

[63] *See* PCF (Ellis) at 7 ("'[t]o date, the COVID-19 pandemic has not had a material impact on our results of operations'") (quoting Sempra Energy 2020 10-K (Feb. 25, 2021) at 37.).

[64] Sempra Energy 2020 10-K (Feb. 25, 2021) at 37 ("COVID-19 pandemic is materially impacting communities, supply chains and markets around the world").

[65] *See, e.g.*, CalPA (Woolridge) at 11 (earnings); TURN (Dowdell) at 2, 19 (discussing rates, earnings and "constructive California regulatory mechanisms").

disconnection moratoriums.[66] As S&P detailed, those moratoriums had a distinct impact of decreasing utilities' operating cash flows during the pandemic by about 10 percent.[67]

But more importantly, the intervenors' arguments underscore why the CCM based on the Measurement Period should be suspended. If the Utilities' risks and credit ratings have largely remained the same since prior to the pandemic,[68] and the Utilities have had strong earnings, a reasonably conducive regulatory environment to cost recovery outside of wildfire-related issues,[69]and low interest rates, then there is no other explanation for utilities' stock market underperformance and increased betas other than the increased risks for utilities resulting from the pandemic.

Similarly, Ms. Dowdell's focus on the fact that certain other sectors in addition to utilities were negatively impacted by the pandemic and federal government response[70] is both an acknowledgement of the material and differential impact on utilities and otherwise not relevant. The standard is whether utilities were affected differently than the overall financial markets; not every individual sector.

Nor can intervenors alter the relevant time period for assessing the CCM. Comparing conditions at the time of the 2019 Decision or even earlier, including to relitigate the 2019

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66 EPUC/IS (Gorman) at 30-31 (citing California's Average-2 regulatory rating).

67 S&P, *Although U.S Regulated Utilities' Operating Cash Flows are Set to Rebound from COVID-19, Credit Quality Remains Pressured* (Dec. 13, 2021), at 3; *see id.* at 5 (The California Utilities were two of the top three and three of the top ten utilities nationwide with the largest increases in accounts receivable in 2020).

68 *See* FEA (O'Donnell) at 12 ("I do not believe the level of risk for utilities has changed relative to the 2019 proceeding.").

69 *See* EPUC/IS (Gorman) at 31 ("Aside from wildfire related issues, California has a robust alternative ratemaking process . . . We generally view alternative ratemaking mechanisms as credit positive") (citing Moody's Credit Opinion for Southern California Edison Company (Dec. 27, 2021)).

70 TURN (Dowdell) at 15.

Decision, is irrelevant.[71] The issue determining whether there has been "extraordinary circumstances" such that the CCM would not provide an accurate measurement of the cost of capital for 2022.[72] The relevant comparison is thus to pre-pandemic conditions with those that existed during the pandemic and CCM measurement period to assess the impact of the pandemic and federal government's response on the Utilities' cost of equity.

And attempts to rewrite the applicable standard for determining whether the CCM Adjustment Mechanism should apply—such as Dr. McCann asserting that suspending the CCM requires "substantial consensus across all stakeholders that the utilities' financial situation requires such a suspension"[73] if the "event is so extraordinary or catastrophic that it disrupts [the Utilities'] ability to attract sufficient capital or remain financially viable"[74]—have no basis in prior Commission orders or decisions. Suspending the CCM Adjustment Mechanism is not an "emergency response" akin to an immediate cash infusion.[75] It is merely a recognition that the Mechanism cannot work as intended. Moreover, Dr. McCann's later acknowledgement that the Great Recession is a situation where a CCM suspension would have been appropriate is a

[71] *See* UCAN (Pavlovic) at 10 (asserting that "the relevant time period for evaluating the pandemic impact on SDG&E and financial markets is the 36 month period of October 1, 2018 to September 30, 2021."); EDF (McCann) at 24 (contending that the "appropriate starting point, at a minimum, are the valuations in 20212 when the authorized ROEs and implied market ROEs were closer together."); PCF (Ellis) at 24 (arguing for a comparison to December 2018, asserting that the "last authorized rate of return (ROR) was based on data as of year-end 2018, not 2019."). Despite Mr. Ellis' claims, the Commission's 2019 Decision was not limited to data from 2018. *Cf* WTF (Rothschild) at 32 ("The relevant time period in this proceeding is the measurement period (October 1, 2020-September 30, 2021).").

[72] *See* Scoping Memo at 3.

[73] EDF (McCann) at 4.

[74] *Id.* at 6.

[75] *Id.*

seeming acknowledgement that a suspension is warranted when the cost of equity and interest rates diverge.[76]

IV. THE COMMISSION SHOULD LEAVE THE UTILITIES' CURRENT COST OF CAPITAL FOR 2022

Given that the CCM Adjustment Mechanism cannot provide an accurate assessment for 2022—because of the breakdown in the relationship between interest rates and the cost of equity—and the temporary nature of these changes, the Commission should suspend the CCM. The Commission should further apply the Utilities' current cost of capital for 2022. The parties can then litigate the Utilities' new cost of capital for 2023-2025 beginning April 2022 in an economic environment that all parties recognize is more stabilized.

