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|---|---|
| Company: | San Diego Gas & Electric Company (U 902 M) |
| Proceeding: | 2019 General Rate Case |
| Application: | A.17-10-007/008 (cons.) |
| Exhibit: | SDG&E-243 |

# SDG&E

# REBUTTAL TESTIMONY OF KENNETH J. DEREMER

# (POST-TEST YEAR RATEMAKING)

**JUNE 18, 2018**

**BEFORE THE PUBLIC UTILITIES COMMISSION**
**OF THE STATE OF CALIFORNIA**

A Sempra Energy utility®

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## SDG&E REBUTTAL TESTIMONY OF KEN J. DEREMER (POST-TEST YEAR RATEMAKING)

## I. INTRODUCTION

This rebuttal testimony regarding San Diego Gas & Electric's (SDG&E) proposal for a post-test year ratemaking (PTY) mechanism addresses the following testimony from other parties:

- The Office of Ratepayer Advocates (ORA), as submitted by Mr. Clayton K. Tang (Exhibit ORA-31), dated April 13, 2018.
- The Utility Consumers Action Network (UCAN), as submitted by Mr. Brandon Charles, dated May 14, 2018.
- The Utility Reform Network (TURN), as submitted by Mr. William Perea Marcus (Exhibit TURN-03), dated May 14, 2018.
- The Coalition of California Utility Employees (CUE), as submitted by Mr. David Marcus, dated May 14, 2018.
- The Federal Executive Agencies (FEA), as submitted by Mr. Ralph Smith (Exhibit FEA-1), dated May 14, 2018.
- Small Business Utility Advocates (SBUA), as submitted by Mr. Michael Brown, dated May 14, 2018.

As a preliminary matter, the absence of a response to any particular issue in this rebuttal testimony does not imply or constitute agreement by SDG&E with the proposal or contention made by these or other parties. The forecasts contained in SDG&E's direct testimony are based on sound estimates of its revenue requirements at the time of testimony preparation.

## II. COMPARISON OF PROPOSALS

The following table provides a summary comparison between SDG&E and intervenors on key items of the PTY mechanism. Further details regarding SDG&E's and intervenors' proposals are outlined below.

**Table 1**

| Issue[1] | | SDG&E | ORA #1 | ORA #2 | UCAN | CUE |
|---|---|---|---|---|---|---|
| GRC Term | | 4 years | 4 years | 4 years | N/A | 3 years |
| Escalation Rates | O&M (excluding medical) | IHS Global Insight | 4.0% | IHS Global Insight,100 bps cap | CPI plus 75 bps | N/A |
| | O&M - Medical | Willis Towers Watson | 4.0% | 4.25% | CPI plus 75 bps | N/A |
| | Capital | IHS Global Insight | 4.0% | IHS Global Insight | CPI plus 75 bps | N/A |
| Capital Additions Adjustment | | 5-year average (2015-2016 actual, 2017-2019 forecast) | 4.0% | 7-year average (2013-2017 actual, 2018-2019 authorized) | CPI plus 75 bps | 2019 authorized |
| Z-factor | | TY and PTYs | Only PTYs | Only PTYs | N/A | N/A |

### A. SDG&E's Proposal

SDG&E issued its tax-reform updated testimony on PTY ratemaking on April 6, 2018.[2] The following is a summary of SDG&E's request:

- A four-year term (2019-2022) for this general rate case (GRC) cycle, with SDG&E's next test year in 2023.
- A PTY mechanism to adjust authorized revenue requirements for:
  - Labor and non-labor costs based on IHS Markit Global Insight's (GI) forecast,
  - Medical costs based on Willis Towers Watson's forecast, and
  - Capital investments based on an escalated 5-year average of capital additions.
- Continuation of the currently authorized Z-factor mechanism.

[1] ORA Proposal #1 is also recommended by UCAN's secondary proposal and FEA's primary proposal. UCAN offered a third proposal recommending the commission adopt ORA's PTY ratemaking mechanism with capital additions based on a 5-year average of 2013-2017 actuals. FEA offered a secondary proposal recommending the commission adopt ORA's PTY ratemaking mechanism with capital additions based on a 7-year average of 2011-2017 actuals. SBUA recommends a three-year GRC term (2019-2021).

