Company: Southern California Gas Company (U 904 G)
Proceeding: 2020 Cost of Capital
Application: A.19-04-XXX
Exhibit: SCG-02

SOUTHERN CALIFORNIA GAS COMPANY (U 904 G)

PREPARED DIRECT TESTIMONY OF RICARDO GONZALEZ

(AUTHORIZED CAPITAL STRUCTURE)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

April 2019

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SOUTHERN CALIFORNIA GAS COMPANY

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(AUTHORIZED CAPITAL STRUCTURE)

I. INTRODUCTION

My testimony presents a proposal for an updated authorized capital structure for Southern California Gas Company (SoCalGas). The authorized capital structure refers to the capital ratios of three components: (1) Long-Term Debt, (2) Preferred Equity (*i.e.*, Preferred Stock), and (3) Common Equity. The capital ratios, in conjunction with the proposed embedded costs (defined later) associated with the three components, determine the weighted-average cost of capital or authorized Rate of Return (ROR). Table 1 below shows SoCalGas' currently authorized capital structure, and its proposed capital structure, to be effective January 1, 2020. Finally, I address the issue of customer deposits.

TABLE 1 – CURRENT AND PROPOSED AUTHORIZED CAPITAL STRUCTURE

Capital Structure Component	Currently Authorized[1]	Proposed 2020	Change (basis points)
Long-Term Debt	45.60%	43.60%	-200 bps
Preferred Equity	2.40%	0.40%	-200 bps
Common Equity	52.00%	56.00%	400 bps
Total	100.00%	100.00%	

[1] *See* D.12-12-034, *mimeo*, p. 53 (Ordering Paragraph 3).

The Long-Term Debt ratio of a utility's authorized ratemaking capital structure represents a measurement of a company's financial leverage. A high Long-Term Debt ratio increases the risk of debt repayment to lenders and, all other things being equal, will result in higher costs of capital over the long-term since the utility will not be as competitive in issuing new Long-Term Debt at low costs. Conversely, a low Long-Term Debt ratio is not preferred as it does not take advantage of a tax-deductible source of financing, resulting in lower cost than equity.

Preferred Equity is a source of capital that is issued in shares and pays dividends, like Common Equity, but Preferred Equity dividends are paid at an agreed upon amount at regular intervals. Preferred Equity generally has a lower cost than Common Equity, but higher cost than Long-Term Debt. Credit rating agencies generally treat preferred stock as a hybrid of debt and equity, assigning a percentage of equity content in accordance with the security's features.

The Common Equity component represents the amount of capital funded by shareholders. The Common Equity ratio reflects how a company is financing its cash needs and shows the percentage of assets on which the shareholders have a claim. A high Common Equity ratio lowers financial risk by reducing the reliance on Long-Term Debt.

In the following sections, I discuss the derivation of each of the capital structure components: Long-Term Debt, Preferred Equity, and Common Equity.

II. LONG-TERM DEBT

A. Embedded Cost of Long-Term Debt

The term "embedded costs" refer to the costs associated with the issuance and servicing of Preferred Equity or Long-Term Debt, expressed as a percentage of the net proceeds received from the issuance of that equity or debt. The embedded cost of Long-Term Debt represents all the costs (including historical costs of past Long-Term Debt issuances currently outstanding) associated with the issuance and servicing of Long-Term Debt, expressed as a percentage of the net proceeds received from Long-Term Debt issuances. As shown in Table 2, SoCalGas is proposing an embedded cost of Long-Term Debt of 4.23%.

TABLE 2 – CURRENT AND PROPOSED AUTHORIZED EMBEDDED COSTS

Embedded Cost Component	Currently Authorized	Proposed 2020	Change (basis points[2])
Long-Term Debt	4.33%	4.23%	-10 bps

In Appendix A, I have included a detailed derivation of this figure. The proposed embedded cost of Long-Term Debt is 10 basis points lower than the currently authorized embedded cost of Long-Term Debt of 4.33%. SoCalGas proposes setting the authorized cost of debt equal to the forecasted embedded cost of Long-Term Debt. A summary of SoCalGas' planned Long-Term Debt issuances is shown in Table 3.

[2] A one basis point change equals a 0.01% change. A ten basis point change equals a 0.1% change. A 100 basis point change equals a 1.0% change. "Basis points" is abbreviated as bps in my tables.

TABLE 3 – FORECASTED[3] LONG-TERM DEBT ISSUANCES

Expected Issue Date	Principal	Term (years)	30-year Treasury	Spread (bps)	Forecasted Coupon Rate
2019	$500,000,000	30	3.16%	130	4.46%
2020	$300,000,000	30	3.42%	130	4.72%

The embedded cost of debt calculation uses the March 2019 IHS Markit Global Insight forecast of the 30-year Treasury bond yield for 2019 and 2020, plus an estimation of a SoCalGas-specific credit spread. The credit spread is estimated as the current G-spread[4] of 110 basis points plus a concession spread of 20 basis points.[5] The concession spread is added to reflect current market conditions. That credit spread equates to 130 basis points.

The Commission has stated that, "[t]he latest available interest rate forecast should be used to determine embedded long-term debt and preferred stock costs in ROE proceedings."[6] In accordance with that guidance, and as it did in the prior Cost of Capital proceeding (Application (A.)12-04-017), SoCalGas plans to submit an embedded cost update that reflects the latest forecast as well as any changes to

[3] The timing and amounts of the forecast provided herein are subject to change based on market conditions and management's discretion.

[4] G-spread means the difference between yield on Treasury bonds and the yield on corporate bonds of the same maturity. Based on market conditions as of April 2, 2019 sourced from Bloomberg. Market conditions will be updated at a later point to reflect current conditions as part of the filing process.

[5] New Issue Concession is the difference between the spread at which new bonds are issued and the spread at which corresponding bonds of the same issuer are traded in the secondary market. New issuance concession assumption based on recent indications from multiple banks and precedent utility transactions.