Contrary to Mr. Gorman's statement,[77] a legal and factual basis for applying SDG&E's current cost of capital exists—the fact that the Commission already found that cost of capital just and reasonable for 2022 in the 2019 Decision.[78] As Mr. Pavlovic notes, if the CCM Adjustment Mechanism does not apply, then "the cost of capital established for established for the first year applies in the second and third years of the three-year cycle."[79] As the CCM Adjustment Mechanism should not apply to 2022 for the reasons discussed above, then the cost of capital established in the 2019 Decision should.

Moreover, as noted, the Commission's findings in the 2019 Decision remain applicable and support applying SDG&E's current cost of capital, including the fact that SDG&E's credit

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[76] EDF Response to SDG&E-DR 01, Response 6, Appendix A, VAB A-16.

[77] EPUC/IS (Gorman) at 2.

[78] D.19-12-056 at 54, CoL 24.

[79] UCAN (Pavlovic) at 6.

ratings and risks largely being the same.[80] As Mr. O'Donnell testified, "I do not believe the level of risk for utilities has changed relative to the 2019 proceeding."[81] Mr. Gorman similarly cited Moody's ongoing concern with California wildfire related issues.[82]

The Utilities' stock prices are already discounted at their current ROEs.[83] Reducing the Utilities' ROE based on reduced interest rates driven by the Federal Reserve's temporary actions when nationwide authorized ROEs largely remained stagnant would threaten credit ratings and impair the Utilities' ability to compete for capital and provide stability to the market.

And, as discussed, credit rating agencies and investors believe that the Utilities' current ROEs are credit supportive and help counteract wildfire and other risks.[84] As Dr. McCann notes, adequate investment by the Utilities is essential to meet goals such as wildfire mitigation and the "expansion of the electricity system" to increase electrification and reduce greenhouse gas emissions.[85] S&P similarly states that "[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."[86]

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[80] SDG&E-06 (Bille) at VAB-16 – VAB-17; *id* at VAB-18 (noting that Moody's subsequently upgraded SDG&E one-notch to A3, but that S&P and Fitch's ratings remain the same (BBB+) as they were at the time of the 2019 Decision).

[81] FEA (O'Donnell) at 12.

[82] EPUC/IS (Gorman) at 31 (citing Moody's Credit Opinion for SCE (Dec. 27, 2021)).

[83] SDG&E-06 (Bille) at VAB-20; *see* UCAN Response to SDG&E DR-1 (Pavlovic), Response 3 ("Q: Do you agree that every equity analyst report cited in footnote 21 to Mr. Pavlovic's testimony applies a "discount" to Sempra and/or California electric utilities' stock? If not, explain in detail why not. A: Yes."), Appendix A, VAB A-13.

[84] *See supra*, n.42 (citing RRA, California Regulatory Review (Dec. 14, 2020) at 1-2).

[85] EDF (McCann) at 2.

[86] S&P Oct. 2021 at 3.

SDG&E's current cost of capital remains critical to meeting these goals and maintain the Utilities' already-approved cost of capital supports predictability and stability.

V. CONCLUSION

The CCM cannot provide an accurate assessment of the cost of capital for 2022. The Mechanism's assumed relationship between changes in interest rates and the cost of equity ceased to function because of the pandemic and federal government's response. Interest rates were driven to extremely low levels by the Federal Reserve's response to mitigate the pandemic. But the cost of equity did not decline, reflected in the increase in utility betas and utility stock underperformance.

The divergence between interest rates and the cost of equity is reflected in the national authorized ROE average that has stayed largely constant despite declining interest rates. The CCM Adjustment Mechanism would reduce the Utilities' ROE by far more than the (at most) modest decline in nationwide authorized ROEs during the pandemic. Moreover, as intervenors acknowledge, the conditions that existed during the pandemic and CCM measurement period were temporary and are ending. Interest rates are increasing. The Commission should thus suspend the CCM for 2022 and apply SDG&E's current cost of capital, before litigating the full cost of capital applications beginning April 2022.

APPENDIX A

CITED INTERVENOR DR RESPONSES

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DATA REQUEST
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DATE: **February 4, 2022**

TO: UCAN
Jane Krikorian
404 Euclid Avenue, Suite 377
San Diego, CA 92114
619-696-6966
jane@ucan.org

Testimony: **Dr. Griffing**
mgriffing@pcmgregcon.com

K. Pavolvic
kpavlovic@pcmgregcon.com

FROM: Jamie York
San Diego Gas & Electric Company
8330 Century Park Court
Mail Code : CP 31E
San Diego, CA 92123

ORIGINATOR: Jamie York
PHONE: 858-654-1739
E-Mail: JYork@semprautilties.com

Request No: **SDG&E Data Request 1** **Due Date: February 9, 2022**

In light of the February 14, 2022 deadline for rebuttal testimony, SDG&E respectfully requests that UCAN respond to the below requests in four business days. If you are unable to provide the information by this date, please provide a written or verbal explanation why the response date cannot be met and your best estimate of when the information can be provided. Please electronic mail all responses that can be transmitted electronically. If attachments cannot be electronically transmitted, please notify myself (JYork@semprautilities.com) and Ross Fulton (RFulton@sdge.com) via e-mail or phone and arrangements will be made for the transmittal of said attachments.