[2] April 6, 2018, Second Revised SDG&E Direct Testimony of Kenneth J. Deremer, Ex. SDG&E-43-2R.

- Application of SDG&E's proposed PTY ratemaking mechanism would result in the following forecasted attrition year revenue requirement increases:

| ($ in millions) | 2020 | | 2021 | | 2022 | |
|---|---|---|---|---|---|---|
| Revenue Requirements Increase | 6.89% | $151.5 | 5.10% | $120.0 | 4.95% | $122.2 |

### B. ORA Proposal #1 (Primary)[3]

The following is a summary of ORA's position(s):

- A four-year GRC term (2019-2022).
- Post-test year increases of 4.0% for 2020, 2021 and 2022.
- ORA does not oppose continuation of implementing PTY revenue requirements annually through the advice letter process.
- ORA does not oppose continuation of the Z-factor mechanism, but recommends that the mechanism be effective only during the post-test years, and not for the test year.

### C. ORA Proposal #2 (Alternate)[3]

If the California Public Utilities Commission (CPUC or Commission) does not adopt ORA's primary proposal, and prefers a mechanism similar to SDG&E's proposal, then ORA recommends the following alternative:

- Regarding PTY increases for operations expenses:
  - Operations and Maintenance (O&M) margin and capital escalation rates, except for medical, using GI as proposed by SDG&E;
  - limit of 1% on update to escalation rates; and
  - PTY medical escalation rates be set at 4.25%.
- In determining the GRC incremental capital-related attrition allowance, ORA recommends: (a) using an escalated 7-year (2013-2019) average of capital additions instead of a 5-year (2015-2019) average; and (b) using 2017 recorded capital additions, as well as Commission-adopted 2018 and 2019 capital additions

[3] April 13, 2018, ORA Report on the Results of Operations for San Diego Gas & Electric Company Electric Post-Test Year Ratemaking by Clayton Tang Ex. ORA-31.

forecasts, as part of the 7-year average instead of using SDG&E's 2017-2019 forecasts.

**D. UCAN**[4]

The following is a summary of UCAN's position(s):

- The Commission should adopt an increase to SDG&E's capital and O&M authorized test year revenue requirements by the projected CPI-Urban annual increase plus 75 basis points.
- If the Commission does not adopt UCAN's recommended PTY ratemaking methodology, UCAN recommends that the Commission adopt ORA's primary proposal of applying a 4.0% annual escalation to SDG&E's capital and O&M revenue requirements.
- If the Commission rejects both UCAN's and ORA's proposals and instead adopts SDG&E's PTY ratemaking methodology, UCAN recommends that the commission modify SDG&E's proposal to incorporate the following:
    - Escalated capital additions and retirements based on recorded data from 2013 through 2017, and
    - SDG&E's 2022 revenue requirement should be adjusted to subtract $39.4 million from the total revenue requirement to account for CIS Replacement Program (CIS) benefits.

**E. TURN**[5]

The following is a summary of TURN's position(s):

- Increase Average Rate Assumption Method (ARAM) in post-test year period.

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[4] May 14, 2018, Prepared Direct Testimony of Brandon Charles on behalf of the Utility Consumers' Action Network (UCAN) addressing San Diego Gas & Electric Company's [2019] General Rate Case Phase 1 Application.

[5] May 14, 2018, Prepared Direct Testimony of William Perea Marcus on behalf of The Utility Reform Network (TURN) addressing Various Results of Operations Issues in San Diego Gas & Electric Company's 2019 General Rate Case Application, Ex. TURN-03.

**F. CUE**[6]

The following is a summary of CUE's position(s):

- A three-year GRC term (2019-2021).
- For Sempra's PTY ratemaking revenue requirement, the capital spending inputs should be based on Commission-adopted 2019 capital spending.

**G. FEA**[7]

The following is a summary of FEA's position(s):

- FEA agrees with ORA's recommendation for 4.0% annual attrition for 2020, 2021, and 2022.
- If, instead, the Commission is to adopt a PTY ratemaking mechanism, then the capital additions should be based on a 7-year average of recorded capital additions (2011-2017).

**H. SBUA**[8]

The following is a summary of SBUA's position(s):

- A three-year GRC term (2019-2021).

