

Company: Southern California Gas Company (U 904 G)
Proceeding: 2023 Cost of Capital
Application: A.22-04-011
Exhibit: SCG-06

SOUTHERN CALIFORNIA GAS COMPANY (U 904 G)
PREPARED REBUTTAL TESTIMONY OF MIA L. DEMONTIGNY
(POLICY OVERVIEW)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

August 2022

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1 reductions, not only to SoCalGas’s proposal of 10.75% ROE and 7.60% ROR,⁸ but to
2 SoCalGas’s currently authorized ROE and ROR of 10.05% and 7.30%, respectively. From my
3 perspective, adoption of a ROE and ROR in the vicinity of intervenors’ recommendations would
4 adversely affect SoCalGas’s “A” credit rating, would be viewed negatively by the credit rating
5 agencies, and in turn, would poorly position SoCalGas to compete for and attract investor capital
6 in a highly competitive market. In the Company’s rebuttal testimony, James Coyne provides his
7 analysis of the intervenors’ proposals (including an evaluation of their ROE proposals).
8 SoCalGas’s witness, Shirley Arazi, also provides rebuttal testimony in which she primarily
9 analyzes certain intervenors’ capital structure proposals, which would keep SoCalGas’s
10 authorized common equity ratio unchanged at 52% and increase the authorized long-term debt
11 ratio to 47.6%, making it difficult for SoCalGas to maintain its “A” credit rating, despite
12 compelling data that supports a higher authorized common equity ratio.

13 My rebuttal testimony will (1) briefly address recommendations contained in the direct
14 testimony from EDF⁹ which are out of scope of this proceeding, (2) address concerns with Cal
15 Advocates’ capital structure analyses, and (3) address PCF’s request that the Commission require
16 SoCalGas to provide an additional analysis of the relationships between ROE, equity ratio, and
17 creditworthiness even though sufficient analysis has already been provided.

18 **II. EDF’S IRRELEVANT POLICY ISSUES SHOULD BE DISREGARDED**

19 EDF’s testimony from Dr. McCann appears to provide a more cursory analysis of
20 SoCalGas’s cost of capital proposal than the testimonies submitted by some other intervenors. In
21 this context, it is noteworthy that EDF recognizes that the move to decarbonize and electrify

⁷ Direct Testimony of Mark E. Ellis (Exhibit PCF-01) at 9.

⁸ Direct Testimony of Mia DeMontigny (Exhibit SCG-01) at 4.

⁹ Direct Testimony of Richard McCann (Exhibit EDF-01).

1 energy use is an increased risk factor for California’s gas utilities. According to Dr. McCann,
2 “This means that the natural gas utilities are likely to face decreasing demand over the next
3 couple of decades and increased likelihood of stranded assets. This could be interpreted as an
4 increased risk factor...”¹⁰ Given Dr. McCann’s recognition of this uniquely gas utility-focused
5 risk, one which disproportionately impacts SoCalGas relative to other gas utilities in the nation
6 and other electric and combined energy utilities in California, SoCalGas’s adopted ratemaking
7 cost of capital should adequately account for this risk and provide for returns commensurate with
8 this increased risk.

9 However, Dr. McCann does not raise this heightened risk factor to acknowledge that gas
10 utility ROEs should sufficiently compensate for this risk. Instead, Dr. McCann’s analysis
11 engages in a discussion of compensating shareholders for stranded costs and disincentivizing
12 investment.¹¹ Here, EDF goes beyond the relevant and permissible scope of this proceeding and
13 argues against longstanding principles established in the *Bluefield* and *Hope* cases that set forth
14 the standard for measuring just and reasonable rates, specifically that allow a public utility’s
15 return to be reasonably sufficient to assure confidence in the financial soundness of the utility
16 and to maintain its credit rating.¹² EDF urges the Commission to effectively use a utility’s cost
17 of capital to effectuate environmental policy outcomes by adopting an authorized ROE for
18 SoCalGas that would *disincentivize* investment. EDF devotes a substantial portion of its
19 testimony to argue this point. Examples are found throughout EDF’s testimony, including the
20 following excerpts:

¹⁰ *Id.* at 25.