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I. DEFINITIONS

The definitions set forth below shall apply to each of the following data requests, unless otherwise explicitly indicated:

1. "Any" means each, every, and all persons, places, or things to which the term refers.

2. "Communication" means any transfer of information, whether written, printed, electronic, oral, pictorial, or otherwise transmitted by any means or manner whatsoever.

3. "Copy" means any reproduction, in whole or in part, of an original document and includes, but is not limited to, non-identical copies made from copies.

4. "Documents" means any written, drawn, recorded, transcribed, filed, or graphic matter, including scientific or researchers' notebooks, raw data, calculations, information stored in computers, computer programs, surveys, tests and their results, however produced or reproduced. With respect to any document that is not exactly identical to another document for any reason, including but not limited to marginal notations, deletions, or redrafts, or rewrites, separate documents should be provided.

5. "Commission" or "CPUC" means the California Public Utilities Commission or any officer or employee of that body.

6. "Identify," "identity," or "identification," when used in relation to "person" or "persons," means to state the full name and present or last known address of such person or persons and, if a natural person, his or her present or last known job title, the name and address of his or her present or last known employer, and the nature of the relationship or association of such person to you.

7. "Identify," "identity," or "identification," when used in relation to "document" or "documents," means to state the date, subject matter, name(s) of person(s) that wrote, signed, initialed, dictated, or otherwise

participated in the creation of same, the name(s) of the addressee(s) (if any), and the name(s) and address(es) (if any) of each person or persons who have possession, custody, or control of said document or documents.

8. “Identify” when used in relation to a “communication” means to identify the participants in each communication and, if such communication is not contained in a document, the date, place, and content of such communication.

9. “Including” means including but not limited to.

10. “Original” means the first archetypal document produced, that is, the document itself, not a copy.

11. “Person” or “persons” means any natural person or persons, group of natural persons acting as individuals, group of natural persons acting as a group (e.g., as a board of directors, a committee, etc.), or any firm, corporate entity, partnership, association, joint venture, business, enterprise, cooperative, municipality, commission, or governmental body or agency.

12. “Relate to,” “relating to,” or “in relation to” means involving, reflecting, identifying, stating, referring to, evidencing, constituting, analyzing, underlying, commenting upon, mentioning, or connected with, in any way, the subject matter of the request.

13. “You,” “your,” or “Interverors” means the Utility Consumers Action Network (“UCAN”) and their affiliates, agents, servants, representatives, and employees or any other person or entity acting or purporting to act on their behalf, including without limitation any witness retained by them. In that regard, each and every data request contained herein is directed at you.

14. “Griffin’s Testimony” or “his testimony” refers to the testimony filed by Dr. Marlon F. Griffing on behalf of UCAN in this proceeding on January 31, 2022.

15. “Pavlovic’s Testimony” or “his testimony” refers to the testimony filed by Karl Pavlovic on behalf of UCAN in this proceeding on January 31, 2022.

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II. INSTRUCTIONS

When responding to the following data requests, please comply with the instructions below:

1. Please supplement and amend your responses if new responsive information becomes available.
2. In responding to these data requests, designate the data request to which any document or narrative response is being provided.
3. In any data request, the present tense shall be read to include the past tense, and the past tense shall be read to include the present tense.
4. In any data request, the singular shall be read to include the plural, and the plural shall be read to include the singular.
5. In any data request, the use of the conjunctive shall be read to include the disjunctive, and the use of the disjunctive shall be read to include the conjunctive.
6. Any document withheld from production on the grounds of a privilege is to be specifically identified by author(s), addressee(s), length, and date, with a brief description of the subject matter or nature of the document, and a statement of the privilege asserted.
7. Where a document or narrative response responds to more than one request, a duplicate need not be provided; a cross-reference will suffice.
8. Where a data request calls for the production of a document or documents, such production should be in the form of legible, complete and true copies of the original documents as "original" is defined herein.
9. Please begin the response to each request on a separate page.
10. Please restate each data request before providing the response or objection.

11. Please specify the data requests in response to which any document, narrative response, or objection is provided. If a document, narrative response or objection relates to more than one request, please cross reference.

12. For any request consisting of separate subparts or portions, a complete response is required to each subpart as if the subpart or portion were propounded separately.

13. Where your response to any of the attached data requests requires reference to or production of calculations, analyses, assumptions, or studies that have been prepared, please identify with specificity the copies of such calculations, analyses, assumptions, studies, and provide all workpapers relating thereto.

14. Please provide all documents in their native format, together with all metadata.

III. DATA REQUESTS

Request 1. Please provide copies of prior testimony in which Dr. Griffing and/or Mr. Pavlovic has discussed or opined on a utility's return on equity, rate of return, and/or credit ratings.

Response: See Exhibit MFG-1 Qualifications and Prior Testimony, Cost of Capital section. Copies of Dr. Griffing's testimony can be obtained from the regulatory commission for each docket listed.

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Request 2. Please provide any and all documents cited or referenced in Dr. Griffing and/or Mr. Pavlovic's testimony and/or footnotes.