## III. REBUTTAL TO PARTIES' GRC TERM PROPOSALS

ORA supports SDG&E's request for a four-year GRC term (2019-2022) and urges the Commission to adopt the proposal. SDG&E appreciates ORA's recognition of the benefits to ratepayers and Commission staff of a four-year cycle, which reduces the administrative burden on all parties, and gives both the Commission and the utilities more flexibility to manage the integrated Safety Model Assessment Proceeding (S-MAP), Risk Assessment and Mitigation

[6] May 14, 2018, Prepared Direct Testimony of David Marcus on behalf of California Utility Employees (CUE) addressing application of San Diego Gas & Electric Company for authority, among other things, to update its Electric and Gas Revenue Requirement and Base Rates effective on January 1, 2019.

[7] May 14, 2018, Prepared Direct Testimony of Ralph C. Smith on behalf of The Federal Executive Agencies (FEA) addressing application of San Diego Gas & Electric Company for authority, among other things, to update its Electric and Gas Revenue Requirement and Base Rates effective on January 1, 2019, Ex. FEA-1.

[8] May 13, 2018, Prepared Direct Testimony of Michael Brown on behalf of Small Business Utility Advocates (SBUA) addressing Issues Affecting Small Businesses (Sempra GRC Phase I).

Phase (RAMP) and GRC proceedings. In ORA's rebuttal, Mr. Tang states,[9] "A 4-year GRC term allows for better utility financial and operational management of spending and investment" and is "consistent with SDG&E's and Southern California Gas Company's (SoCalGas) GRCs for Test Years 2008 (2008-2011) and 2012 (2012-2015)." A longer GRC cycle is not unprecedented and provides better rate certainty and stability to ratepayers. Furthermore, it protects ratepayers from large increases that can occur in a test year as the utility seeks to implement new programs.

CUE and SBUA advocate for a three-year GRC term.[10] SBUA states that effective advocacy becomes difficult if major issues can only be brought up once every four years, and that "treating the utilities differently sets a bad precedent" since Southern California Edison (SCE) and Pacific Gas & Electric (PG&E) both use a three-year rate cycle. CUE argues that a longer term would unnecessarily defer the implementation of new technologies or approaches that are identified during the GRC cycle. As explained above, the administrative burden and time involved in litigating a GRC every three years is alleviated with a longer term, providing more time to focus on and better understand the incorporation of RAMP and S-MAP into the GRC process. RAMP and S-MAP are new and complex components of the GRC. We have already seen the timing related impacts with respect to the new RAMP and S-MAP processes taking longer than anticipated.

SoCalGas and SDG&E requested (and were granted) a five-week extension[11] for the 2019 GRC application from September 1 to October 6, in part, to incorporate RAMP into the GRCs. In the extension letter request, SDG&E and SoCalGas noted that the utilities have been diligently working to incorporate risks and mitigations identified in the RAMP process and how they influence GRC funding requests. The Commission found the request reasonable and granted the five-week extension. RAMP and S-MAP proceedings faced similar issues. For example, the Commission initiated a Phase 2 of the first S-MAP, which was not initially anticipated when considering the impacts of timing on utility rate cases. Moreover, a one-year extension was requested (and granted) to file the next S-MAP application from May 1, 2018 to

[9] Ex. ORA-31 (Tang) at 16-17.

[10] Ex. CUE (Marcus) at 38-39, Ex. SBUA (Brown) at 22-23.

[11] Extension Letter from Dan Skopec to File 2019 GRC and 2016 Spending Reports, granted by CPUC Executive Director Timothy Sullivan August 22, 2017.

May 1, 2019.[12] The reason for the extension was to allow parties time to complete on-going settlement negotiations, reflect a common methodology in the next S-MAP applications, and allow the utilities to internally implement the methodologies.