¹¹ *Id.* at 25-26.

¹² *Bluefield Water Works Co. v. Public Serv. Comm’n*, 262 U.S. 679, 692 (1923); *see also*, Direct Testimony of Deana Ng (Exhibit SCG-03) at 1-5.

- 1 • “[T]he Commission should separately consider the ROEs by utility function to
2 align incentives with the state’s environmental policy objectives.”¹³
- 3 • “[T]he utilities’ ROE should be reduced to conform with the changes in the
4 general equities market and maintain affordable electricity prices to further the
5 state’s goals in reducing greenhouse gas emissions.”¹⁴
- 6 • “[A]djusting the overall ROE can provide incentives that affect many other utility
7 decisions that are not germane to the specific risk at hand.”¹⁵
- 8 • “The move to decarbonize and electrify energy use will likely lead to decreased
9 natural gas (methane) use. . . . We are left with one other risk that requires a
10 broader policy decision. . . . The Commission should begin to engage on
11 facilitating this transition so as to compensate utility shareholders for their past
12 investments and equitably share responsibilities and burdens.”¹⁶
- 13 • “The authorized ROE for the utilities’ gas operations should reflect incentive for
14 reduced investment and eventual decommissioning of the natural gas distribution
15 system. Importantly, for both new investment and legacy investments, a lower
16 ROE makes the legacy costs more affordable for dwindling remaining customers.
17 Further, the Commission should adopt accelerated depreciation of natural gas
18 assets. Accelerated depreciation leads to a lower ROE because investors have a
19 greater assurance of recovering their investments.”¹⁷

¹³ Direct Testimony of Richard McCann (Exhibit EDF-01) at 7.

¹⁴ *Id.* at 6.

¹⁵ *Id.* at 23.

¹⁶ *Id.* at 25.

¹⁷ *Id.* at 44.

1 While the State’s legislative and regulatory policies and proclamations impacting natural
2 gas are relevant in the context of assessing SoCalGas’s risk relative to other utilities, EDF’s
3 suggestion that the Commission should somehow advance or accelerate statewide
4 decarbonization or electrification through adoption of a cost of capital that disincentivizes
5 investment is in clear and direct conflict with the applicable law set forth in *Hope* and *Bluefield*
6 and the purpose of this proceeding.¹⁸

7 It bears emphasizing that these very issues were advanced in EDF’s Protest to
8 SoCalGas’s Application and were not adopted by the Commission in its ensuing Scoping
9 Memo.¹⁹ Indeed, the Commission gave due consideration to the issues that parties wanted
10 addressed in this proceeding, through its review of the filed protests and replies, and its
11 solicitation of comments on scope at the prehearing conference. EDF’s decarbonization policy
12 issues were among those considered and ultimately not included. In fact, the Scoping Memo
13 states that there is the potential for an additional track following the culmination of a decision of
14 all issues identified in the Scoping Memo for “other policy modifications [...] with regard to
15 future cost of capital application cycles.”²⁰ Despite this, EDF raises them again in direct
16 testimony, causing continued burden upon, and distraction to,²¹ parties and the Commission in

¹⁸ See Southern California Gas Company (U 904 G) Reply to Protests (June 6, 2022) at 5-7.

¹⁹ Moreover, this same argument was advanced in the test year 2020 Cost of Capital proceeding and was also not adopted by the Commission in the scoping memo. (See Southern California Gas Company (U 904 G) Reply to Protests (June 3, 2019) at 4-7 and Assigned Commissioner’s Scoping Memo and Ruling (July 2, 2019) at 3.)

²⁰ See Assigned Commissioner’s Scoping Memo and Ruling (July 12, 2022) at 3.