Response: For filings in this proceeding, A.19-04-017, that are cited or referenced in Dr. Griffing's testimony and/or footnotes, copies can be obtained from the CA PUC docket.

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Request 3. Do you agree that every equity analyst report cited in footnote 21 to Mr. Pavlovic's testimony applies a "discount" to Sempra and/or California electric utilities' stock? If not, explain in detail why not.

Response: NA

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Request 4. Please produce all evidence support Table 3 on page 20 of Mr. Pavlovic's testimony, specifically to support his claim that SDG&E's total equity percentages for the CCM period.

Response: NA

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Request 5. Please provide all reports and/or statements from S&P supporting Dr. Griffing's testimony on 15, lines 19-20 that S&P "found that SDG&E is of average risk among U.S. utilities."

Response: S&P did not find that SDG&E is of average risk among U.S. utilities. Rather, S&P assigned a credit rating of BBB+ to SDG&E. As Dr. Griffing established on page 15, lines 1-17 of his testimony, this credit rating is average among the 38 electric utilities considered in Dr. Griffing's analysis.

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Request 6. Does Dr. Griffing agree that the Federal Reserve has already begun tapering its monthly purchase of bonds (i.e., reducing the amount of bonds it is buying monthy) under its "quantative easing" program that it began in response to the COVID-19 pandemic? If not, please explain in detail why this is incorrect.

Response: Dr. Griffing agrees that the Federal Open Market Committee of the Federal Reserve began reducing its monthly purchases of Treasury securities and mortgage-backed securities in November 2021. https://www.federalreserve.gov/monetarypolicy/files/monetary20211103a1.pdf

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III. DATA REQUESTS

Request 1. Please provide copies of prior testimony in which Dr. Griffing and/or Mr. Pavlovic has discussed or opined on a utility's return on equity, rate of return, and/or credit ratings.

Response: Discussed return on equity – testimony in CA PUC A.19-04-017 SDG&E Cost of Capital. Copies of testimony can be obtained from the CA PUC docket.

Discussed rate of return – testimony in every proceeding listed in Exhibit KRP-1 in which Dr. Pavlovic appeared regarding cost of service and rate design. Copies of testimonies can be obtained from the listed dockets.

Discussed credit ratings – testimony in CA PUC A.19-04-017 SDG&E Cost of Capital. Copies of testimony can be obtained from the CA PUC docket.

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Request 2. Please provide any and all documents cited or referenced in Dr. Griffing and/or Mr. Pavlovic's testimony and/or footnotes.

Response: For filings in this proceeding, A.19-04-017, that are cited or referenced in Dr. Pavlovic's testimony and/or footnotes, copies can be obtained from the CA PUC docket. For the documents referenced in footnote 21, see SDGE Data Request 1.2 Attachments 1-4.

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Request 3. Do you agree that every equity analyst report cited in footnote 21 to Mr. Pavlovic's testimony applies a "discount" to Sempra and/or California electric utilities' stock? If not, explain in detail why not.

Response: Yes.

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Request 4. Please produce all evidence support Table 3 on page 20 of Mr. Pavlovic's testimony, specifically to support his claim that SDG&E's total equity percentages for the CCM period.

Response: See SDGE Data Request 1.4 Attachment 1.

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DATA REQUESTS 1 – EDF RESPONSE

Request 1. Please provide copies of prior testimony in which Dr. McCann has discussed or opined on a utility's return on equity, rate of return, capital structure and/or credit ratings.

Response 1. Testimony that was filed in A.19-04-014 is sent under separate cover.

Request 2. Please provide any and all documents cited or referenced in Dr. McCann's testimony and/or footnotes.

Response 2. Please see Exhibit B to EDF's Testimony. Commission documents may be found on the Commission's website at https://www.cpuc.ca.gov/.

Request 3. Please provide citations to CPUC decisions, orders, or statements that support Dr. McCann's statement that the "CCM should only be suspended when there is substantial consensus across all stakeholders that the utilities' financial situation requires such a suspension." (McCann at 4, lines 4-7).

Response 3. See D.09-10-016 and D.16-02-019.

Request 4. Please provide citations to CPUC decisions, orders, or statements that support Dr. McCann's statement that the intent of a CCM suspension is "to provide immediate relief to prevent a potential financial catastrophe for the utility." (McCann at 5, lines 1-2).

Response 4. No standard for what constitutes an "extraordinary or catastrophic event" in any CPUC decision, order or statement. In fact, the Assigned Commissioner's Ruling in this case specifically invites expert witnesses to define that standard: "Are there extraordinary circumstances that warrant a departure from the CCM for 2022?" A consequence of a "catastrophic event" of sufficient magnitude to require suspension of the CCM trigger is an impending financial catastrophe for the utility.

Request 5. Please provide citations to CPUC decisions, orders, or statements that that support Dr. McCann's statement that the CCM standard of an "extraordinary event that materially impacts their respective cost of capital and/or capital structure" requires that "the utilities clearly demonstrate that the event is so extraordinary or catastrophic that it disrupts their ability to attract sufficient capital or to remain financially viable. The evidence required for this standard should include reduction of bond ratings below investment grade, universal hold and sell recommendations by financial analysts, and balance sheet projections that show that the company faces financial collapse before the next cost of capital application filing." (McCann at 6, lines 1-8).

