Company: Southern California Gas Company (U 904 G)
Proceeding: 2020 Cost of Capital
Application: A.19-04-XXX
Exhibit: SCG-05

SOUTHERN CALIFORNIA GAS COMPANY (U 904 G)

PREPARED DIRECT TESTIMONY OF BRUCE MACNEIL

(COST OF CAPITAL MECHANISM)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

April 2019

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SOUTHERN CALIFORNIA GAS COMPANY

PREPARED DIRECT TESTIMONY OF BRUCE MACNEIL

(COST OF CAPITAL MECHANISM)

I. INTRODUCTION

The purpose of my testimony is to (1) address Southern California Gas Company's (SoCalGas) current Cost of Capital Mechanism (CCM), (2) provide a recent history of SoCalGas' credit ratings, and (3) propose that the Commission authorize the continuation of the current CCM with certain clarifications and modifications to this mechanism. The current CCM was originally adopted by the California Public Utilities Commission (Commission) for the other California investor-owned utilities (IOUs) in Decision (D.) 08-05-035. As part of the last Cost of Capital proceeding, the Commission adopted the CCM for all four California IOUs, including SoCalGas, in D.13-03-015.[1] The Commission allowed the California IOUs to retain the CCM (although in some cases, suspending the mechanism from triggering), most recently in D.17-07-005.

The CCM automatically recalibrates SoCalGas' authorized Return on Equity (ROE) and overall Rate of Return (ROR) on SoCalGas-jurisdictional operations between Cost of Capital proceedings upon a triggering of the mechanism, based on movements in the bond markets. My testimony presents the history of SoCalGas' credit ratings since the last Cost of Capital was decided, the factors that have led to recent ratings actions, and the proposed modifications to the current CCM to make the mechanism more appropriate and functional based on the changing credit ratings

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[1] For SoCalGas, adoption of the CCM replaced SoCalGas' previous mechanism known as the Market-Indexed Capital Adjustment Mechanism (MICAM).

landscape. The current CCM, with certain clarifications and modifications, should continue to be the basis for ROE and ROR adjustments between Cost of Capital proceedings.

II. CURRENT CCM

A. Objectives of an Automatic Adjustment Mechanism

Unless otherwise authorized or directed, the California IOUs are generally required to file Cost of Capital applications every three years to refresh and update their levels where appropriate. The CCM provides a formula to adjust a utility's ROE (one of the components of a comprehensive Cost of Capital) based on changes in utility bond rates. The CCM achieves several objectives:

- reduces the time and costs associated with filing and litigating Cost of Capital proposals annually;
- produces objective results through readily available historical rates that eliminate the need for interest rate forecasts (and related forecasting risk);
- represents a simple, transparent, and non-controversial adjustment mechanism (*i.e.*, automatic adjustment rather than adjustment by litigated outcome);
- does not produce frequent or abrupt changes, while remaining sensitive enough to trigger when fluctuations in the bond markets necessitate an adjustment; and
- provides timely ratemaking information to stakeholders and the financial markets.

According to the Commission, the CCM effectively balances the interests of shareholders and ratepayers while reducing the workload requirements and regulatory costs associated with Cost of Capital proceedings:

> This CCM streamlines the major energy utilities' COC process while providing greater predictability of the utilities' COC by eliminating the use of interest rate forecasts and disputes concerning interest rate levels and trends, as well as uncertainties associated with conflicting perceptions of financial markets and the return requirements of investors. Hence, shareholders and ratepayers alike share in the burden and benefit of market changes, while eliminating the burden of annual COC applications. The CCM also enables the utilities, interested parties, and Commission staff to reduce and reallocate their respective workload requirements for litigating annual COC proceedings.[2]

The CCM is also viewed positively by various market stakeholders in addition to regulatory stakeholders, for many of the reasons noted above. Credit rating agencies and banks – who regularly evaluate the financial condition of the utilities – have indicated their preference for the automatic rate-setting mechanism, since it provides greater clarity and transparency in understanding changes to a utility's ROE compared to the uncertainty of trying to predict the outcome of litigation. This in turn promotes a degree of stability; and, financial markets generally respond favorably to stability.

