

Company: Southern California Gas Company (U 904 G)
Proceeding: 2020 Cost of Capital
Application: A.19-04-018
Exhibit: SCG-07

SOUTHERN CALIFORNIA GAS COMPANY (U 904 G)
PREPARED REBUTTAL TESTIMONY OF BRUCE A. FOLKMANN
(POLICY OVERVIEW)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

August 2019

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1 keep SoCalGas' authorized common equity ratio unchanged at 52%, despite compelling
2 data that supports a higher authorized ratio.³

3 The purpose of my rebuttal testimony is to (1) address recommendations
4 contained in the direct testimony from Environmental Defense Fund (EDF)⁴ which are
5 out of scope of this proceeding, and (2) address a concern I have with Public
6 Advocates' capital structure analyses.

7 **II. EDF ON DECARBONIZATION AND ELECTRIFICATION**

8 EDF's testimony from witness, Dr. McCann, appears to provide a more cursory
9 analysis of SoCalGas' cost of capital proposal³ than the testimonies submitted by other
10 intervenors. However, it does address elements of SoCalGas' risk testimony (Exhibit
11 SCG-03) more substantively than other intervenor testimonies, to a certain degree.⁵
12 For instance, EDF does recognize as an increased risk factor for gas utilities, efforts in
13 California to move to decarbonize and electrify energy use.⁶ Given Dr. McCann's
14 recognition of this uniquely gas-focused risk, one which disproportionately impacts
15 SoCalGas relative to other gas utilities in the nation, as well as to electric and combined
16 energy utilities in this State, SoCalGas' adopted ratemaking cost of capital should

³ See Exhibit SCG-02 (Gonzalez), pp. 13-16.

⁴ See Prepared Direct Testimony of Richard McCann, Ph.D. on Authorized Cost of Capital for Utility Operations for 2020 on behalf of the Environmental Defense Fund (August 1, 2019) (McCann Direct).

⁵ Based on its review of intervenor testimonies, SoCalGas does not believe rebuttal testimony is needed to address EDF's or other intervenors' testimony and review of SoCalGas' qualitative risk assessment, as presented in Exhibit SCG-03 (Aragon). Mr. Aragon's direct testimony sufficiently presents and supports the company's position on business, financial, and regulatory risks. Intervenors have provided their opinions on those risks, for the Commission's consideration.

⁶ See McCann Direct at 29.

1 adequately account for this risk and provide for returns commensurate with this
2 increased risk.

3 However, Dr. McCann does not raise this heightened risk factor to acknowledge
4 that a gas utility's ROE should sufficiently compensate for this risk. Instead, Dr.
5 McCann's analysis goes sideways, as he engages in a discussion of compensating
6 shareholders for stranded costs.⁷ It is at this point where EDF goes beyond the relevant
7 and permissible scope of this proceeding. EDF urges the Commission to effectively use
8 a utility's cost of capital to effectuate environmental policy outcomes by adopting a
9 result for SoCalGas that would actually *disincentivize* investors. EDF devotes a
10 substantial portion of its testimony to argue this point. Examples are found throughout
11 EDF's testimony, including the following excerpts:

- 12 • The adoption and implementation of these GHG policy objectives
13 means that the Commission must act to encourage investment in our
14 electricity system while at the same time acting to limit the amount of
15 potential stranded assets in our natural gas utilities. One of the
16 Commission's tools in achieving these objectives is adjusting the
17 ROE to provide a differential between gas and electricity
18 investments.⁸
- 19 • Such an order should clearly reflect how the capital structure will
20 align with the state's policy objectives of decarbonization.⁹

⁷ See *Id.*

⁸ *Id.* at 3.

⁹ *Id.* at 22.

- 1 • We are left with one other risk that requires a broader policy decision.

2 The move to decarbonize and electrify energy use will likely lead to
3 decreased natural gas (methane) use. . . . The Commission should
4 begin to engage on facilitating this transition so as to compensate
5 utility shareholders for their past investments and equitably share
6 responsibilities and burdens.¹⁰

- 7 • The authorized ROE for the utilities' gas operations should reflect
8 incentive for reduced investment and eventual decommissioning of
9 the natural gas distribution system. . . . Further, the Commission
10 should adopt accelerated depreciation of natural gas assets.
11 Accelerated depreciation leads to a lower ROE because investors
12 have a greater assurance of recovering their investments.¹¹

13 While the State's legislative and regulatory policies and proclamations impacting
14 natural gas are relevant in the context of assessing SoCalGas' risk relative to other
15 utilities, EDF's suggestion that the Commission should somehow advance or accelerate
16 statewide decarbonization or electrification through adoption of a cost of capital that
17 *disincentivizes* investors is in clear and direct conflict with the purpose of this
18 proceeding.¹²

19 The Commission gave due consideration to the issues that parties wanted
20 addressed in this proceeding, through its review of the filed protests and replies, and its

¹⁰ Id. at 29.