Response 5. No standard for what constitutes an "extraordinary or catastrophic event" in any CPUC decision, order or statement. In fact, the Assigned Commissioner's Ruling in this case specifically invites expert witnesses to define that standard: "Are there extraordinary circumstances that warrant a departure from the CCM for 2022?" A consequence of a "catastrophic event" of sufficient magnitude to require suspension of the CCM trigger is an impending financial catastrophe for the utility.

Request 6. Please provide any examples that Dr. McCann is aware of where a California utility subject to the CCM would have met or satisfied Dr. McCann's statement that the CCM standard of an "extraordinary event that materially impacts their respective cost of capital and/or capital structure" requires that "the utilities clearly demonstrate that the event is so extraordinary or catastrophic that it disrupts their ability to attract sufficient capital or to remain financially viable. The evidence required for this standard should include reduction of bond ratings below investment grade, universal hold and sell recommendations by financial analysts, and balance sheet projections that show that the company faces financial collapse before the next cost of capital application filing." (McCann at 6, lines 1-8).

Response 6. As specified at page 9, lines 4-8, conditions to satisfy suspension of the CCM trigger may have existed in October 2020 but none of the utilities filed for such relief.

In the fall of 2008 at the beginning of the Great Recession, after the CCM was established, the conditions may have been sufficient to suspend the CCM. By October 2009, any sufficiently extraordinary or catastrophic events had passed.

Request 7. Please provide citations to CPUC decisions, orders, or statements that support Dr. McCann's statement that the intent of a CCM suspension is "to provide immediate relief to prevent a potential financial catastrophe for the utility." (McCann at 5, lines 1-2).

Response 7. No standard for what constitutes an "extraordinary or catastrophic event" in any CPUC decision, order or statement. In fact, the Assigned Commissioner's Ruling in this case specifically invites expert witnesses to define that standard: "Are there extraordinary circumstances that warrant a departure from the CCM for 2022?" A consequence of a "catastrophic event" of sufficient magnitude to require suspension of the CCM trigger is an impending financial catastrophe for the utility.

Request 8. Please provide examples of circumstances where suspending the CCM would prevent a potential financial catastrophe for the utility and explain how suspending the CCM would do so.

Response 8. This question calls for speculation about a hypothetical situation. Refer to my testimony as to the statement that extraordinary conditions sufficient to suspend the CCM trigger do not currently exist.

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Request 9. Please explain in detail with evidence or other support what "likely outcome" of this proceeding the equity markets have already priced into share prices and how it would be shown or can be observed in financial or market data that this "likely outcome" has been priced in (McCann at 8, lines 13-15). Identify any publications or other statements that support Dr. McCann's statements, providing copies if not publicly available.

Response 9. As discussed in Dr. McCann's testimony, p. 8, lines 8-19, the Assigned Commissioner' Ruling lists all of the publicly filed documents that define what would happen with under the CCM trigger. It is a well and widely accepted understanding that the U.S. financial markets deeply research and analyze all public documents and information on publicly-held companies, particularly those that trade their shares on the major stock exchanges. With that widely available information, the equity markets will have acted to price in their expectations about the likely outcome of this proceeding. EDF is not aware of why SDG&E would be differently situated with respect to the equity markets than other publicly traded companies.

Request 10. Please explain in detail with evidence or other support how maintaining the ROE previously authorized by the CPUC in D.19-12-056 "runs directly counter to th[e] state mandate" to reduce greenhouse gas (GHG) emissions (McCann at 3, lines 8-10).

Response 10. D.19-12-056 had two aspects that undermined the state's mandate to reduce GHG emissions. As specified in EDF's testimony filed in that case, California can only meet its GHG reductions goals by (1) rapidly replacing its natural gas use with electric applications and (2) electrifying stationary and mobile energy uses. D.19-12-056 kept the utilities' returns on equity (ROEs) largely unchanged despite sufficient evidence provided by a number of intervenors that the equity markets were accepting a lower authorized ROE from regulated utilities. That higher ROE in turn results in higher electricity rates which discourages consumers from fuel switching from natural gas and transportation fossil fuels to electricity. Second, the D.19-12-056 did not bifurcate the ROEs for SDG&E and Pacific Gas & Electric between their electric and gas investments so as to address the differential risks between the two types of utilities and to begin the separate oversight needed to begin phasing out most of the natural gas use in the state.

Request 11. Does Dr. McCann agree that the stock market is perfectly efficient? Please explain in detail why or why not.

Response 11. The stock market is not perfectly efficient—if so it would not experience variations in equity prices because shareholders would be completely informed about all aspects of potential outcomes. That said, the stock market is sufficiently efficient to price in expectations about publicly available information on publicly traded companies.

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Request 12. Does Dr. McCann agree that the fourth quarter of 2021 is not in the CCM measurement period at issue in this proceeding? If he does not agree, please explain why in detail.