[6] *See* D.07-12-049, *mimeo*, p. 33 (Conclusion of Law 33).

SoCalGas' Long-Term Debt forecast that may take place between the preparation of this testimony and the submittal of the update.

B. Long-Term Debt Ratio

SoCalGas is proposing an authorized Long-Term Debt ratio of 43.60%, which is a 200 basis point reduction to the currently authorized Long-Term Debt ratio of 45.60%. However, the proposed 43.60% is 113 basis points higher than the average recorded long-term debt ratio of 42.47%, as shown in Table 4.

TABLE 4 – RECORDED LONG-TERM DEBT RATIO

Recorded[7]	2013	2014	2015	2016	2017	2018	2013-2018 Average	Proposed 2020
Long-Term Debt	35.52%	40.61%	44.31%	46.11%	43.47%	44.80%	42.47%	**43.60%**

The proposed authorized Long-Term Debt ratio supports SoCalGas' expected level of capital expenditures and is intended to maintain SoCalGas' credit rating.

1. Capital Expenditures

As discussed in Exhibit SCG-03 (Aragon), SoCalGas' capital expenditure forecast is expected to exceed cash flow from operations over the next five years. Over that period, SoCalGas anticipates that its capital spending will average $1.3 billion per year. SoCalGas' investment program reflects significant investments in large-scale capital projects such as the Pipeline Safety Enhancement Plan (PSEP) and pipeline integrity and safety-related projects. In addition, SoCalGas has proposed significant

[7] Represents capital structures recorded at year-end.

capital investments as part of 2019 General Rate Case (GRC)[8] that is currently pending before this Commission.

As a result, SoCalGas plans to raise approximately $500 million in 2019 and $300 million in 2020 of new Long-Term Debt by issuing taxable first mortgage bonds to fund capital investments, as shown in Table 3.

2. Authorized Capital Structure Should Be Credit Supportive

SoCalGas manages its capitalization in a manner that supports and maintains its current solid "A" credit rating. An optimal capital structure supports a strong credit rating, lowering borrowing costs for the utility and, ultimately, ratepayers. This optimal capital structure involves a blend of Long-Term Debt and Common Equity financing. Long-Term Debt is normally less expensive than Common and Preferred Equity, due to its tax advantage and lower risk. However, there are limits to this benefit since a higher Long-Term Debt ratio may result in a credit rating downgrade and increased financial risk.[9] A high debt ratio increases financial risks because the fixed costs associated with Long-Term Debt require a higher return for both debt and equity for investors, as the earnings available to shareholders become more volatile and secondary to debt payments.

In an environment of significant business risks, as described in Exhibit SCG-03 (Aragon), it is crucial to manage financial risk. Financial risk can be effectively managed through the use of debt such that debt relative to total capitalization does not exceed thresholds established by the credit rating agencies. SoCalGas' proposed

[8] A.17-10-008.

[9] *See* D.89-11-068, *mimeo*, p. 28.

capital structure aims to support and maintain its current solid "A" credit rating by minimizing financial risk, strengthening key credit metrics, and optimizing the use of debt relative to equity at levels that will ultimately minimize costs to the ratepayer.

a. Financial Risk

The more debt a company utilizes, the greater the financial risk to both stockholders and debt holders. A rising debt-equity ratio implies that a company has growing fixed obligations to holders of securities that have precedence to revenues. As those obligations increase, more revenues must be committed to these payments, thus increasing risk to the company's initial debt holders. Similarly, the larger the revenues committed to fixed obligation payments, the greater the financial risk exposure to the common stockholders, as they are entitled only to revenues available after all fixed obligation payments are satisfied.

While the lower cost of debt relative to equity may be viewed as a way to lower a utility's cost of capital by having the utility issue more Long-Term Debt rather than equity, this can increase the financial risk to the utility. SoCalGas' proposed Long-Term Debt ratio is intended to keep financial risk low while still supporting a significant debt portfolio to help finance SoCalGas' capital expenditures.

b. Key Credit Metrics

The major credit rating agencies commonly employ a few key metrics as a means to quantify financial risk, such as interest coverage ratios and funds from operations as a percent of total debt. Together with their assessment of business risk, the major credit rating agencies use these credit metrics to help guide the credit ratings they assign.

The coverage ratio (CR) measures the cash from operations, or funds from operations (FFO) in a given period, available for servicing debt, measured as a ratio to total debt servicing obligations in that period. It is indicative of a company's ability to pay its annual debt servicing obligations, where a higher ratio indicates a stronger ability to service its debt, and thus lower financial risk.

FFO-to-Total Debt is another of the key metrics employed by major credit rating agencies. FFO-to-Total Debt measures FFO as a percent of total debt and indicates how much of its debt a company could retire with annual cash from operations, where a higher figure indicates a stronger ability to retire its debt, and thus lower financial risk.

In its most recent credit opinion of SoCalGas, Moody's specified a lower bound FFO-to-Total Debt of 22% for SoCalGas to avoid a downgrade from its current "A1" rating for senior unsecured debt.[10] In the section titled "Factors that could lead to a downgrade," Moody's states that SoCalGas' ratings could be downgraded if:

- there is a deterioration in the utility's relationship with the Commission and/or the credit supportiveness of the California regulatory environment,
- the 2019 GRC results in inadequate rate relief or higher leverage the weakens SoCalGas' credit metrics, and/or
- a significant decline in Sempra Energy's credit quality.

[10] Source: Moody's, Credit Opinion: "Southern California Gas Company," (November 15, 2018). Moody's "A1" rating is equivalent to "A."

Under their own methodology, Standard & Poor's (S&P) specified a lower bound FFO-to-Total Debt of 13% in its most recent report on SoCalGas.[11] S&P also stated that SoCalGas could be downgraded if Sempra Energy's FFO-to-Total Debt falls below 16%.