[2] D.13-03-015, mimeo, p. 7.

In summary, SoCalGas agrees with the Commission's assessment of the balanced benefits that an adjustment mechanism provides, and therefore recommends the continuation of the CCM for the reasons articulated by the Commission.

B. How the Current CCM Works

The current CCM is fundamentally simple in its construction and consists of (i) a benchmark and (ii) a deviation range or "dead band" from that benchmark, which determines whether the CCM will trigger. The CCM is based upon:

- the most recently adopted authorized capital structure and embedded costs for long-term debt and preferred stock;
- the benchmark index as Moody's Utilities Bond Index, based on the utility's credit ratings (for SoCalGas, an "A" rated utility, Moody's "A" Bond Utilities Index);
- a benchmark interest rate representing either (a) the October through September average of the applicable Moody's Utilities Bond Index from the Test Year of the most recently adopted Cost of Capital; or (b) the October through September average following a triggering event and corresponding effective date of an automatic adjustment to the authorized Cost of Capital;
- a 100 basis point dead band whereby within plus or minus 100 basis points from the benchmark interest rate, the mechanism will not trigger; and
- an adjustment ratio of 50 percent (*i.e.*, if there is a triggering event and corresponding adjustment to ROE, the ROE will be adjusted by half of

the difference between Moody's Utility Bond Index and the benchmark interest rate.[3]

If the CCM does trigger in a given year, the adjustment to the authorized ROE, and updating of the embedded costs of long-term debt and preferred stock, will result in a revised authorized Rate of Return to be effective January 1 of the following year. SoCalGas would make this change through the advice letter process. The CCM would continue to operate, but with a revised benchmark interest rate, which would be the 12-month (October to September) average interest rate that caused the CCM to trigger.

A utility's authorized capital structure itself (*i.e.*, the ratios) is not adjusted if the CCM triggers; however, the utility can file a Cost of Capital application outside of the CCM process if an extraordinary or catastrophic event occurs that has a material impact on a utility's Cost of Capital and/or capital structure and affects the utility differently than the overall financial markets.[4]

C. SoCalGas' Experience Under the CCM

Either by design or during periods where the CCM was suspended by the Commission, SoCalGas' CCM has not triggered since being adopted in the prior Cost of Capital proceeding. Illustratively, a SoCalGas trigger event would have occurred if the 12-month (October through September) average of Moody's "A" Utilities Bond Index changed more than 100 basis points (higher or lower) from the 4.24% benchmark interest rate.[5] As shown in Figure 1 below, the CCM did not trigger (and would not have

[3] *See* D.13-03-015, Appendix A.

[4] *See* Id. at 7.

[5] Based on Moody's October 2011-September 2012 average of "A" Rated Utility Bond Index yields.

triggered) over the past 6 years (2013 – 2018). During that time, each 12-month (October through September) average was within 25 basis points of the benchmark interest rate, well within the 100 basis point dead band (and well within a 50 basis point dead band).

Figure 1

III. CCM PROPOSAL

A. Summary

SoCalGas proposes the continuation of the currently authorized CCM, with four modifications. SoCalGas requests the following CCM attributes be retained:

- a three-year application cycle, providing a balance between not having a full proceeding every year and having one often enough to review for significant changes or impacts to SoCalGas;
- Moody's "A" Utilities Bond Index as the benchmark index, which is

appropriate based on the current company credit ratings;

- measure a 12-month average of Moody's "A" Utilities Bond Index yields for the period of October 1 through September 30;
- the 50% adjustment to ROE of total change to utility bond index when CCM is triggered;
- updating the embedded costs of long-term debt and preferred stock when a trigger occurs, to reflect actual August month-end embedded costs in the trigger year and forecasted interest rates for variable long-term debt, new long-term debt, and preferred stock[6] to be issued;
- the current advice letter process to implement trigger provisions effective January 1 of the following year; and
- allow SoCalGas to file a Cost of Capital application outside of the CCM process if an extraordinary or catastrophic event materially impacts the Cost of Capital or capital structure and affects the company differently than the overall financial markets.