SBUA's claim that the utilities would be treated differently assumes the other utilities would not be interested in also transferring to a four-year cycle. SDG&E cannot speak on their behalf and cannot assume to know what the other utilities would be thinking on this topic. However, on June 4, 2018, PG&E served to the parties of services lists R.13-11-006, A.15-09-001 and I.17-11-003 a "Request for an Extension of Time to File Test Year 2020 General Rate Case Application." In that letter to the Executive Director of the CPUC, PG&E claims the need to delay, among other reason is to "allow PG&E to prepare proposals that more fully consider these complex financial issues and the results of the current legislative session, which will not be completed until September 30, 2018." Although PG&E is only seeking a four-month delay, it appears that three-year GRC cycles are becoming problematic for other investor-owned utilities (IOUs) as well. Further, in response to an ALJ ruling on R.13-11-006, PG&E states that "PG&E – contrary to Energy Division's proposal – now recommends that the Commission adopt a four-year, rather than three-year cycle, beginning with PG&E's 2023 GRC."[13]

These examples speak to the complex nature of integrating the new risk mitigation efforts in conjunction with a GRC proceeding. SDG&E believes that the additional year will be crucial as the utilities and the Commission alike work to operate under these new conditions.

## IV. REBUTTAL TO PARTIES' PRIMARY PTY RATEMAKING ESCALATION PROPOSALS

### A. ORA recommendation for a flat 4.0% and UCAN recommendation for CPI plus 75 basis points for annual post-test year increases lack numerical basis and support.

ORA's proposal for post-test year increases of 4.0% per year for 2020, 2021 and 2022 is guided by:

- A recent forecast of the annual percent change in Consumer Prices Index (CPI);

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[12] R.13-11-006 and A-15-05-002, March 14, 2018, Letter from Executive Director Alice Stebbens to Charles Manzuk granting joint request by SDG&E, Southern California Edison (SCE) and SoCalGas regarding compliance to D.14-12-025 OP 5, for extension of deadline to file next S-MAP Proceeding from May 1, 2018 to May 1, 2019.

[13] April 5, 2018 "Response of Pacific Gas and Electric Company (U39M) to Administrative Law Judge's Ruling Issuing Energy Division Workshop Report for Comment" in Rulemaking 13-11-006, at page 4.

- Recognition of capital investment programs which require additional revenues above a strict increase in CPI;
- Attrition increases adopted by the Commission in recent large energy utility GRCs; and
- The two most recent post-test year percentage increases adopted for SDG&E and SoCalGas in D.13-05-010 and D.16-06-054.

ORA further states that their proposed 4.0% annual post-test year revenue increase for this GRC would provide SDG&E with higher revenue increases compared to its last GRC, but lower increases compared to its request in this proceeding.[14] UCAN recommends that the Commission adopt the methodology approved by the Commission in SDG&E and SoCalGas' TY 2012 GRC, which is to increase the utilities' capital and O&M authorized test year revenue requirements by the projected CPI-Urban annual increase plus 75 basis points (resulting in a 3.7% per year average attrition).[15] For reasons explained below, ORA's and UCAN's proposals inappropriately utilize CPI as a basis for forecasting utility-specific costs, do not represent SDG&E's anticipated growing costs, are below attrition increases adopted by the Commission in recent large energy utility GRCs, and contain no numerical basis.

First, the CPI measures changes in the price of a representative basket of goods and services purchased by a typical U.S. household, and is not intended to and does not gauge price changes of goods and services purchased by businesses, or more specifically, utilities. As my testimony states, and also stated more broadly in the testimony of Scott Wilder, GI is weighted to incorporate "Utility Service Works," "Managers and Administrators," and "Professional and Technical Workers" and is therefore more appropriate as an industry-specific source for escalation.[16] In addition, the CPI would not appropriately distinguish between the attrition necessary for capital and O&M costs, which is a position that has previously been supported by the Commission. In PG&E's 2014 GRC decision, the Commission stated:

> We adopt a two-part mechanism to capture distinctions driving attrition increases: (a) for expenses versus and (b) for capital expenditures. We decline to adopt Division of Ratepayer Advocate's (DRA) primary proposal to set post-test-year

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[14] Ex. ORA-31 (Tang) at 19.

[15] UCAN (Charles) at 35.

[16] Ex. SDG&E-43-2R (Deremer) at KJD-4-KJD-5.