These stated credit metric targets represent a lower bound as to which these metrics could move in order to sustain an "A" rating over time. SoCalGas believes it has a prudent policy to manage debt levels so that its credit metrics remain reasonably above the lower bounds presented in these analyses, in order to allow for short-term fluctuations and disruptions to credit markets and the business environment, and ultimately maintain its "A" rating for senior unsecured debt.

c. Target Debt Ratio

Moody's explains their approach to assessing credit risk for regulated electric and gas utilities globally.[12] The report provides a detailed rating grid, which can be used as a reference tool to approximate credit profiles within the regulated electric and gas sector. Table 5 below replicates Moody's Debt Ratio benchmarks presented in the report.

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[11] Source: S&P, *Ratings Direct*, Research Update: "Southern California Gas Co. Ratings Affirmed; Stand-Alone Credit Profile Revised To 'a+'; Outlook Remains Negative," (October 30, 2018).

[12] Source: Moody's, "Rating Methodology for Regulated Electric and Gas Utilities," (June 23, 2017).

TABLE 5 – Moody's Debt Ratio Benchmarks

Bond Rating	Debt/Capital %[13]
Aaa	<25%
Aa	25% - 35%
A	35% - 45%
Baa	45% - 55%
Ba	55% - 65%
B	65% - 75%
Caa	≥75%

Together with other indicators, Moody's uses the table above as a guideline for assigning a utility's credit rating. The table suggests that for SoCalGas to sustain its strong single "A" bond rating, it must maintain a debt ratio in the range of 35% – 45% which is in line with SoCalGas' proposed Long-Term Debt ratio of 43.60%.

Credit metric guidance provided by the credit rating agencies is an invaluable guide to help determine the appropriate use of debt. Debt utilization beyond the levels indicated by the target credit metrics defined above would put downward pressure on SoCalGas' "A" credit rating, as stated by Moody's.

III. PREFERRED EQUITY

A. Embedded Cost of Preferred Equity

The embedded cost of Preferred Equity represents all the costs (including historical) associated with the issuance and servicing of Preferred Equity, expressed as a percentage of the net proceeds received from Preferred Equity issuances. SoCalGas

[13] Ratios shown are for companies that Moody's has identified to have a standard risk profile.

is proposing an embedded cost of Preferred Equity of 6.00%. Appendix B shows the derivation of this figure. The proposed embedded cost of Preferred Equity is unchanged from the currently authorized embedded cost of Preferred Equity of 6.00%.

TABLE 6 – CURRENT AND PROPOSED AUTHORIZED EMBEDDED COSTS

Embedded Cost Component	Currently Authorized	Proposed 2020	Change (basis points)
Preferred Equity	6.00%	6.00%	0 bps

SoCalGas does not anticipate the need to issue any new Preferred Equity in 2019 or 2020. Furthermore, none of SoCalGas' perpetual Preferred Equity is expected to be retired in 2019 or 2020. In the absence of any projected issuances or retirements, the forecasted embedded cost of Preferred Equity is equivalent to the current actual embedded cost of Preferred Equity.

As discussed above with respect to the embedded cost of Long-Term Debt, SoCalGas will submit an update that will reflect any changes to SoCalGas' Preferred Equity forecast that may take place between the preparation of this testimony and the submittal of the update.

B. Preferred Equity Ratio

SoCalGas is proposing an authorized Preferred Equity ratio of 0.40%, which is a 200 basis points reduction to the currently authorized Preferred Equity ratio of 2.40%. The proposed 0.40% is 202 basis points lower than the average recorded Preferred Equity ratio of 0.38%, as shown in Table 7.

TABLE 7 – RECORDED PREFERRED EQUITY RATIO

Recorded[14]	2013	2014	2015	2016	2017	2018	2013-2018 Average	Proposed 2020
Preferred Equity	0.55%	0.46%	0.38%	0.33%	0.31%	0.28%	0.38%	**0.40%**

As stated above, at this time, SoCalGas does not anticipate issuing any new or retiring any Preferred Equity during this Cost of Capital cycle. Despite a downward trend in bond rates, the relative cost of preferred stock has increased significantly in recent years. This increase in the cost of Preferred Equity is due to a shrinking buyer base that has severely limited demand for traditional institutional utility preferred stock. In recent years, SoCalGas has been successful in issuing Long-Term Debt at relatively low costs to fund its large capital investment plan, thus reducing the need to rely on Preferred Equity. Accordingly, SoCalGas proposes reducing the authorized Preferred Equity ratio to the current recorded ratio of 0.40%.

IV. COMMON EQUITY

A. Return on Equity

The Common Equity component varies from the Long-Term Debt and Preferred Equity components in that there is no embedded cost calculation. Instead, a Return on Equity (ROE) is developed. For 2020, SoCalGas is proposing a ROE of 10.70%, which is a 65 basis points increase from its currently authorized ROE of 10.05%. See Exhibit SCG-04 (Morin) for a full presentation of SoCalGas' ROE proposal.

[14] Represents capital structures recorded at year-end.

B. Common Equity Ratio

SoCalGas is proposing a Common Equity ratio of 56.00%, which is a 400 basis point increase to the currently authorized Common Equity ratio of 52.00%. However, the proposed 56.00% is 115 basis points lower than the average recorded Common Equity ratio of 57.15%, as shown in Table 8.

TABLE 8 – RECORDED COMMON EQUITY RATIO

Recorded[15]	2013	2014	2015	2016	2017	2018	2013-2018 Average	Proposed 2020
Common Equity	63.94%	58.93%	55.31%	53.56%	56.22%	54.92%	57.15%	**56.00%**

SoCalGas' proposal to increase its Common Equity ratio in order to align the capital structure more closely with recorded actuals, will also help SoCalGas maintain its credit rating strength by minimizing financial risk (discussed in the Long-Term Debt section).