As I explain in the following section, in light of recent bond market history, rating downgrades at other California IOUs (including SDG&E), and future uncertainties around its credit ratings, SoCalGas believes the following four modifications to the CCM are appropriate:

1) change the dead band trigger to 50 basis points from the currently authorized 100 basis points;

[6] As explained in Exhibit SCG-02 (Gonzalez), SoCalGas does not expect to issue any new preferred stock in the upcoming Cost of Capital cycle.

2) clarify the selection of a CCM benchmark index when the utility has split ratings;
3) clarify approach when SoCalGas' credit ratings change during CCM years; and
4) provide guidance for utilities with non-investment grade ratings.

I discuss the reasons for these modifications next.

B. Modified Dead Band

1. Overview

The size of the dead band, combined with the measurement period, influences how often the adjustment mechanism will be activated, and therefore it is important to strike a reasonable balance between triggering too often and not triggering enough. Choosing a dead band and/or measurement period that is too sensitive to interest rates would be disruptive, while having a dead band and/or measurement period that is too wide could potentially prevent a trigger when it would be appropriate for one to occur. As shown earlier in Figure 1, the prior six years have demonstrated that a 50 basis point dead band would have provided the same stability that a 100 basis point dead band would. However, it would have also made the CCM more attuned to material fluctuations in the bond interest rates and therefore would have set an appropriate level of allowable variance from the benchmark interest rate. The combination of a 12-month measurement period and a 50 basis point dead band going forward, will therefore provide a level of stability that strikes a balance between triggering too often and triggering too infrequently.

Additional reasons for recommending a narrowing of the current dead band are based on credit rating agency actions and proclamations since the last Cost of Capital was adopted, discussed next.

2. SoCalGas' Credit Ratings Since 2013[7]

Credit rating agencies routinely evaluate SoCalGas and its long-term and short-term debt ratings. These ratings are based on numerous factors, including the perceived supportiveness of the regulatory environment affecting utility operations, ability to generate cash flows, level of indebtedness, overall financial strength and the status of certain capital projects, as well as factors beyond its control, such as political changes, the state of the economy, and the industry generally.

The credit rating agencies have historically viewed SoCalGas' risk and credit ratings favorably due to its largely low-risk regulated gas operations, the supportive nature of the California regulatory environment, track-record of supportive rate cases, and predictable cost recovery mechanisms. SoCalGas' current credit rating for its long-term debt is considered investment grade, which reflects a lower investment risk and provides adequate liquidity at reasonable costs to the company. By contrast, sub-investment grade companies have limited access to capital markets because they are considered high risk investments.

Therefore, any capital that is accessible comes at significantly higher cost than what is available to investment grade borrowers, and companies with sub-investment grade ratings may have to post collateral to access debt markets. Given the capital-intensive nature of its business and the best interest of both ratepayers and

[7] *See* Appendix A for additional credit ratings data and information.

shareholders, it is important for SoCalGas to maintain the highest investment grade ratings possible. As Standard & Poor's (S&P) notes, "because utilities have negative discretionary cash flow their creditworthiness is linked to reliable access to the capital markets to operate their businesses."[8]

However, more recent rating agency actions and proclamations are indicative of potential negative impacts to SoCalGas' credit ratings, due to the current environment. While SoCalGas does not have the same level of wildfire risk as compared to the California electric IOUs, SoCalGas has experienced indirect negative impacts and debt performance due to the change in the rating agencies' view on the overall California legislative and regulatory construct driven by wildfires and the application of inverse condemnation. SoCalGas' ratings have not been downgraded since 2013; however, S&P did place their ratings on negative outlook. Both Moody's and Fitch have noted that the negative impacts from current regulatory and legislative environment could impact SoCalGas' credit ratings in the future.