¹¹ Id. at 32.

¹² See Southern California Gas Company (U 904 G) Reply to Protests (June 3, 2019), pp. 4-7.

1 solicitation of comments on scope at the prehearing conference.¹³ EDF's
2 decarbonization policy issues were among those considered and ultimately not
3 included.¹⁴ Despite this, EDF raises them again in direct testimony, causing continued
4 burden upon, and distraction to, parties and the Commission in the determination of a
5 fair and reasonable cost of capital which satisfies the legal standard set forth in the
6 Bluefield and Hope cases.¹⁵

7 Meanwhile, in this proceeding, the Commission should not be driven to
8 disincentivize one utility's investments over another, but instead to determine a return
9 that is reasonably sufficient to instill confidence in the financial soundness of the utility;
10 commensurate with returns available on alternate investments of comparable risks; and
11 adequate, under efficient management, to maintain and support its credit and enable it
12 to raise the funds necessary for the proper discharge of its public duties.¹⁶ Therefore,
13 SoCalGas asks the Commission to hold parties to the adopted scope in this proceeding,
14 which would exclude litigation of EDF's policy agenda.

¹³ See e.g., Transcript, pp. 34 (ln. 6) to 35 (ln. 3); p. 41 (ln. 6) to 43 (ln. 6). At the prehearing conference, SoCalGas commented that litigating or addressing environmental policy issues in the cost of capital proceeding [in a manner suggested by EDF] would be outside the proceeding's scope. PG&E commented that environmental issues like decarbonization, as well as justifying investments in grid modernization, do not belong in a cost of capital proceeding. Instead, investments in facilities belong in proceedings like a general rate case, where one looks at what the utility is proposing to do with infrastructure. In contrast, the cost of capital sets the percentages for ROE, debt costs, and capital structure, which then are turned into the ROR, which is applied to the assets that are deemed appropriate as determined in those other cases.

¹⁴ See Assigned Commissioner's Scoping Memo and Ruling (July 2, 1019), p. 3.

¹⁵ Supra, SoCalGas Reply to Protests at 5-6.

¹⁶ Id. at 6 (referencing D.12-12-034).

1 **III. PUBLIC ADVOCATES ON CAPITAL STRUCTURE**

2 Public Advocates' witness Rothschild provides the more expected and traditional
3 type of review of the utilities' cost of capital proposals. Dr. Morin provides an in-depth
4 analysis of Mr. Rothschild's analysis of ROE which demonstrates material flaws and
5 shows that Public Advocates' ROE proposal for SoCalGas is unreasonable.

6 However, I want to highlight something I observed in Mr. Rothschild's analysis of
7 authorized capital structure which stood out as unconventional and misguided. Mr.
8 Rothschild opines that the holding company's consolidated capital structure should
9 inform the outcomes for the regulated utility in this proceeding. He then claims that
10 utilities were not forthcoming in discovery with respect to holding company and affiliate
11 information. I respectfully disagree with Mr. Rothschild's perspective, and want to
12 address it as a foundational matter. I defer to Mr. Gonzalez and Dr. Morin to more fully
13 address Mr. Rothschild's capital structure and ROE analysis.

14 Mr. Rothschild states,

15 For each of these companies, the consolidated capital structures
16 contain materially less common equity that has been currently
17 authorized let alone the even higher requested ratios. When the
18 consolidated capital structure ratios contain noticeably less common
19 equity that regulated subsidiaries, one should be careful in
20 interpreting the so-called actual capital structure of the subsidiary.¹⁷

21
22

¹⁷ Rothschild Direct at 31.