1. Authorized Capital Structure Should Align with Recorded

SoCalGas is proposing an authorized capital structure that more closely aligns with its average recorded capital structure. In prior decisions, the Commission adopted authorized capital structures, which closely aligned with a utility's actual capital structures. In the California investor-owned utilities' (IOUs) last Cost of Capital case (A.12-04-015 et al.), the Commission approved San Diego Gas & Electric Company's (SDG&E's) requested Common Equity ratio because it was consistent with their actual Common Equity ratio:

[15] Represents capital structures recorded at year-end.

> In this case, SDG&E seeks a common equity ratio for its revenue requirement which is the same as its actual common equity ratio. We concur with SDG&E and find . . . [the requested] capital structure reasonable and we adopt it.[16]

In addition, in the 2017 proceeding for large California water utilities,[17] the utilities requested capital structures that were slightly higher than their average historical capital structures. Ultimately, the Commission adopted the utilities' proposals, stating that their request was not materially different than the recent historical actual capital structures proposed by California Public Advocates (formerly Office of Ratepayer Advocates (ORA)):

> ORA witness Dawadi arrived at his recommended capital structures by calculating the weighted average capital structures of the Applicants' regulated operations as shown in their annual reports. His recommended capital structures are not materially different from those proposed by the Applicants . . . Therefore, we adopt the applicants' proposed capital structures.[18]

SoCalGas believes that its proposal for a 56.00% Common Equity ratio better aligns its authorized capital structure with recent historically recorded actuals and is supported by Commission precedent.

[16] D.12-12-034 at 11.

[17] *See* A.17-04-001 et al.

[18] D.17-04-001, *mimeo*, p. 21.

2. Authorized Equity Ratios of Comparable Natural Gas Utilities

As a benchmark, SoCalGas evaluates its authorized capital structure relative to the authorized capital structure of other comparable natural gas utilities. SoCalGas has identified 9 proxy companies with 27 subsidiaries, as shown in Appendix D.[19] Of this proxy group, SoCalGas has identified 13 recent regulatory decisions from 2018 in 11 states, that have authorized the ratemaking capital structure for comparable utilities offering natural gas services. Table 9 shows the authorized Common Equity ratios for these comparable utilities.

TABLE 9 – RECENT AUTHORIZED[20] COMMON EQUITY RATIOS FOR COMPARABLE NATURAL GAS UTILITIES

Natural Gas Utility	State	Previously Authorized Common Equity Ratio	Currently Authorized Common Equity Ratio	Date
Atmos Energy of Colorado	CO	52.57%	55.58%	04/04/18
Atmos Energy Corporation	KY	49.16%	52.57%	05/03/18
Atmos Energy Corporation	TN	53.00%	51.40%	12/04/18
Atmos Energy Corporation	MS	53.00%	54.69%	11/01/18
Atmos Energy Corp., West Texas Division	TX	N/A	58.00%	10/01/18
Atmos Energy Corp., Mid Texas Division	TX	55.00%	58.00%	10/01/18
Spire Inc.	MO	55.00%	54.20%	02/21/18

[19] Pursuant D.17-07-005, SoCalGas has provided a comparison of SoCalGas' currently authorized capital structure to other utilities nationally and to other California energy IOUs in Appendix D.

[20] Authorized ratios were established through a Cost of Capital, rate case, or other applicable proceeding that received a decision in 2018.

Northwest Natural Gas Co. – OR	OR	50.00%	50.00%	10/26/18
Southwest Gas Corp. – NV	NV	42.74%	49.66%	12/21/18
Northern IN Public Service Co.	IN	58.80%	56.02%	09/19/18
Columbia Gas of Kentucky	KY	52.42%	52.42%	12/05/18
Bay State Gas Company	MA	53.54%	53.25%	09/05/18
Columbia Gas of Maryland	MD	54.29%	52.34%	10/02/18
Average		**52.46%**	**53.70%**	

On average, these comparable utilities were recently authorized Common Equity ratios of 53.70%. This represents an increase of 124 basis points over the group's previously authorized average Common Equity ratio of 52.46% indicating multiple jurisdictions recognize the need to strengthen utility balance sheets.

3. Impact of Tax Reform

The recently enacted Tax Cuts and Jobs Act (TCJA) of 2017 has created a potential for negative impact on utility credit ratings. A recent article from S&P highlights some of the actual impact that the TCJA had on utilities in 2018:

> The impact of tax reform on utilities is likely to be negative to varying degrees depending on a company's tax position going into 2018, how its regulators react, and how the company reacts in turn. It is negative for credit quality because the combination of a lower tax rate and the loss of stimulus provisions related to bonus depreciation or full expensing of capital spending will create headwinds in operating cash-flow generation capabilities as customer rates are lowered in response

> to the new tax code . . . Regulators must also recognize that tax reform is a strain on utility credit quality, and we expect companies to request stronger capital structures and other means to offset some of the negative impact . . . More equity may make sense and be necessary to protect ratings if financial metrics are already under pressure and regulators are aggressive in lowering customer rates.[21]

This industry-wide negative impact alone warrants an increase in all utility capital structures to offset the loss of benefits such as bonus depreciation and less cash flow from customer rates. A recent article from S&P highlights some of the actual impact that the TCJA had on utilities in 2018:

> The RRA-calculated effective income tax rate for our energy and water coverage universe declined significantly during 2018 to 11.6% from 34.7%. This 67% decline can reasonably be attributed to the enactment of tax reform legislation in December 2017 . . . [T]he [natural] gas group saw the largest relative decline in the effective tax rate [with] 72% . . . [T]ax expense declined by 49.3% in 2018 to $5.430 billion. The gas subgroup saw the largest percentage decline of 87.8% to $81.4 million.[22]

Generally, less cash flow from customer rates will result in lower credit ratios and potentially lower credit metrics. Overall, the negative impact of the TCJA from a cash

[21] Source: S&P, "U.S. Tax Reform: For Utilities' Credit Quality, Challenges Abound," (January 24, 2018).