On July 9, 2018, S&P affirmed SoCalGas' credit ratings, but revised the outlook to negative based on wildfire risks. The ratings on SoCalGas would be lowered following a downgrade to Sempra Energy (SoCalGas' parent company) because S&P assesses SoCalGas as a core subsidiary of Sempra Energy. S&P stated that without a

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[8] *See* S&P, *Global Ratings*, Credit FAQ: "Will California Still Have an Investment-Grade Investor-Owned Electric Utility?" publicly available at: https://www.capitaliq.com/CIQDotNet/CreditResearch/RenderArticle.aspx?articleId=2168627&SctArtId=467165&from=CM&nsl_code=LIME&sourceObjectId=10866063&sourceRevId=14&fee_ind=N&exp_date=20290218-21:25:39

concrete near-term improvement of the regulatory compact, the credit quality of Sempra Energy as an electric utility holding company would weaken.[9]

In its October 30, 2018 report reaffirming the investment grade ratings of SoCalGas, S&P indicated that they viewed Senate Bill (SB) 901 as a shorter-term measure and that further longer-term reform is necessary in California to preserve the state's electric utilities' credit quality. S&P further indicated that it could lower ratings of SoCalGas within the next two years if the Commission interprets SB 901 in a manner that does not limit the risks to California electric utilities reflecting continued and persistent California wildfires without a longer-term reform to inverse condemnation.[10] In its November 15, 2018 report on SoCalGas, Moody's indicated that SoCalGas' rating could experience negative momentum if there is a deterioration in the utility's relationship with the Commission and/or the credit supportiveness of the California regulatory environment.[11]

Table 1 summarizes the credit agency ratings for SoCalGas over the past three years:

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[9] Source: S&P, *Ratings Direct*, Research Update: "Sempra Energy And Subsidiaries Outlooks Revised to Negative On Wildfire Risks; Ratings Affirmed," (July 9, 2018).

[10] 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).

[11] Source: Moody's, Credit Opinion: "Southern California Gas Company," (November 15, 2018).

Table 1 – SoCalGas Credit Ratings 2017 to Present

Current	S&P	Moody's	Fitch
Long Term Issuer	A	A1	A
Unsecured Debt	A	A1	A+
Secured Debt	A+	Aa2	AA-
Preferred Stock	BBB+	A3	A-
Outlook	Negative	Stable	Stable

2018	S&P	Moody's	Fitch
Long Term Issuer	A	A1	A
Unsecured Debt	A	A1	A+
Secured Debt	A+	Aa2	AA-
Preferred Stock	BBB+	A3	A-
Outlook	Negative	Stable	Stable

2017	S&P	Moody's	Fitch
Long Term Issuer	A	A1	A
Unsecured Debt	A	A1	A+
Secured Debt	A+	Aa2	AA-
Preferred Stock	BBB+	A3	A-
Outlook	Stable	Stable	Stable

If SoCalGas were to be downgraded, or its outlooks were changed to or remain on negative, SoCalGas may be adversely affected. For example, this could make it costlier for SoCalGas to issue debt securities or commercial paper, to borrow under its credit facilities and to raise certain other types of financing. Such amounts could materially and adversely affect cash flows, results of operations, and financial condition.

Based on the assessment of this rating agency information, the current environment in which SoCalGas is operating, with the more recent concerns being expressed on all California IOUs, including SoCalGas, a narrowing of the dead band is appropriate to account for the decrease in market stability relative to when the last Cost of Capital was adopted. As shown in Figure 1, a 50 basis point dead band would not cause the CCM to become overly sensitive such that it would trigger too frequently. A refresh of the dead band will continue to achieve a balanced result and provide the same benefits that the Commission articulated.

C. Clarification on Split Ratings Index Selection[12]

The applicable CCM index should be based on the credit ratings of the utility. In the event of split ratings where not all agencies' ratings are at the same level, the lowest rating should be used in determining the applicable index for the CCM. SoCalGas believes this is appropriate because the lowest credit rating of the three credit rating agencies is known by the financial markets and is therefore reflected in the competitive pricing of financial instruments.