> revenue increases simply based on a single index, with no distinction between expenses versus capital additions. While applying a single index, as proposed by DRA, offers simplicity, we conclude that such an approach fails to adequately capture the distinctions between expense and capital expenditure attrition. We also decline to apply the CPI as an escalation factor. The CPI reflects consumer retail price changes, not the escalation in wholesale purchases of utility goods and services. Accordingly, we generally adopt industry specific escalation factors, rather than use of the CPI.[17]

Furthermore, an attrition adjustment based on CPI will not reflect revenue requirement increases from plant additions in excess of depreciation (rate base growth) and cost escalation SDG&E will face in the attrition years. Changes in capital revenue requirement components (authorized returns on rate base, depreciation expense, and taxes) are determined almost entirely by the relationship between capital additions and depreciation. When capital additions exceed depreciation, rate base increases and the related capital revenue requirement components also increase. These increases are unrelated to inflation, and rate base growth has no correlation to CPI.

Second, as described in my direct testimony, SDG&E expects to make significant annual capital investments during the TY 2019 GRC cycle in order to maintain and enhance its safety and risk-focused investment plan aligned with Commission policy.[18] This includes increasing investments necessary to build and maintain safe and reliable infrastructure and to mitigate safety risks identified in the RAMP proceeding, as described in the risk policy testimony of witness Ms. Diana Day[19] and the various operations witnesses. Moreover, my testimony states that these expenditures should not be considered a one-time investment, but rather a part of an ongoing effort, which will continue beyond the test-year period. Both ORA and UCAN recognize that capital investment programs will require additional revenues above a strict increase in CPI. However, CPI plus an adder does not appropriately capture increases in utility-specific cost inflation or increases in depreciation, taxes and return.

Third, recent non-Sempra GRC decisions for Post-Test Year attrition do not yield a 4.0% midpoint. In all recent utility decisions among the other California IOU's, 4.0% is the lowest

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[17] D.14-08-032 at p.655.

[18] SDG&E-43-2R (Deremer) at KJD-4.

[19] SDG&E-02-R (Day), Chapter 1.

attrition approved.[20] Since 2012, the average approved post-test year escalation for the other California IOU's is ~5.2%. SDG&E does not support using a historical fixed rate to apply to future attrition rates since the historical rates do not align with the current economic conditions reflected in the forecasted GI rates. That said, if ORA believes it is reasonable to base attrition on recent GRC decisions, historical trends should justify a higher figure than the 4.0% that is currently recommended. As it pertains to Sempra's approved attrition in the TY 2016 GRC decision,[21] SDG&E and SoCalGas settled this case for an approved post-test year escalation of 3.5%. SDG&E emphasizes that parties make trade-offs when negotiating elements of an overall settlement, and therefore these results should not be precedential in the current GRC proceeding.

Finally, ORA's and UCAN's recommendations for annual attrition of 4.0% and CPI plus 75 basis points, respectively, appear arbitrarily determined. As I described earlier, in ORA's rebuttal testimony Mr. Tang states that the 4.0% attrition was guided by the following factors: CPI, recognition of capital addition revenues required above a strict increase in CPI, and attrition adopted in recent historical GRCs. However, in response to SDG&E data request on May 7, 2018,[22] ORA stated, "there were no supporting workpapers/calculations utilized in determining the 4.0% figure." Similarly, in response to an SDG&E data request on June 13, 2018,[23] UCAN stated, "there are no workpapers associated with the 75 basis points figure." To best capture SDG&E operating needs in the post-test year environment, the attrition amounts should reflect a numerical basis for the representative index of cost escalation, an appropriate estimation of capital additions, the associated impact on rate base, and the calculated increases for each revenue requirement component. This is the methodology utilized in SDG&E's proposed PTY mechanism. Both ORA and UCAN appear to recognize the deficiency of their primary proposals as they offer an alternate that is similar to SDG&E's PTY mechanism, which is addressed below.

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[20] SCE's and PG&E's authorized post-test year attrition since 2012. 4.0% granted in the first Post-Test Year of SCE's 2015 rate case; the second Post-Test Year attrition was granted at 5.0%.

[21] D.16-06-054 at 18.

[22] SEU-ORA-DR-7, referencing exhibit ORA-31.

[23] SEU-UCAN-DR-1, referencing UCAN rebuttal testimony of Brandon Charles.

## V. REBUTTAL TO ALTERNATIVE POST-TEST YEAR RATEMAKING PROPOSALS

ORA, UCAN, and FEA all present an alternative proposal to implement a PTY mechanism that align with SDG&E's proposal, but contain alternate recommendations to certain components of SDG&E's proposed mechanism. SDG&E appreciates the intervenors' recognition of the viability of SDGE's recommended mechanism, but disagrees with the changes intervenors make in their alternate proposals. While the below rebuttal will primarily address ORA's alternate proposal, it will also cover the specific recommendations from FEA and UCAN when they differ from ORA.