Response 12. The utilities in their filings have relied on forecasts about potential market conditions in 2022 as one the justifications that "extraordinary or catastrophic events" may exist. If forecast of 2022 conditions are being relied on, then the period between October 1, 2021 and December 31, 2021 also must be relied on. There is not a three-month discontinuity in time that should be completely ignored—that would be an irrational consideration of the evidence. In using the 2022 forecasts, the utilities must explain how these forecasts are consistent with the conditions in the fourth quarter of 2021. Further, if the conditions that the utilities were basing their rationale for suspending the CCM on October 1, 2021 have now since passed, the Commission should not act to grant the requested relief.

Request 13. Please provide all evidence in support of Dr. McCann's statement that the utilities have adjusted their investment programs in response to anticipation of the CCM trigger. (McCann at 12, lines 14-16).

Response 13. SDG&E has misread that passage. Dr. McCann states, "(t)he transparency of the CCM has allowed the financial markets to easily anticipate the trigger and for the utilities **to adjust** their investment programs in response." (Emphasis added.) The statement does not claim that the utilities have already adjusted their investment programs.

Request 14. Please provide all evidence or support demonstrating that "equity market activity indicates that investors have *not* priced a risk discount into California utility shares," including but not limited to "EDF's analysis of equity market activity" as referenced by Dr. McCann (McCann at 13, lines 1-2).

Response 14. The evidence is presented at pages 12-24.

Request 15. Please provide all CPUC decisions, orders, or statements supporting Dr. McCann's statement that the "Commission usually targets the ROE so that the book and market values of the utility company are roughly comparable." (McCann at 13, lines 17-18).

Response 15. The CPUC has not specified a specific standard for the relationship between market and book values, but such a standard is necessary for establishing an appropriate return on book value. As discussed at pp. 14-15, if the Commission allows market value to exceed book value by an amount that is not explicitly justified, the Commission is allowing the creation of an unauthorized regulatory asset. Regulatory assets have been explicitly created by the Commission for specific purposes, but if such assets are simply to be created market activity, the utility will be enjoying the benefit of that asset without specific authorization. That violates the fundamental principle of rate of return regulation.

The CPUC has implicitly weighed in on whether to use the value of actual physical capital as the benchmark metric for valuing a utility's assets rather than a market-determined value. The CPUC has used this principle previously in valuing the acquisition of local distribution systems by municipal utilities, by setting the price at the replacement cost new less depreciation (RCNLD).[1] The RCNLD is not determined by the value of utility shares traded in the equities market. The Commission further endorsed this principle in adopting the RCNLD method for setting PG&E's marginal customer service costs in D.21-11-016, Order No. 1.

Request 16. Provide all peer-reviewed academic journals, other studies, and/or other analyses supporting the idea that regulatory commissions should "target the ROE so that the book and market values of the utility company are roughly comparable."

Response 16. It is not possible to provide an *absolutely complete* review of *all* literature covering a topic. Dr. McCann has provided citations to two publications that come to this conclusion and provided evidence on the matter.

Request 17. Please provide all evidence or support for the statement that "The Commission only needs to allow the market return rate to attract sufficient investment to cover the book value." (McCann at 21, lines 6-8).

Response 17. It is not possible to provide an *absolutely complete* review of *all* literature covering a topic. The burden of proof is on the utilities to demonstrate that they require a market return to attract sufficient investment to cover more than their book value of investments including their incremental investments to maintain services. Dr. McCann's citation to Alfred Kahn's *Economics of Regulation* is one example that discusses this standard.

[1] See, for example, Decision 04-03-036 authorizing PG&E's sale of the Mountain House development franchise to Modesto Irrigation District.

A.21-08-013 Wild Tree Foundation Response to PG&E Data Request #4

Q 1: State whether Mr. Rothschild agrees that the Formula Adjustment Mechanism assumes a positively correlated relationship between long-term interest rates and the cost of equity by adjusting a utility's return on equity (ROE) by one half of the change in long-term interest rates as measured by an average change in the applicable interest rate index. If Mr. Rothschild does not agree, describe in as much detail as possible the basis for his disagreement.

Response: The CCM adjustment is intended to serve as described in Commission precedent: "This CCM streamlines the major energy utilities' cost of capital process while providing greater predictability of the utilities' cost of capital by eliminating the use of interest rate forecasts and disputes concerning interest rate levels and trends, as well as uncertainties associated with conflicting perceptions of financial markets and the return requirements of investors. The CCM also enables the utilities, interested parties, and Commission staff to reduce and reallocate their respective workload requirements for litigating annual cost of capital proceedings." (D.08-05-035 at p. 16.)

Q 2: Page 11, lines 12-13, of the Rothschild Testimony states, "Consumers were overcharged in the 2019 Energy COC proceeding based, in part, upon such speculations." Describe in as much detail as possible the basis for this statement and provide any analysis that supports this statement.

Response: In A.19-04-014, Wild Tree's expert Aaron Rothschild, on behalf of Cal Advocates, recommended an 8.49% cost of equity. The Commission approved a 10.25% cost of equity. Wild Tree takes the position that the cost of equity should have been set at 8.49% or even lower and thus ratepayers have been overcharged.