D. Clarification on Ratings Changes During CCM Years

In D.08-05-035, the Commission noted that the CCM should include a provision involving the filing of a capital structure adjustment application to address the ratepayer impacts of a credit rating change between full Cost of Capital applications.[13] SoCalGas recommends that the Commission clarify and adopt the CCM for the upcoming Cost of Capital cycle to allow this regulatory relief. The process would be consistent with the existing CCM processes as follows:

- a ratings change (upgrade or downgrade) that occurs over the October through September CCM measurement period of any year that affects the applicable Moody's Utilities Bond Index for the CCM would allow for the utility to update the applicable Moody's Utilities Bond Index for the following year;

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[12] *See* Appendix B for an illustration of split ratings.

[13] *See* D.08-05-035, *mimeo*, p. 8.

- the applicable Moody's Utilities Bond Index is based on the company's ratings as of September 30 of that ratings change year;
- the benchmark rate resets based on the 12-month average of the Moody's Utilities Bond Index for the period of October 1 through September 30 preceding the change; and
- any rating change update will be made through filing an advice letter in October of the ratings change year to implement the revised index and benchmark rate for the CCM to be effective in the following CCM measurement period.

This index adjustment does not cause the CCM to trigger. Only a CCM trigger event would adjust the authorized Cost of Capital.

E. Guidance for Non-Investment Grade Rating

Given that credit rating agencies have expressed the potential to downgrade SoCalGas and that other California utilities are currently or are close to becoming non-investment grade, SoCalGas also proposes that the CCM should be clarified for the actions to be taken in the event of a downgrade to below investment grade. Such a downgrade event would trigger the use of a "Modified CCM"[14] where:

- the CCM utility bond index trigger is suspended;
- the authorized ROE is not adjusted;

[14] *See* Appendix B for additional analysis of the Modified CCM, as proposed.

- the authorized capital structure is not adjusted, but a utility would have the option to file a capital structure adjustment application related to the change in credit rating;
- the costs of long-term debt and preferred stock would be updated to reflect the actual August month-end embedded costs, forecasted interest rates for variable long-term debt and new long-term debt and preferred stock schedule to be issued;
- a Tier 2 advice letter would be filed in October of the downgrade year, to be effective January 1 of the following year;
- beginning the year immediately following the initial downgrade year, the costs of long-term debt and preferred stock would continue to be trued up annually in the same manner as in the downgrade year, until the first of: (1) the next full Cost of Capital proceeding; or (2) an upgrade of credit ratings back to investment grade; and
- an upgrade from non-investment grade to investment grade would trigger the re-instatement of the traditional CCM. The annual cost of long-term debt and preferred stock true up would cease;
- such an upgrade would not trigger an automated ROE adjustment. Instead, it would set the applicable CCM index and benchmark rate, with the 12-month October through September average Moody's utility bond rates of that upgrade year becoming the new benchmark.

IV. CONCLUSION

SoCalGas respectfully requests that the Commission maintain the CCM, but with a modified dead band of 50 basis points. In addition, SoCalGas requests the Commission's consideration of the clarifications and modifications described earlier.

This concludes my prepared direct testimony.

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V. WITNESS QUALIFICATIONS

My name is Bruce E. MacNeil, and my business address is 488 8th Avenue, San Diego, CA 92101. I am currently employed by Sempra Energy as Vice President & Treasurer. My responsibilities include oversight of capital markets activities, credit ratings and rating agencies, cash management and pension and trust investments. I assumed my current position in April 2019. My prior role was as Assistant Treasurer of Sempra Energy from 2017 until 2019.

From 2005 until 2017, I served in a variety of roles at the National Rural Utilities Cooperative Finance Corporation in Dulles, Virginia. From 2013 to 2017, I was Vice President, Capital Markets Funding where my responsibilities included all aspects of capital markets, corporate finance, loan product pricing and interest rate risk management for the organization. From 2011 until 2013, I was Director, Long-Term Funding & Risk Management responsible for long-term financing and interest rate risk. From 2009 to 2011, I served as Director, Short-Term Funding responsible for cash management operations, short-term debt and corporate liquidity. From 2005 until 2009, I worked as Associate Vice President responsible for relationship and credit management of a portfolio of electric cooperative utility borrowers.

