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Witness: Michael W. Foster
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PREPARED REBUTTAL TESTIMONY OF

MICHAEL W. FOSTER

ON BEHALF OF SOUTHERN CALIFORNIA GAS COMPANY

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

AUGUST 29, 2012

The Gas Company

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I. INTRODUCTION

Division of Ratepayer Advocates ("DRA") and The Utility Reform Network ("TURN") proposed no changes to the embedded cost calculations and proposed capital structure set forth in direct testimony. Therefore, this rebuttal testimony does not specifically address all the arguments, statements, or rationale that DRA and TURN articulated in their respective testimonies. Instead, Southern California Gas Company ("SoCalGas" or "Company") considers the embedded cost calculations and capital structure as uncontested issues in this proceeding with respect to DRA and TURN.

The purpose of this rebuttal testimony is to address the testimony of Federal Executive Agencies ("FEA"), by its witness, Stephen G. Hill, contesting the Company's proposed capital structure. FEA does not contest the Company's embedded cost calculations.

II. SUMMARY OF FEA'S RECOMMENDATION

Mr. Hill proposes a ratemaking capital structure for SCG of 50.0% common equity, 2.4% preferred stock and 47.6% long-term debt.[1] The capital structure proposal of SoCalGas is contrasted to FEA's proposal in Table 1.

[1] *See* Direct Testimony and Exhibits of Stephen G. Hill Regarding Cost of Capital, on Behalf of The Federal Executive Agencies, pp. 87-88.

Table 1 – Capital Structure Proposals Contrasted

	SoCalGas	FEA
Long-Term Debt	45.6%	47.6%
Preferred Stock	2.4%	2.4%
Common Equity	52.0%	50.0%

III. REBUTTAL TO FEA'S TESTIMONY

In making his recommendation, Mr. Hill does not contest reducing the Company's authorized preferred stock level from its current authorized level of 6.39% to 2.4%. However, Mr. Hill rejects the Company's proposal to maintain its currently authorized debt level at 45.6%, and proposes "that the percentage reduction each company seeks in its use of preferred stock be split evenly between equity and debt,"[2] which results in an authorized debt level of 47.6% and common equity level of 50.0%. SoCalGas makes the following observations regarding Mr. Hill's recommendation:

- Mr. Hill's proposed "even split" of preferred stock to debt and equity is arbitrary and lacking in empirical or analytical support. Additionally, in adopting the Company's proposed capital structure, DRA also showed that the average common equity ratio for its gas proxy group was 56.8%.[3] TURN likewise provided evidence that shows that the Company's proposed 52.0% common equity ratio falls below the 2013 average among comparable gas utilities (i.e., 56.86%) as reported by Value Line, with the lowest common equity ratio in the group being 51.5%.[4] Mr. Hill did not provide any analysis on the common equity ratios of gas utilities; therefore, he

[2] FEA/Hill testimony at 87.
[3] *See* DRA Report of the Cost of Capital for Test Year 2013 (J. Randall Woolridge testimony), pp. 3-19 to 3-20.
[4] *See* Direct Testimony and Exhibits of Daniel J. Lawton on Behalf of The Utility Reform Network, p. 82 and Schedule DJL-18.

provides no evidence that demonstrates that the Company's proposed common equity ratio and capital structure on the whole are unreasonable.

- Mr. Hill states that the Company's proposed changes to its currently authorized capital structure are "expensive."[5] When viewed in isolation, and all else unchanged, an increase in a utility's authorized common equity level will increase rates. However, the Company's Cost of Capital recommendation, when viewed as a whole, results in a net decrease to rates. The decrease in the embedded cost of debt, along with a reduction in the preferred stock ratio, causes the weighted costs of both debt and preferred stock to decrease, which offsets the increased weighted cost of common equity, and leads to a lower overall rate of return than currently authorized.[6]
- In proposing a capital structure which increases the company's authorized long term debt level, Mr. Hill states that, "[g]iven that the Companies' current financial position puts them very near the top of the industry, and that they have achieved that lofty status with more cost effective capital structures that utilized less common equity than the amount requested by SDG&E and SCG…."[7] This statement is not correct. SoCalGas currently uses less leverage than what has been requested or is currently authorized, and utilizes more common equity, not less, in anticipation of increased capital expenditure levels. This has solidified the Company's credit rating and leaves room for greater debt issuance in the future to finance AMI and PSEP investments. The fact that SoCalGas is requesting to align its actual common equity percentage to a more commensurate authorized equity position should be viewed by

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[5] *See* FEA/Hill testimony at 86.
[6] *See* Exh. SCG-1, Prepared Direct Testimony of Robert M. Schlax, pp. 2-3.
[7] FEA/Hill testimony at 87.

the Commission as a positive and constructive position because it shows greater shareholder commitment to the utility's credit quality and the utility's financial strength necessary to carry out Commission-approved capital projects.

- Mr. Hill states that "…Sempra raised its dividend earlier this year by 25%. By any standard, that is an enormous dividend increase and represents a transfer of significant capital to the Company's stockholders."[8] The dividend policy of the parent company, Sempra Energy, is not relevant in determining the appropriate capital structure for SoCalGas, and is not supportive of Mr. Hill's position, as the size and timing of Sempra Energy's dividends are not solely dependent on its utility businesses. In addition, as mentioned above, in anticipation of increased capital expenditure levels, the Company has been capitalized more with common equity than authorized, the cost of which is not recoverable in rates.

IV. CONCLUSION

Mr. Hill's testimony does not provide convincing evidence or compelling arguments to merit adoption of FEA's proposed capital structure over the Company's proposal, which is adopted by DRA, and not contested by TURN, based on their respective expert witnesses' analyses. SoCalGas maintains that its requested (and currently authorized) long term debt ratio of 45.6%, and overall capital structure for the test year, are appropriate and promote the long term best interests of ratepayers and shareholders alike. Therefore, the Company respectfully requests that the Commission approve SoCalGas' proposed capital structure.

This concludes my prepared rebuttal testimony.

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[8] FEA/Hill testimony at 87.