[22] Source: S&P, "FINANCIAL FOCUS - Effective utility tax rate shows major decline in 2018; taxes paid increased," (March 26, 2019).

flow perspective is a reduction in revenue requirement, with no reduction in the cost of both equity and debt capital. According to Moody's, the average reduction in the ratio of cash flow to debt for utilities due to the TCJA is 150 – 250 basis points.[23] Although the magnitude of the impact varies for each company depending on their tax position before the reform, the impact of the TCJA is another factor SoCalGas considered when proposing a 56.00% Common Equity ratio.

V. CUSTOMER DEPOSITS

A. Background

In SoCalGas' 2019 GRC proceeding, SoCalGas' customer deposits request was the subject of litigation as part of its working cash proposal. During the course of that litigation, there were arguments that one possible venue for determining the ratemaking treatment of customer deposits could be the Cost of Capital proceeding. While the Commission has not made any ruling or determination on this point, the topic is covered here because SoCalGas was one of the parties that supported addressing customer deposits in the Cost of Capital.[24]

B. SoCalGas' Current Treatment of Customer Deposits

Customer deposits are funds collected from customers for security against non-payment that will be returned to those same customers if bills are paid timely or used as a credit against their bills in the event of non-payment. SoCalGas pays interest at the

[23] Source: Moody's, "Moody's Changes Outlook on 25 Regulated Utilities Primarily Impacted by Tax Reform," (January 19, 2018). The average reflects bonus depreciation and the impact on cash flow and financing of both new and pre-existing assets.

[24] *See* A.17-10-007/ 008, Reply Brief of Southern California Gas Company and San Diego Gas & Electric Company in the Test Year 2019 General Rate Case (October 12, 2018), p. 427.

Federal Reserve published prime non-financial 3-month commercial paper rate on these balances.

Historically, SoCalGas has consistently treated of customer deposits as directed in the Commission's Standard Practice (SP) U-16 whereby interest-bearing accounts are excluded from working cash. SoCalGas is requesting continuation of the same methodology it has advocated in past GRCs. SP U-16 states that "[o]nly non-interest bearing customer deposits are to be considered."[25]

The Commission has stated its preference for consistency under SP U-16: "[a]s a general matter, however, we presume that ratemaking treatment consistent with SP U-16 should be deemed reasonable, especially where there are no special circumstances that justify a deviation."[26] As there are no such special circumstances here, there is no need to make changes to SoCalGas' long-standing treatment. Including ratepayer money (customer deposits) as a form of Long-Term Debt would be inconsistent with the fact that substantially larger amounts of shareholder-provided balances such as net balancing account under collections, which receive the same interest rate are excluded from Long-Term Debt and rate base. There is no logical reason to make an exception for one interest-bearing account (customer deposits) from SP U-16.

C. Customer Deposits Should Not Impact Capital Structure

In addition to SoCalGas' working cash position, SoCalGas would also consider inclusion of customer deposits in a utility's authorized capital structure (as determined in

[25] Standard Practice U-16, Chapter 3, Section 22.

[26] D.14-08-032, *mimeo*, p. 628.

Cost of Capital proceedings) as equally inconsistent with SP U-16. Because customer deposits are essentially earning a short-term debt rate, it is the equivalent of short-term debt, and should therefore be excluded from a utility's ratemaking capital structure.

Long-term financing provides a static, dependable source of funds with known maturity dates. By contrast, the customer deposit balances can fluctuate and are not permanent in nature, thus lacking the same characteristics as long-term financing.

Financial principles provide that short-term assets should be financed with short-term liabilities and long-term assets should be financed with long-term liabilities. Customer deposits are short-term and refunded after 12 months. Therefore, customer deposits should not be included as part of Long-Term Debt in SoCalGas' capital structure which would be used to finance long-term assets, such as rate base assets.

Moreover, the Commission has stated that "balancing accounts and customer deposits should both earn the short-term debt rate."[27] By stating that customer deposits should earn a short-term debt rate, the Commission has effectively distinguished customer deposits as shorter-term liabilities.

VI. COMMISSION QUESTIONS

In D.17-07-005, the Commission directed the California IOUs to address eight specific questions in testimony. Questions 4 and 5 will be addressed here.

Question 4 states:

> How has the utility's recorded capital structure changed since the 2013 Cost of Capital application? How has the recorded capital structure compared to authorized capital structure over this time period?

[27] D.14-08-032, *mimeo*, p. 630.

SoCalGas' annual recorded capital structure for the period of 2013 – 2018 has been presented in Tables 4, 7, and 8 of my testimony. It may also be found in Appendix C. As stated above, the recorded capital structure has had a higher Common Equity ratio and lower Long-Term Debt and Preferred Equity ratios than authorized.

Question 5 states:

> How does the utility's current capital structure compare to other utilities nationally and to other California utilities? Include separate comparisons for vertically integrated and non-vertically integrated utilities.

As shown in Appendix D, SoCalGas has performed a comparison of both authorized and recently recorded capital structure with a group of 9 comparable proxy companies with 26 subsidiaries across 19 states which SoCalGas has identified as comparable peer utilities. All utilities in the proxy group are non-vertically integrated.

In response to the California comparison portion of Question 5, SoCalGas has provided both the authorized and recent recorded capital structures for several California utilities, which include water and combined gas and electric utilities, in Appendix D. However, Southwest Gas Corporation is the only gas-only California utility that qualifies as a comparable proxy company.[28] Comparing SoCalGas' capital structure to any of the other California utilities listed would not be particularly relevant as they are not comparable proxy companies.

[28] Per Exhibit SCG-04 (Morin), p. 27, SoCalGas has defined comparable proxy companies to be "investment-grade dividend-paying natural gas utilities contained in Value Line's natural gas distribution utility group.

VII. CONCLUSION

SoCalGas' comprehensive authorized capital structure proposal will support a solid credit rating, as well as its ability to manage financial and business risk. The proposal has support in financial data of historically recorded company actuals, Commission precedent, and comparable national gas utilities. A total snapshot of SoCalGas' proposal is depicted in Table 10.