SDG&E disagrees with ORA's recommendation on the following items: (1) lower the annual medical escalation rate to a fixed rate (4.25%), (2) implement a 7-year average of capital additions (instead of SDG&E's proposed 5-year average), including actuals for 2017 and authorized forecasts for 2018 and 2019, and (3) limit the change in O&M escalation rates to a cap of no more than 100 basis points (1.00%) above the currently forecasted rates.

### A. Medical Escalation Rates

SDG&E believes utilization of Willis Towers Watson's medical escalation rates is more appropriate for the post-test years than ORA's recommended 4.25% flat rate.[24] ORA takes issue with the medical cost escalation rates used by SDG&E. SDG&E recommends using post-test year escalation rates of 6.5% for 2020, 6.0% for 2021, and 5.5% for 2022, while ORA recommends a rate of 4.25% per year for 2018 through 2022. The medical escalation forecast prepared by Willis Towers Watson is more appropriate because it takes into account demographic factors specific to SDG&E. These demographic factors – location, workforce demographics, and medical plan design – are key drivers of medical plan costs. Additional information is provided in Debbie Robinson's testimony.[25] The medical escalation rates shown in Ms. Robinson's chapter should be utilized for the PTY methodology.

[24] UCAN agrees with ORA's proposed medical escalation if a PTY mechanism is to be adopted. However, UCAN incorrectly claims that SDG&E proposes a 7.8% medical escalation rate for each post-test year in rebuttal testimony of Brandon Charles. SDG&E intends to utilize Willis Towers Watson actuarial forecast, which would result in a medical escalation rate of 6.5%, 6.0% and 5.5% for 2020, 2021 and 2022, respectively.

[25] October 6, 2017, Prepared Direct Testimony of Debbie S. Robinson, Ex. SCG-30/SDG&E-28.

### B. Capital Related Revenue Requirement

ORA recommends use of a 7-year average of capital additions (2013-2017 recorded and 2018-2019 Commission adopted). Similarly, FEA recommends use of a 7-year average of capital additions; however, their proposal is based on 2011-2017 recorded results. UCAN recommends use of a 5-year average of 2013-2017 recorded capital additions. SDG&E disagrees with the above proposals. Utilizing a 5-year average (2015-2016 recorded and 2017-2019 forecasted) best captures the utility investment profile and operating initiatives of the current utility environment, which has changed in the past few years. The five-year average has been widely used and adopted as a relevant and reasonable basis for the forecast of future costs in past and current SDG&E rate cases. As stated in my direct testimony[26] and in the testimonies of SDG&E's capital witnesses, SDG&E's capital program continues to evolve, with a greater focus on increasing investment in utility safety, reliability, grid modernization and clean energy, which directly support California's energy policies. As I mentioned earlier in my rebuttal, S-MAP and RAMP have also become a focus over the past few years, and through these proceedings the company will continue to identify necessary investment opportunities in safety and reliability in the upcoming years. The five-year average includes recorded and forecasted capital additions, which incorporate the company's more recent historical capital trend and focuses on critical improvements within our service territory. To illustrate the recent changes in SDG&E's capital program, the average escalated capital additions in the 2013-2014 period is ~$571 million compared to ~$683 million average of the 2015-2016 period, which results in an average annual growth rate of ~6% over the four-years. The demonstrated increase in capital additions over this time-frame reflects SDG&E's evolving priorities in the areas mentioned above. By utilizing the 5-year average of capital additions (2015-2019), SDG&E is able to more appropriately capture the future environment of the utility through the utilization of the most recent historical trends.

SDG&E also disagrees with intervenors' proposal to utilize 2017 actual capital additions and 2018-2019 authorized. 2017 recorded information was not available when SDG&E filed original testimony in October of 2017 and therefore could not be used in SDG&E's direct testimony presentation. It would significantly complicate the current GRC application to selectively choose certain items to update for actuals, while leaving others at the original

[26] Ex. SDG&E-43-2R (Deremer) at KJD-7: 3-9.

forecast. SDG&E disagrees with subjectively updating items after the date of our original submission. The forecasted capital additions for 2018 and 2019 are SDG&E's best estimate of future capital-related costs and should be used in the five-year average.