I received a Bachelor of Arts degree in Economics from McGill University in 1997, and a Master's in Business Administration from the University of Maryland, Robert H. Smith School of Business in 2008. I am a licensed Certified Public Accountant in the state of Virginia, and in 2013, I obtained the Certified Treasury Professional credential from the Association of Finance Professionals.

I have not previously testified before this Commission.

APPENDIX A

Credit Rating Information since 2012

RATINGS HISTORY, RATINGS ACTIONS, AND RATINGS AGENCY COMMENTARY

History of Credit Ratings 2012 - 2019

Table 1 – SoCalGas Credit Ratings 2012-Present

Current	S&P	Moody's	Fitch
Long Term Issuer	A	A1	A
Unsecured Debt	A	A1	A+
Secured Debt	A+	Aa2	AA-
Preferred Stock	BBB+	A3	A-
Outlook	Negative	Stable	Stable

2018	S&P	Moody's	Fitch
Long Term Issuer	A	A1	A
Unsecured Debt	A	A1	A+
Secured Debt	A+	Aa2	AA-
Preferred Stock	BBB+	A3	A-
Outlook	Negative	Stable	Stable

2017	S&P	Moody's	Fitch
Long Term Issuer	A	A1	A
Unsecured Debt	A	A1	A+
Secured Debt	A+	Aa2	AA-
Preferred Stock	BBB+	A3	A-
Outlook	Stable	Stable	Stable

2016	S&P	Moody's	Fitch
Long Term Issuer	A	A1	A
Unsecured Debt	A	A1	A+
Secured Debt	A+	Aa2	AA-
Preferred Stock	BBB+	A3	A-
Outlook	Stable	Stable	Stable

2015	S&P	Moody's	Fitch
Long Term Issuer	A	A1	A
Unsecured Debt	A	A1	A+
Secured Debt	A+	Aa2	AA-
Preferred Stock	BBB+	A3	A-
Outlook	Stable	Stable	Stable

2014	S&P	Moody's	Fitch
Long Term Issuer	A	A1	A
Unsecured Debt	A	A1	A+
Secured Debt	A+	Aa2	AA-
Preferred Stock	BBB+	A3	A-
Outlook	Stable	Stable	Stable

2013	S&P	Moody's	Fitch
Long Term Issuer	A	A2	A
Unsecured Debt	A	A2	A+
Secured Debt	A+	Aa3	AA-
Preferred Stock	BBB+	Baa1	A-
Outlook	Stable	RUR - Up	Stable

2012	S&P	Moody's	Fitch
Long Term Issuer	A	A2	A
Unsecured Debt	A	A2	A+
Secured Debt	A+	Aa3	AA-
Preferred Stock	BBB+	Baa1	A-
Outlook	Stable	Stable	Stable

Credit Rating Changes/Outlook Since 2012

- November 8, 2013: Moody's places SoCalGas' on watch for possible upgrade to reflect a more favorable view of the relative credit supportiveness of the US regulatory environment.

- January 30, 2014: Moody's upgrades SoCalGas to reflect more favorable view of the relative credit supportiveness of the US regulatory environment, outlook stable.
    - Long-term Issuer Rating -- A1 from A2
    - Senior Secured Rating -- Aa2 from Aa3
    - Senior Unsecured Rating -- A1 from A2
    - Preferred Stock Rating -- A3 from Baa1

- July 9, 2018: S&P revises SoCalGas' outlook to Negative on wildfire risks, ratings affirmed

- October 30, 2018: S&P affirms SoCalGas ratings, outlook remains negative.

APPENDIX B

Modified CCM Analysis

RATINGS TABLE FOR THE CCM AND MODIFIED CCM INCLUDING INDEX SELECTION

The following table provides the applicable Moody's Bond Index for each ratings level and the ratings bands for the Modified CCM.