TABLE 10 – PROPOSED EMBEDDED COSTS AND CAPITAL STRUCTURE

Component	Proposed Embedded Costs	Proposed Capital Structure
Long-Term Debt	4.23%	43.60%
Preferred Equity	6.00%	0.40%
Common Equity	10.70%	56.00%
Total		100.00%

SoCalGas believes that its request is closely aligned with its recent recorded capital structure and will allow SoCalGas to maintain a strong "A" credit rating. Viewed in its entirety, the proposed capital structure will support SoCalGas' access to markets during the anticipated period of significant capital expenditures, thereby providing ratepayers with lower capital costs over the long term. Finally, SoCalGas does not believe that its authorized capital structure should be encumbered by customer deposits, which is the functional equivalent of short-term debt.

This concludes my prepared direct testimony.

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VIII. WITNESS QUALIFICATIONS

My name is Ricardo Gonzalez. My business address is 555 West 5th Street, Los Angeles, CA 90013.

I am currently employed by SoCalGas as the Utility Accounting Manager. My responsibilities include managing the month-end close process, supporting the company's SEC filings, and SOX compliance of our internal controls over financial reporting. Prior to my current role, I was the Financial Planning Manager responsible for the company's financial planning and analysis function. In this role, I also managed our cash forecasting and financing plans. I have been employed by SoCalGas since 2003 and have held numerous roles of increasing responsibility primarily within the Accounting Operations and Financial & Operational Planning departments.

I received a Bachelor of Science degree in Business Administration with an emphasis in Finance from California State University, Northridge in 2002. I also received a Master of Business Administration degree with an emphasis in Global Business from the Graziadio School of Business and Management at Pepperdine University in 2010. I am a Certified Public Accountant in the State of California and a Certified Management Accountant.

I have not previously testified before this Commission.

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APPENDIX A

Embedded Cost of Long-Term Debt

Southern California Gas Company
Embedded Cost of Long-Term Debt
(figures in dollars unless otherwise stated)

Line #	Description	A Principal	B Total Discounts and Expenses	C Net Proceeds (C = A - B)	D Total Annual Cost	E Effective Rate (E = D / C)
1	Series R (1)		616,334	(616,334)	204,560	-33.19%
2	Series T (2)		1,023,654	(1,023,654)	318,878	-31.15%
3	Series Y (5)		612,348	(612,348)	309,198	-50.49%
4	Series BB (5)		350,856	(350,856)	116,926	-33.33%
5	Series DD (5)		705,324	(705,324)	219,678	-31.15%
6	Series EE (5)		434,729	(434,729)	88,340	-20.32%
7	Swiss Francs	4,338,770	0	4,338,770	81,352	1.88%
8	Medium term Note	5,000,000	0	5,000,000	283,500	5.67%
9	Series KK (CPCFA91A)	250,000,000	3,960,222	246,039,778	14,507,007	5.90%
10	Series MM	300,000,000	3,816,052	296,183,948	15,502,202	5.23%
11	SERIES NN	350,000,000	5,478,830	344,521,170	13,307,628	3.86%
12	SERIES OO	250,000,000	43,939,736	206,060,264	12,143,215	5.89%
13	SERIES PP	500,000,000	5,973,758	494,026,242	16,347,376	3.31%
14	SERIES RR	350,000,000	3,456,594	346,543,406	11,546,005	3.33%
15	SERIES TT	500,000,000	5,229,164	494,770,836	13,525,544	2.73%
16	SERIES UU	400,000,000	4,575,075	395,424,925	16,652,502	4.21%
17	SERIES VV	550,000,000	5,769,326	544,230,674	23,842,311	4.38%
18	Revolving line of Credit				386,964	
19	**Total Outstanding (12/31/2018)**	**3,459,338,770**	**85,942,001**	**3,373,396,769**	**139,383,187**	**4.13%**
20						
21	**Changes During 2019**					
22	30 year in Q2, 2019, 130 bps,4.46%	500,000,000	5,553,798	494,446,202	22,468,505	4.54%
23	Revolving Line of Credit				31,672	
24	**Total Changes During 2019**	**500,000,000**	**5,553,798**	**494,446,202**	**22,500,178**	
25	**Total Outstanding (12/31/2019)**	**3,959,338,770**	**91,495,799**	**3,867,842,971**	**161,883,365**	**4.19%**
26						
27	**Changes During 2020**					
28	30 year in Q2, 2020, 130 bps,4.72%	300,000,000	3,550,896	296,449,104	14,275,809	4.82%
29	Revolving Line of Credit				15,836	
30	**Total Changes During 2020**	**300,000,000**	**3,550,896**	**296,449,104**	**14,291,646**	
31	**Total Outstanding (12/31/2020)**	**4,259,338,770**	**95,046,694**	**4,164,292,076**	**176,175,010**	**4.23%**
32						
33			**Forecasted 2020 Embedded Cost of Long-Term Debt**			**4.23%**

Southern California Gas Company
Embedded Cost of Long-Term Debt Detail
(figures in dollars unless otherwise stated)