### C. O&M (Labor and Non-Labor) Margin Escalation Cap

ORA recommends that escalation rates be limited to 100 basis points (1.00%) above the currently forecasted GI rates. SDG&E disagrees with ORA's proposal to set limits on the post-test year O&M (labor and non-labor) escalation rates. Using GI escalation rates is fair and equitable for both ratepayers and shareholders and uses the best available data to forecast utility-specific costs. ORA's recommendation adds unnecessary complication to SDG&E's request. If a cap is adopted, it should act as a floor as well.[27]

## VI. REBUTTAL TO Z-FACTOR MECHANISM

### A. ORA does not oppose continuation of the Z-Factor mechanism, but recommends that it only be effective during the post-test years.

SDG&E disagrees with ORA's recommendation that the Z-factor mechanism only be effective during the post-test years, and not in the test year. The Z-factor was established to protect both the utility and ratepayers by preventing both windfall profits and large financial losses as a result of unexpected and uncontrollable events. These events can take place at any time during the rate case cycle, including the test year, which is why the Z-factor should remain continuously effective throughout.

In the final decision which granted SDG&E Z-factor treatment for increased insurance premiums, the Commission cited a list of 8 criteria that needed to be met in order to approve SDG&E's Z-factor eligibility.[28] Not included in this list is the additional requirement ORA suggests: that the Z-factor mechanism only be in effect for the post-test years, and not the test year. Rather, the timing of the Z-factor event is required to be "caused by an event that occurred after the implementation of rates." In D.10-12-053, the Commission stated, "the incurred costs caused by increases in insurance occurred in 2009, after the implementation of rates in 2008, thus satisfying the second Z-factor criterion." SDG&E emphasizes that in its evaluation of the

[27] In response to an SDG&E data request (SEU-ORA-DR-7, referencing exhibit ORA-31), ORA confirms that its escalation update proposal would also cap changes to O&M escalation updates more than 100 basis points (1.00%) below the SDG&E forecasted rates.

[28] D.10-12-053.

criterion above, the Commission states that the effective date of the rate change is the first day of the test year, January 1, 2008. Since the Z-factor event occurred after the first day of rate implementation, the Commission granted SDG&E's requested Z-factor treatment. This decision demonstrates that the Z-factor is in effect during both the test year and the post-test years.

Furthermore, the very nature of a Z-factor event is its unpredictability. Although the Z-factor case for insurance premium adjustments occurred in the following year after the implementation of rates, the fact remains that this was an unforeseen incident that just as easily could have occurred within the first year. If this were the case, SDG&E would not have been able to file for a Z-factor rate-change under ORA's recommendation. This would have resulted in substantial, unrecoverable financial losses for the utility due to an unforeseen event that was outside of the company's control. On the contrary, if a Z-factor event occurred in the test year that served to benefit SDG&E, the ratepayers would be similarly unprotected from a justified lowering of rates, resulting in surplus utility profit. Therefore, SDG&E believes the Commission should remain true to the Z-factor's practical intent, which serves as a protection to both the ratepayer and utility, and disregard ORA's limiting proposal.

## VII. OTHER INTERVENOR ISSUES

### A. UCAN claims that SDG&E's proposal is excessive, and disproportionately benefits shareholders at the expense of ratepayers.

In the testimony of Brandon Charles,[29] UCAN argues that, despite lower attrition rates approved in prior GRCs, "SDG&E's actual Rate of Return (ROR) has exceeded its authorized ROR in nine out of the past eleven years and in every year since 2013." According to UCAN, revenue requirement increases have been "used to pad the utilities' revenue requirements in order to reduce shareholder risk and increase shareholder profit," and eliminates "management responsibility to seek continued cost savings and efficiency enhancements." SDG&E disagrees. The attrition request for revenue requirement is decoupled from earnings. Attrition is designed to adjust utility revenues for the corresponding expected increase in cost escalation during the post-test year period. Separately, the utilities are able to realize earnings above or below the authorized margin based on how effectively they are able to manage those costs. SDG&E's future authorized revenue requirement should not be impacted by profits (or losses) earned in

[29] Ex. UCAN (Charles) at 13-14.

prior years. Attrition in the post-test years is implemented to capture cost escalation due to inflation and an expanding capital program, not profits, and the mechanism proposed by SDG&E is accordingly designed to account for these elements.