Ratings Based Index Selection Table for Cost of Capital Mechanism (CCM) [i]

Credit Worthiness	Moody's	Standard & Poor's	Fitch	Applicable Index to be Used for Cost of Capital Mechanism (CCM)
Investment Grade	Aaa	AAA	AAA	Moody's AA Utilities Bond Index (MOODUAA Index) [ii]
	Aa1	AA+	AA+	
	Aa2	AA	AA	
	Aa3	AA-	AA-	
	A1	A+	A+	Moody's A Utilities Bond Index (MOODUA Index) [ii]
	A2	A	A	
	A3	A-	A-	
	Baa1	BBB+	BBB+	Moody's Baa Utilities Bond Index (MOODUBAA Index) [ii]
	Baa2	BBB	BBB	
	Baa3	BBB-	BBB-	
Non-investment-grade	*Ba1*	*BB+*	*BB+*	*Suspend use of the CCM and replace with Annual Cost of Debt and Preferred Stock True Up* [iii]
	Ba2	*BB*	*BB*	
	Ba3	*BB-*	*BB-*	
	B1	*B+*	*B+*	
	B2	*B*	*B*	
	B3	*B-*	*B-*	
	Caa1	*CCC+*	*CCC+*	
	Caa2	*CCC*	*CCC*	
	Caa3	*CCC-*	*CCC-*	
	Ca	*CC*	*CC*	
	C	*C*	*C*	
	/	*D*	*DDD*	
			DD	
			D	

[i] - Index determined based on lowest long term issuer rating, based on precident set by decisions D.08-05-035 and D.13-03-015.

[ii] - D.08-05-035 pg 19, "Moody's Aa utility bond interest rates should be used for those utilities having an AA credit rating or higher, Moody's A utility bond insterest rates should be used for those utilities having an A credit rating, and MOody's Baa utility bond interest rates for utilities having a BBB credit rating".

[iii] - See Gudance for Non-Investment Grade Rating in Section III.E. of this testimony.

Example of selecting Moody's Utilities Bond Index for a utility with split credit ratings:

For illustrative purposes, suppose SoCalGas was rated A2 by Moody's, BBB+ by S&P and A- by Fitch as of September 30 of a given year. To select the applicable Moody's Utilities Bond Index for the CCM, SoCalGas would use the lowest of the three ratings, or BBB+ by S&P in this example. BBB+ falls in Moody's Baa Utilities Bond Index range in the table above, and that would be the applicable index in the CCM for SoCalGas with these hypothetical split ratings.

MODIFIED CCM AUTOMATIC TRIGGER EXAMPLE

Two scenarios are provided in this example to illustrate the use of the Modified CCM.

Scenario 1:
Trigger of the modified CCM – Downgrade from investment grade to non-investment grade

For illustrative purposes, assume SoCalGas is rated by all agencies at a BBB S&P equivalent level (Baa2 for Moody's and BBB for Fitch). S&P then imposes a two-notch downgrade across all California utilities. This downgrade moves SoCalGas to a rating of BB+ from the current BBB level, moving the company to a non-investment grade level. This event triggers the suspension of the traditional CCM ROE adjustment mechanism and implements the Modified CCM.

An advice letter would be filed in October, including the cost of debt true up to be effective January 1 of the following year. ROE and capital structure would not be adjusted through this mechanism. Each year following, the cost of debt would continue to true up automatically through an October advice letter until the earlier of the next full Cost of Capital filing or a ratings upgrade from non-investment grade.

Scenario 2:
Upgrade from non-investment grade to investment grade

For illustrative purposes, and as a continuation from scenario 1, assume SoCalGas is non-investment grade rated at S&P BB+. SoCalGas is then upgraded from BB+ to BBB. SoCalGas is again now rated in the investment grade level. This triggers the re-instatement of the traditional CCM, and the end of the Modified CCM annual debt true up. The CCM index would be set based Moody's Baa Utility Bond Index, given the BBB rating. The benchmark would be set based on the on the 12-month average rate between October and September preceding the upgrade.

SoCalGas would file a Tier 2 Advice Letter informing the Commission of the re-instatement of the CCM, including all necessary calculations to determine the benchmark. The CCM would then continue as normal, until the earlier of the filing of the next full Cost of Capital or a CCM trigger event.