1 Mr. Rothschild continues,

2 This causes me, and I suggest should also cause the Commission
3 to be highly suspicious when a company decides that it can have a
4 lower level of common equity at the consolidated level than at what
5 is typically at the lower risk subsidiary level.¹⁸

6 Mr. Rothschild later states,

7 Numerous interrogatories were asked of the companies in an
8 attempt to provide the company with a reasonable defense of the
9 capital structure anomalies that appear when comparing
10 consolidated and regulated utility subsidiary levels. They
11 consistently chose to not answer these questions.¹⁹

12 Mr. Rothschild wants to use Sempra Energy's consolidated capital structure
13 (which has lower common equity ratio than SoCalGas' authorized and actual capital
14 structures²⁰) to justify a reduction to SoCalGas' authorized common equity ratio
15 proposal. He states that, "[i]f the higher common equity ratio were the one-sided benefit
16 as claimed by company witness Mr. Folkman[n], it should be expected that Sempra
17 would first increase its consolidated common equity ratio by such techniques as selling
18 more common equity and using the proceeds to pay off debt."²¹ He later states, "[t]he
19 Commission should find it very telling that Sempra management has chosen not to

¹⁸ Id. at 31-32.

¹⁹ Id. at 32.

²⁰ See Id. at 40.

²¹ Id. at 39.

1 increase its common equity ratio to anywhere near the level requested for SDG&E or
2 SoCalGas.”²²

3 The Commission neither regulates nor authorizes the capital structure of Sempra
4 Energy, and is not examining the decisions or the financial drivers of Sempra Energy or
5 any of its non-regulated, out-of-state, and international affiliates in this proceeding.
6 Furthermore, those entities are (appropriately) not parties to this proceeding. Sempra
7 Energy is a holding company that owns multiple regulated and non-regulated
8 subsidiaries. Sempra Energy’s consolidated capital structure and financials are
9 comprised of all of these subsidiaries, including not only the two Commission-regulated
10 utility subsidiaries (SoCalGas and SDG&E), but also out-of-state and international
11 subsidiaries that are not regulated by this Commission and do not impact the operations
12 or financial performance of SoCalGas (or SDG&E).

13 Further, SoCalGas complies with the ring fencing measures instituted by the
14 Commission to prevent the utility from potentially being pulled into bankruptcy by its
15 parent holding company, something Mr. Rothschild acknowledges (to some degree).²³
16 The various subsidiaries owned by Sempra Energy have distinguished risk profiles, and
17 as such, Sempra Energy’s consolidated risk profile is distinguished from any one of its
18 subsidiaries. Credit rating agencies’ view of Sempra Energy’s risk profile is apparent in
19 its BBB+ credit rating compared to SoCalGas’ “A” rating. SoCalGas’ higher credit rating
20 in comparison with Sempra Energy could be attributed, in part, to SoCalGas’ higher

²² Id. at 40.

²³ See Id. at 38.

1 equity percentage. The risks and capital structures of these non-Commission regulated
2 entities are not relevant to, or being reviewed in this proceeding.

3 Because the consolidated capital structure is by its very definition a reflection of a
4 diversity of different business enterprises, one cannot make any meaningful
5 comparisons between a regulated utility's authorized capital structure and the parent
6 company's consolidated structure, in the context of adopting a ratemaking cost of
7 capital. SoCalGas' proposal is supported by utility's actual capital structure levels over
8 the past six years, as well as comparisons to structures of other gas utilities.²⁴

9 SoCalGas' proposed capital structure is evaluated based on utility-specific planned
10 capital investments, utility-specific credit ratings, utility-specific risks, and utility-specific
11 operational and financing needs. This is the type of probative data and analysis that the
12 Commission has given weight in prior cost of capital decisions.

13 Thus, Mr. Rothschild's reliance upon consolidated data to evaluate SoCalGas'
14 ratemaking capital structure is inappropriate. If Mr. Rothschild truly believes that the
15 holding company's consolidated capital structure should inform the authorized capital
16 structure of the regulated utility, then one would expect that his proposal for SoCalGas
17 would be for a much lower common equity ratio rather than his recommended 52% (i.e.,
18 no change to currently authorized).²⁵ When Mr. Rothschild rationalizes his proposal as
19 "conservatively high,"²⁶ one can infer from that statement that he has not established a

²⁴ See Exhibit SCG-02 (Gonzalez) at 13-16.

²⁵ See Rothschild Direct at 5 (Table 3).

²⁶ See Id. at 32.

1 | credible nexus between the holding company's consolidated capital structure and the
2 | regulated utility's capital structure, at least in a manner that he suggests.

3 | **IV. CONCLUSION**

4 | In the interest of creating a relevant and meaningful record, the Commission
5 | should disregard the portions of EDF's and Public Advocates' testimony that do not
6 | advance the issues that are in scope in this proceeding.

7 | This concludes my prepared rebuttal testimony.