Q 3: Page 17, lines 9-10, of the Rothschild Testimony states, "this comprehensive hybrid beta measure shows that there was not a material impact on the Utilities' cost of equity."

a. Does Mr. Rothschild agree that the hybrid beta measure he describes shows that there was a material impact on the RFC Electric Proxy Group's or Utilities' cost of equity at any time in the period from March 2020 through December 2021? If Mr. Rothschild does not agree, describe in as much detail as possible the basis for his disagreement.

Response: The legal standard has not been met: "The utilities have a right to file a cost of capital application outside of the CCM process upon an extraordinary or catastrophic event that materially impacts their respective cost of capital and/or capital structure and impacts them differently than the overall financial markets." (D.08-05-035 at p. 19, COL 6.) There was no material impact during the measurement period.

b. State how a measure of beta that did have a material impact on the RFC Electric Proxy Group's or Utilities' cost of equity would be shown and can be observed in financial or market data.

Response: In general, it is often possible to design an analysis to produce a desired result. However, Mr. Rothschild does not engage in this kind of practice because it lacks integrity and is unscientific.

Q 4: Chart 11 in the Rothschild Testimony (page 17) shows hybrid betas for the RFC Electric Proxy Group going back to October 2019. Provide hybrid betas for the RFC Electric Proxy Group going back to January 1, 2018.

Response: This question is outside the scope of Wild Tree Foundation's testimony and the request that Wild Tree's experts develop new analysis is objectionable pursuant to California Code of Regulations Title 20, Division 1, Chapter 1, Rule 10.1.

Q 5: Appendix B of the Rothschild Testimony (page 45, lines 4-16) states, "I calculate historical betas following the methodology used by Value Line, with the following improvements," and then describes four adjustments to the Value Line methodology.

a. State whether Mr. Rothschild has developed any analysis to evaluate the impact of his adjustments on the calculated historical betas. For example, has Mr. Rothschild developed any analysis that compares historical betas calculated with his adjustments to the Value Line-calculated betas? If so, provide all such analysis.

Response: The results of Mr. Rothschild's weekly beta calculations for the last nine quarters are presented in Mr. Rothschild's Direct Testimony, which also explains the reasoning behind each of his adjustments. Detailed calculations are provided in the workpapers. Value Line only publishes betas every three months, but a comparison of Mr. Rothschild's results versus Value Line betas is a straightforward exercise that can be easily performed by anyone at any time.

b. Identify any publications reviewed by Mr. Rothschild that discuss or analyze (favorably or unfavorably) the adjustments to the Value Line methodology discussed in the Rothschild Testimony, and provide copies for any not publicly available.

Response: The book *Risk and Return for Regulated Industries* at pages 73-81 by Dr. Vilbert and Dr. Villadsen addresses some of Mr. Rothschild's adjustments. Most literature addressing the correct application of CAPM theory in detail addresses the issue of using a matching market index between betas and the market risk premium. Calculating betas weekly instead of only every three months is an obvious improvement that requires no academic support.

Q 6: Appendix B of the Rothschild Testimony (page 46, lines 3-5) states, “Recognizing the pros and cons of different time horizons in calculating historical beta coefficients, I use historical betas based on 5-year, 2-year, and 6-month time horizons, giving them a weight of 20%, 30%, and 50%, respectively.” State the pros and cons recognized by Mr. Rothschild with respect to the different time horizons referenced in the Rothschild Testimony.

Response: See Direct Testimony of Aaron Rothschild at pp. 46-48.

Q 7: Is Mr. Rothschild aware of any analysts or data services that publish option implied betas? If so, identify each such analyst or data service.

Response: Mr. Rothschild is not aware of any analysts or data services that public option implied betas.

Q 8: The Rothschild Testimony cites a 2008 paper titled “Forward-Looking Betas.”
a. State whether Mr. Rothschild has developed any analysis to validate the conclusions of the authors in the cited 2008 paper. If so, provide all such analysis.

Response: It is not clear which “conclusions” of the referenced 60-page document the question refers to, but it is assumed it refers to the statement that “Forward-looking betas contain information relevant for forecasting future betas that is not contained in historical betas.” As explained in Mr. Rothschild’s Direct Testimony, these forward-looking option-implied betas are a core component of the CAPM method he has used in almost two dozen cost of capital proceedings in seven states since 2018. The predictive power of these forward-looking betas speak for themselves, as evidenced in Charts 1, 2, and 5 of his Direct Testimony.

b. Identify any additional papers or other publications reviewed by Mr. Rothschild that discuss or analyze (favorably or unfavorably) the “predictive power” of any of the methodologies for calculating betas discussed in the Rothschild Testimony. Provide copies for any papers or other publications that are not publicly available.

Response: No additional papers.

Q 9: Describe in as much detail as possible the basis for the statement at page 19, lines 16-17, of the Rothschild Testimony that “the predictive power of longer-term historical betas seems to be quite reduced” and provide any analysis that supports this statement.

Response: See Direct Testimony of Aaron Rothschild at pp. 18-19.