²¹ In addition, witness McCann in EDF’s testimony provides purported recommendations for what the Commission should address in the Long-Term Gas System Planning OIR (R.20-01-007). (Direct Testimony of Richard McCann (Exhibit EDF-01) at 47). Those are plainly issues addressed in the Long-Term Gas System Planning OIR and issues are not in scope for this proceeding. Accordingly, such issues should not be considered for this proceeding.

1 the determination of a fair and reasonable cost of capital, which satisfies the legal standard set
2 forth in the *Bluefield* and *Hope* cases.²²

3 The Commission should not be driven to disincentivize one utility's investments over
4 another, but instead should determine a return that is reasonably sufficient to instill confidence in
5 the financial soundness of the utility; commensurate with returns available on alternate
6 investments of comparable risks; and adequate, under efficient management, to maintain and
7 support its credit and enable it to raise the funds necessary for the proper discharge of its public
8 duties. Put simply, the Commission should determine a fair and reasonable authorized cost of
9 capital which satisfies the legal standard set forth in *Bluefield* and *Hope*. Therefore, SoCalGas
10 asks the Commission to hold parties to the adopted scope in this proceeding, which would
11 exclude litigation of EDF's policy agenda.

12 **III. CAL ADVOCATES' ARGUMENT REGARDING USING THE COMMON** 13 **EQUITY RATIO OF HOLDING COMPANIES IS MISGUIDED**

14 Cal Advocates' witness J. Randall Woolridge provides a comparatively traditional review
15 of the utilities' cost of capital proposals. In rebuttal testimony, Mr. Coyne provides an in-depth
16 analysis of Dr. Woolridge's analysis of ROE and Ms. Arazi provides an analysis of Cal
17 Advocates' testimony regarding proposed capital structure.

18 However, I identified an issue observed in Dr. Woolridge's analysis of authorized capital
19 structure which stood out as misguided, irrelevant, and in which a similar proposal was raised in
20 Cal Advocates' 2020 Cost of Capital testimony²³ but was not ultimately adopted by the

²² SoCalGas Reply to Protests at 5-7; *see also*, Direct Testimony of Mia DeMontigny (Exhibit SCG-01) at 2-3.

²³ *See* A.19-04-018 (2020 Cost of Capital) Direct Testimony of Aaron L. Rothschild at 31-32, 37-41.

1 Commission.²⁴ Dr. Woolridge opines that the holding company’s consolidated capital structure
2 should inform the authorized capital structure of the regulated utility in this proceeding.²⁵

3 Determining SoCalGas’s capital structure based on that of its holding company rather
4 than based on its own operations, is not relevant. Operating regulated utilities possess their own
5 capital structure. Moreover, the Commission neither regulates nor authorizes the capital structure
6 of Sempra (SoCalGas is a regulated utility subsidiary of Sempra) and is not examining the
7 decisions or the financial drivers of Sempra or any of its non-regulated, out-of-state, or
8 international subsidiaries in this proceeding. Furthermore, Sempra and those subsidiary entities
9 are (appropriately) not parties to this proceeding.

10 The various subsidiaries owned by Sempra have distinguished risk profiles, and as such,
11 Sempra’s consolidated risk profile is distinguished from any one of its subsidiaries. Credit rating
12 agencies’ view of Sempra’s risk profile is apparent in its “BBB+” credit rating compared to
13 SoCalGas’s “A” rating. SoCalGas’s higher credit rating in comparison with Sempra could be
14 attributed, in part, to SoCalGas’s higher common equity ratio. The risks and capital structures of
15 Sempra and those of its subsidiaries (except SoCalGas and SDG&E) are not being reviewed in
16 this proceeding.