**B. ARAM**

SDG&E disagrees with TURN's proposal to increase ARAM in the attrition years. Witness Ragan Reeves speaks to the complexity of ARAM in his response to data request IS-SCG-009 in May 2018. Mr. Reeves states, "Due to the thousands of SoCalGas' [and SDG&E's] plant-related assets, and the (Tax Cuts and Jobs Act) TCJA's requirement to compute ARAM on an asset-by-asset basis, the ARAM computation is too complex and detailed to incorporate within SoCalGas' [or SDG&E's] Results of Operations (RO) Model or within an Excel file." For simplicity, SDG&E applied the 2019 ARAM amount to the attrition years. The ARAM calculation determined through Mr. Reeves' chapter should be utilized for the PTY methodology.

**C. Factoring CIS benefits into the 2022 Post-Test Year proposal**

UCAN argues that SDG&E's 2022 revenue requirement should be adjusted to subtract $39.4 million from the total revenue requirement to account for CIS Replacement Program benefits.[30] SDG&E agrees that the benefits of CIS should be incorporated into the company's revenue requirement. However, SDG&E has two issues with UCAN's proposal. First, the $39.4 million UCAN cites represents direct costs, and it would not be appropriate for SDG&E to reduce its revenue requirement by the direct cost amount. The CPUC-jurisdictional revenue requirement amount associated with these direct costs is $11.7 million.[31] Second, SDG&E has not received final approval of the CIS project, and depending on the timing of the decision, the associated benefits may be delayed. With these two caveats, SDG&E agrees it is reasonable to adjust the applicable post-test year revenue requirement as determined by the final decision in the CIS Replacement proceeding.

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[30] Ex. UCAN (Charles) at 45.

[31] November 13, 2017, Prepared Rebuttal Testimony of Michael R. Woodruff on Behalf of San Diego Gas & Electric Company, Ex. SDG&E-16 at 2:Table 3.

## VIII. CONCLUSION

To summarize, ORA's primary attrition proposal of a 4.0% flat rate and UCAN's CPI plus 75 basis points should not be adopted because they are not an appropriate measure of SDG&E's attrition needs during the post-test years, and they fail to adequately capture the changing environment in which the utility operates. The alternative proposals recommended by ORA, UCAN, and FEA to implement a PTY mechanism is a more appropriate measure of SDG&E's attrition needs, provided that the shortfalls outlined in my rebuttal are properly addressed. SDG&E's attrition mechanism is fair and reasonable, and provides the foundation for operational and financial stability in the post-test years. Finally, as stated in my direct testimony and earlier in my rebuttal, SDG&E agrees with ORA that the four-year rate case cycle should be adopted. This proposal accounts for the major cost drivers impacting the Company, which allows SDG&E to provide safe and reliable service to its customers, comply with regulations, and manage its operations as prudent financial stewards.

This concludes my prepared rebuttal testimony.

## APPENDIX A – GLOSSARY OF TERMS

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|---|---|
| ARAM | Average Rate Assumption Method |
| CIS | CIS Replacement Program |
| Commission | California Public Utilities Commission |
| CPI | Consumer Prices Index |
| CUE | Coalition of California Utility Employees |
| DRA | Division of Ratepayer Advocate |
| FEA | Federal Executive Agencies |
| GI | Global Insight |
| GRC | General Rate Case |
| O&M | Operations and Maintenance |
| ORA | Office of Ratepayer Advocates |
| PG&E | Pacific Gas and Electric Company |
| PTY | Post-Test Year |
| RAMP | Risk Assessment and Mitigation Phase |
| RO | Results of Operations |
| ROR | Rate of Return |
| SBUA | Small Business Utility Advocates |
| SCE | Southern California Edison Company |
| SDG&E | San Diego Gas & Electric Company |
| S-MAP | Safety Model Assessment Proceeding |
| SoCalGas | Southern California Gas Company |
| TURN | The Utility Reform Network |
| TY | Test Year |
| UCAN | Utility Consumers Action Network |