Q 10: Page 20, lines 1-3, of the Rothschild Testimony states, "It should be noted that I have used this exact weighing of historical and option-implied betas in the calculation of hybrid betas in numerous cost of capital proceedings in seven states since before the pandemic." Identify each cost of capital proceeding in which Mr. Rothschild has used the hybrid beta calculation he describes, with reference to specific docket numbers, states, and dates of Mr. Rothschild's testimony.

Response: Mr. Rothschild has relied upon hybrid betas in rate of return proceedings since August 2019. See Appendix D for proceeding details. Mr. Rothschild's methodology and data-processing capabilities have improved over time. In testimonies filed in proceeding between August 2019 and October 2019 Mr. Rothschild's hybrid beta consisted of the exact weighting of historical and option-implied betas as he has done in this proceeding. However, his historical betas consisted of the 6-month and 5-year historical betas and did not include the 2-year historical beta. Beginning with testimonies filed October 2019, the 2-year historical beta was included as it has been in this proceeding.

In addition to those proceeding listed in Appendix D, Mr. Rothschild has also used hybrid betas in testimony in the following proceedings:

- California American Water Company, Application 21-05-001, Rate of Return, January 2022
- California Water Service Company, Application 21-05-002, Rate of Return, January 2022
- Golden State Water Company, Application 21-05-003, Rate of Return, January 2022
- San Jose Water Company, Application 21-05-004, Rate of Return, January 2022

Mr. Rothschild has also used hybrid betas in numerous other proceedings and negotiations which settled before filing direct testimony.

Q 11: Page 55, lines 7-9, of the Rothschild Testimony states, "Option-implied forward looking betas are a core component of the CAPM method I have used in almost two dozen cost of capital proceedings in seven states since 2018." Identify each cost of capital proceeding in which Mr. Rothschild has used the CAPM method he describes, with reference to specific docket numbers, states, and dates of Mr. Rothschild's testimony.

Response: Mr. Rothschild has relied upon option-implied betas in rate of return proceedings since May 2018. See Appendix D for proceeding details as well as the additional proceeding listed in response to Q 10. Mr. Rothschild has also used option-implied betas in numerous other proceedings and negotiations which settled before filing direct testimony.

Q 12: For each of the cost of capital proceedings identified in response to Questions 10 and/or 11, state whether the applicable public utility commission or other utility regulatory authority adopted or did not adopt the use of "option-implied betas" or "hybrid betas" as those terms are used in the Rothschild Testimony. If a public utility commission or other utility regulatory authority adopted the "option-implied beta" or "hybrid beta" approach, please include the decision or order and specific citation to where that approach was adopted.

Response: See Direct Testimony of Aaron Rothschild at pp. 54-56.

Q 13: Referring to page 35 of the Rothschild Testimony:
a. Describe in as much detail as possible how "inflation can possibly impact the cost of equity because it can impact interest rates."

Response: If inflation increases, interest rates will likely rise as well. This occurs because lenders will demand higher interest rates as compensation for the decrease in purchasing power of the money they are paid in the future.

b. With respect to Mr. Rothschild's statement that "the cost of equity should be based on investors' return expectation because they are the ones providing the capital," describe in as much detail as possible how Mr. Rothschild identifies and measures "investors' return expectation."

Response: See Direct Testimony of Aaron Rothschild at pp. 4-56.

Q 14: Referring to Chart 11 in the Rothschild Testimony (page 36):
a. Identify the source of data used in Chart 11 and provide link(s) to the data source(s). If multiple data sources were used, please explain how each type of data was used in Chart 11.

Response: The source is the U.S. Treasury. https://home.treasury.gov

b. Explain how the data used in Chart 11 measures "Investors' Inflation Expectations."

Response: Chart 11 measures investors inflation expectations by showing the difference between interest rates on treasury bonds and interest on inflation protected treasury bonds. This difference is referred to as the break even inflation rate.

Q 15: State whether Mr. Rothschild agrees that the fourth quarter of 2021 (October 1, 2021-December 31, 2021), is not in the Formula Adjustment Mechanism measurement period at issue in this proceeding. If Mr. Rothschild does not agree, describe in as much detail as possible the basis for his disagreement.

Response: The measurement period is October 1, 2020 – September 30, 2021.

Q 16: State whether Mr. Rothschild agrees that the average yield for the 10-year Treasury between January 1, 2022-February 3, 2022 is higher than the average yield for the 10-year Treasury during the Formula Adjustment Mechanism measurement period at issue (October 1, 2020-September 30, 2021). If Mr. Rothschild does not agree, describe in as much detail as possible the basis for his disagreement.

Response: The average yield for the 10-year Treasury bonds between January 1, 2022-February 3, 2022 remains historically low at 1.77, which is equivalent to pre-pandemic average yields in January 2020 of 1.76. During the measurement period it was 1.28. As stated in the Direct Testimony of Aaron Rothschild at p. 27, "The yield on 30-year U.S. Treasury bonds remains below what it was before the pandemic – the average yield was 1.85% in December 2021 compared to an average yield of 2.22% in January 2020, before the pandemic started to significantly impact capital markets." During the measurement period, yield on 30-year U.S. Treasury bonds was 1.98, not significantly lower then 2.1 during Jan-Feb 2022.