Line #	Description	A Interest Rate	B Date of Issue	C Due Date	D Life of Bond	E Principal	F Issued Discount	G DFD CHG A/C 13300xx Issue Expense	H Swap Lock Termination	I (Net of Tax schedules) Loss on Reacq.	J Total Discounts and Expenses	K Annual interest expense	L Interest expense swap lock termination	M Annual Amortization Discount	N Amortization Expense	O Amortization Loss	P Total Discounts and Expenses
1	Series R (1)		03/01/86	03/01/16						616,334	616,334					204,560	204,560
2	Series T (2)		12/01/86	12/01/16						1,023,654	1,023,654					318,878	318,878
3	Series Y (3)		10/01/91	10/01/21						612,348	612,348					309,198	309,198
4	Series BB (3)		03/01/93	03/01/23						350,856	350,856					116,926	116,926
5	Series DD (3)		06/15/93	06/15/23						705,324	705,324					219,678	219,678
6	Series EE (3)		11/01/93	11/01/25						434,729	434,729	-				88,340	88,340
7	Swiss Francs Bond	1.875%	05/14/06	05/14/16	10.0	4,338,770	0	0		-	-	81,352		-	-		81,352
8	Medium term Note	5.670%	01/15/03	01/18/28	25.0	5,000,000				-	-	283,500		-	-		283,500
9	Series KK	5.750%	11/18/05	11/15/35	30.0	250,000,000	1,520,000	2,440,222		-	3,960,222	14,375,000		50,667	81,341		14,507,007
10	Series MM	5.125%	11/18/10	11/15/40	30.0	300,000,000	729,000	3,087,052			3,816,052	15,375,000		24,300	102,902		15,502,202
11	SERIES NN	3.750%	09/21/12	09/15/42	30.0	350,000,000	1,746,500	3,732,330		-	5,478,830	13,125,000		58,217	124,411		13,307,628
12	SERIES OO	4.450%	03/13/14	03/15/44	30.0	250,000,000	1,517,500	2,668,436	39,753,800	-	43,939,736	11,125,000	878,684	50,583	88,948		12,143,215
13	SERIES PP	3.150%	09/11/14	09/15/24	10.0	500,000,000	1,830,000	4,143,758		-	5,973,758	15,750,000		183,000	414,376		16,347,376
14	SERIES RR	3.200%	06/18/15	06/15/25	10.0	350,000,000	829,500	2,627,094		-	3,456,594	11,200,000		83,033	262,972		11,546,005
15	SERIES TT	2.600%	06/03/16	06/15/26	10.0	500,000,000	970,000	4,259,164		-	5,229,164	13,000,000		97,487	428,057		13,525,544
16	SERIES UU	4.125%	05/15/18	06/01/48	30.0	400,000,000	420,000	4,155,075		-	4,575,075	16,500,000		14,000	138,502		16,652,502
17	SERIES VV	4.300%	09/24/18	01/15/49	30.0	550,000,000	247,500	5,521,826		-	5,769,326	23,650,000		8,250	184,061		23,842,311
18	Revolving line of Credit											386,964					386,964
19	Total Outstanding (12/31/2018)					3,459,338,770	9,810,000	32,634,956	39,753,800	3,743,245	85,942,001	134,851,816	878,684	569,537	1,825,571	1,257,580	139,383,187
20																	
21	**Forecast of**		**GI**	**Spread**			**Issuance**		**Underwriting**			**Annual**		**Annual**			**Total Annual**
22	**New Issuances**	**Coupon**	**Forecast**	**(bps)**	**Term**	**Principal**	**Fees**	**Underwriting**	**fees (bps)**		**Total Fees**	**Interest**		**Fees**			**Expenses**
23	New Issuance in 2019	4.457%	3.157%	130	30	500,000,000	1,178,798	4,375,000	87.5		5,553,798	22,283,379		185,127			22,468,505
24	Revolving Line of Credit (4)											31,672					31,672
25	New Issuance in 2020	4.719%	3.419%	130	30	300,000,000	925,896	2,625,000	87.5		3,550,896	14,157,446		118,363			14,275,809
26	Revolving Line of Credit (4)											15,836					15,836
27																	
28																	

29 (1) Series R - refunded by Series BB and DD and amortized over the life of Series BB and DD.
30 (2) Series T - refunded by Series DD and amortized over life of Series DD.
31 (3) These bond series are being amortized over the remaining life of the original bond issuance at the time of reacquisition.
32 (4) Basis point spread is forecasted based on the current G-spread as of April 2, 2019 plus a concession spread of 20 bps in an effort to reflect current market conditions.

Southern California Gas Company
Forecasted Issuance Cost Summary
Taxable First Mortgage 30 Year Bonds
(figures in dollars unless otherwise stated)

	2019	2020
Principal issued	**500,000,000**	**300,000,000**
Up-Front Costs:		
Underwriter (1)	4,375,000	2,625,000
Issuance Fees:		
Legal	112,387	114,792
Printing	20,397	20,833
Rating agency (2)	660,000	396,000
Trustee	37,225	38,021
Auditor	45,893	46,875
CPUC	228,446	233,333
SEC	74,449	76,042
Total Issuance Fees	1,178,798	925,896
Total Up-Front Costs	**5,553,798**	**3,550,896**

(1) Based on 87.5 bps of principal issuance
(2) Based on 13.2 bps of principal issuance

APPENDIX B

Embedded Cost of Preferred Equity

Embedded Cost of Preferred Equity

(figures in dollars unless otherwise stated)

Funding Type	Class/ Series	Prices ($)	Dividend Rate (%)	Amount Outstanding ($000)	Shares Outstanding
Preferred Equity	A	$27.50	6.00%	$19,575	783,032
Preferred Equity	-	$30.00	6.00%	$1,975	79,011
Weighted Average Cost			6.00%	$21,550	

APPENDIX C

Historically Recorded Capital Structures Compared to Authorized

Historically Recorded Capital Structures Compared to Authorized

	Recorded Capital Structures[1]							Currently Authorized Capital Structure
	2013	2014	2015	2016	2017	2018	2013-2018 Average	
Long-Term Debt	35.52%	40.61%	44.31%	46.11%	43.47%	44.80%	42.47%	45.60%
Preferred Stock	0.55%	0.46%	0.38%	0.33%	0.31%	0.28%	0.38%	2.40%
Common Equity	63.94%	58.93%	55.31%	53.56%	56.22%	54.92%	57.15%	52.00%
Total	100%	100%	100%	100%	100%	100%	100%	100%

[1] Represents capital structures recorded at year-end. These percentages are rounded to the hundredth decimal point. In the event they do not add up to 100.00%, it is due to rounding.