17 Because a consolidated capital structure is by its very definition a reflection of a diversity
18 of different business enterprises, one cannot make any meaningful extensions of a holding
19 company’s consolidated structure to a regulated utility subsidiary’s authorized capital structure
20 in the context of adopting an authorized ratemaking cost of capital. As described in Ms. Arazi’s
21 direct and rebuttal testimony, SoCalGas’s proposal is supported by the utility’s actual capital

²⁴ D.19-12-056.

²⁵ Direct Testimony of J. Randall Woolridge (Exhibit Cal Adv-01) at 28.

1 structure levels over the past five years,²⁶ as well as comparisons to authorized capital structures
2 of other comparable regulated local distribution gas utilities,²⁷ and the resulting ability to support
3 a strong credit profile for efficient access to capital markets. SoCalGas's proposed capital
4 structure is evaluated based on utility-specific planned capital investments, utility-specific credit
5 ratings, utility-specific risks, and utility-specific operational and financing needs. This is the
6 type of probative data and analysis that the Commission has given weight to in prior cost of
7 capital decisions and should be applied again in this proceeding.

8 Accordingly, Cal Advocates' argument that the common equity ratio of SoCalGas's
9 holding company should be used in determining SoCalGas's capital structure is inappropriate
10 and should not be considered.

11 **IV. PCF'S REQUEST FOR ADDITIONAL ANALYSIS SHOULD NOT BE ADOPTED**

12 Mr. Ellis on behalf of PCF requests:

13 The Commission should require SDG&E and SoCalGas each to provide a detailed
14 analysis of the relationships between ROE, equity ratio, and creditworthiness so
15 that the Commission possesses the facts it needs to come to fact-based
16 conclusions about the Sempra Utilities' authorized capital structures.²⁸

17 In my direct testimony,²⁹ as well as that of Ms. Arazi,³⁰ Mr. Coyne,³¹ Ms. Ng,³² and Mr.
18 Billings,³³ SoCalGas has provided ample analysis and discussion regarding the interactions

²⁶ Direct Testimony of Shirley Arazi (Exhibit SCG-02) at 4-5, 12-14.

²⁷ Rebuttal Testimony of Shirley Arazi (SCG-07) at 7-9.

²⁸ Direct Testimony of Mark E. Ellis (Exhibit PCF-01) at 29.

²⁹ Direct Testimony of Mia DeMontigny (Exhibit SCG-01).

³⁰ Direct Testimony of Shirley Arazi (Exhibit SCG-02).

³¹ Direct Testimony of James Coyne (Exhibit SCG-04).

³² Direct Testimony of Deana Ng (Exhibit SCG-03).

³³ Direct Testimony of Patrick Billings (Exhibit SCG-05).

1 between the components of our cost of capital, including the relationships between ROE,
2 quantitative and qualitative risk, equity ratios, creditworthiness, and policy considerations.
3 SoCalGas’s application and direct testimony highlight the importance of authorizing a fair rate of
4 return for maintaining its “A” credit rating, cites its historical actual capital structure and
5 embedded costs, and addresses quantitative and qualitative risk. Additionally, PCF’s request for
6 additional analysis would be in contrast with the schedule laid out in the scoping ruling of this
7 proceeding, which determined to conclude by year-end,³⁴ and would unnecessarily delay the
8 proceeding. The Commission should not afford these proposals weight as SoCalGas has already
9 provided sufficient evidence in its direct and rebuttal testimony.

10 **V. CONCLUSION**

11 For the reasons stated herein, the Commission should disregard the above-discussed
12 portions of intervenor testimony that do not advance the issues that are in scope in this
13 proceeding. SoCalGas respectfully asks the Commission to adopt its proposed Test Year 2023
14 Cost of Capital, as it represents a fair Rate of Return, supported by sound data and financial
15 modeling, consideration of qualitative and quantitative analysis from witnesses, is credit
16 supportive, and is commensurate with SoCalGas’s risks.

17 This concludes my prepared rebuttal testimony.

³⁴ Scoping Memo at 4-5.