APPENDIX D

Non-California and California Utilities' Capital Structures

Non-California Utilities' Capital Structure

Company[1]	State	Authorized Ratios				Recently Recorded Ratios[2]		
		Common Equity	Long-Term Debt/ Preferred Equity	Effective Date	Case Identification Number	Common Equity	Long-Term Debt/ Preferred Equity	Current As of
Atmos Energy								
Atmos Energy of Colorado	CO	55.58%	44.42%	04/04/18	17AL-0429G			
Atmos Energy	KS			02/27/18	18-ATMG-218-TAR (GSRS)			
Atmos Energy Corporation	KY	52.57%	47.43%	05/03/18	2017-00349			
Atmos Energy Corporation	TN	51.40%	48.60%	12/04/18	18-00067			
Atmos Energy Corporation	MS	54.69%	45.31%	11/01/18	2005-UN-0503			
Atmos Energy Corp., West Texas Division	TX	58.00%	42.00%	10/01/18	N/A			
Atmos Energy Corp., Mid Texas Division	TX	58.00%	42.00%	10/01/18	N/A			
Spire Energy								
Spire Energy	MO	54.20%	45.80%	02/21/18	GR-2017-0215	57.20%	42.80%	12/31/18
Northwest Natural Gas Co.								
Northwest Natural Gas Co. - OR	OR	50.00%	50.00%	10/26/18	UG-344			
Northwest Natural Gas Co. - WA	WA	50.74%	49.26%	12/26/08	UG-08-0546			
South Jersey Industries								
South Jersey Gas	NJ	52.50%	47.50%	10/20/17	GR-17010071	53.01%	46.99%	12/31/18
Elizabethtown Gas	NJ	46.00%	54.00%	06/30/17	GR-16090826			
Southwest Gas								
Southwest Gas Corp. - AZ	AR	51.70%	48.30%	04/11/17	G-01551A-16-0107			
Southwest Gas Corp. - NV	NV	49.66%	50.34%	12/21/18	18-05031			
New Jersey Resources								
New Jersey Natural Gas Co.	NJ	52.50%	47.50%	09/23/16	GR15111304	60.65%	41.20%	12/31/17
NISource								
Northern IN Public Service Co.	IN	56.02%	43.98%	09/19/18	44988	58.60%	41.40%	12/31/17
Columbia Gas of Ohio	OH			12/03/08	C-08-0072-GA-AIR	50.07%	49.93%	12/31/17
Columbia Gas of Pennsylvania	PA			12/06/18	R-2018-2647577	54.04%	45.96%	12/31/17
Columbia Gas of Virginia	VA	38.13%	61.87%	03/17/17	PUE-2016-00033	43.15%	56.85%	12/31/17
Columbia Gas of Kentucky	KY	52.42%	47.58%	12/05/18	C-2018-00341 (AMRP)	53.76%	46.24%	12/31/17
Bay State Gas Company	MA	53.25%	46.75%	09/05/18	D.P.U. 18-45	61.19%	38.81%	12/31/17
Columbia Gas of Maryland	MD	52.34%	47.66%	10/02/18	9480	54.06%	45.94%	12/31/17
ONE Gas								
Kansas Gas Service Co.	KS			02/05/19	18-KGSG-560-RTS	63.35%	36.65%	12/31/17
Oklahoma Natural Gas Co.	OK	60.50%	39.50%	01/06/16	PUD201500213	62.13%	37.87%	12/31/16
Texas Gas Service Co.	TX	60.10%	39.90%	09/27/16	10506	63.01%	36.99%	12/31/17
UGI								
UGI Utilities Inc.	PA			09/01/16	R-2015-2518438	55.74%	44.26%	12/31/17
Southern California Gas Company	**CA**	**52.00%**	**48.00%**	**12/26/12**	**12-12-034**	**54.92%[3]**	**45.08%[3]**	**12/31/18**

[1] All Companies shown are non-vertically integrated.
[2] Based on 2018 10-K or most recent filed FERC Form 2. Total capitalization excludes short-term debt.
[3] Represents the actual ratemaking capital structure.

California Utilities' Capital Structure

Company	State	Authorized Ratios				Recently Recorded Ratios[1]			Vertically Integrated?
		Common Equity	Long-Term Debt/ Preferred Equity	Effective Date	Case Identification Number	Common Equity	Long-Term Debt/ Preferred Equity	Current As of	
California-American Water Company	CA	55.39%	44.61%	03/22/18	18-03-035				Yes
California Water Service Company	CA	53.40%	46.60%	03/22/18	18-03-035	44.75%	55.25%	12/31/18	Yes
Golden State Water Company	CA	57.00%	43.00%	03/22/18	18-03-035	61.04%	38.96%	12/31/18	Yes
Great Oaks Water Company	CA	70.00%	30.00%	12/20/18	18-12-002				Yes
Liberty Utilities (Park Water/Apple Valley Ranch Water)	CA	57.00%	43.00%	12/20/18	18-12-002				Yes
Pacific Gas & Electric	CA	52.00%	48.00%	12/26/12	12-12-034	41.23%	58.77%	12/31/18	Yes
San Diego Gas & Electric	CA	52.00%	48.00%	12/26/12	12-12-034	56.15%[2]	43.85%[2]	12/31/18	Yes
San Gabriel Valley Water Company	CA	64.46%	35.54%	12/20/18	18-12-002				Yes
San Jose Water Company	CA	53.28%	46.72%	03/22/18	18-03-035				Yes
Southern California Edison	CA	48.00%	52.00%	12/26/12	12-12-034	47.53%	52.47%	12/31/18	Yes
Southwest Gas Corp. - CA	CA	55.00%	45.00%	06/12/14	12-12-024				No
Suburban Water Systems	CA	60.00%	40.00%	12/20/18	18-12-002				Yes
Southern California Gas Company	**CA**	**52.00%**	**48.00%**	**12/26/12**	**12-12-034**	**54.92%**	**45.08%**	**12/31/18**	**No**

[1] Based on 2018 10-K. Total capitalization excludes short-term debt.

[2] Represents the actual ratemaking capital structure.