Company:	San Diego Gas & Electric Company (U 902 M)
Proceeding:	2026 Cost of Capital
Application:	A.25-03-XXX
Exhibit:	SDG&E-02

PREPARED DIRECT TESTIMONY OF

MARITZA MEKITARIAN

CAPITAL STRUCTURE, EMBEDDED COST OF DEBT, AND PREFERRED EQUITY

ON BEHALF OF SAN DIEGO GAS & ELECTRIC COMPANY

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

March 20, 2025

TABLE OF CONTENTS

I. INTRODUCTION 1
II. OVERVIEW OF CAPITAL STRUCTURE AND FINANCIAL RISK 2
III. PROPOSED CAPITAL STRUCTURE 5
  A. SDG&E's Proposal Tracks the Company's Actual Capital Structure 6
  B. SDG&E Proposal to Reflect its Actual Capital Structure Better Balances Shareholder and Ratepayer Interests 9
  C. The Proposed Capital Structure Helps the Company Manage its Business and Financial Risks and is Credit Supportive 10
    1. SDG&E's Proposed Capital Structure Reflects the Need to Reduce Financial Risks to Respond to Increased Business Risks and Lowered Credit Ratings 11
    2. SDG&E Faces Increased Financial Risks 13
      a. Increased Financial Risks from Carrying Larger Costs for Longer Periods in Balancing and Memorandum Accounts 13
      b. Elevated Levels of Capital Investment 16
      c. Debt Equivalence 16
    3. SDG&E's Capital Structure Proposal is a Prudent Counter to the Company's Unique Business and Financial Risks and Supports its Credit Ratings 17
IV. EMBEDDED COST OF DEBT AND PREFERRED STOCK RECOMMENDATIONS 19
V. CONCLUSION 21
VI. WITNESS QUALIFICATIONS 22

APPENDIX A - SDG&E EMBEDDED COST OF DEBT - TEST YEAR 2026

PREPARED DIRECT TESTIMONY OF
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I. INTRODUCTION

My testimony presents San Diego Gas & Electric Company's ("SDG&E" or "Company") proposals regarding the adoption of an updated authorized capital structure and embedded cost of debt in support of the Company's California Public Utilities Commission ("CPUC" or "Commission") regulated operations in Test Year 2026.

Capital structure refers to the capital ratios of three components: (1) common equity; (2) long-term debt; and (3) preferred stock (if applicable). The capital ratios, in conjunction with the costs associated with each of the three components, determine the weighted-average cost of capital ("COC") or authorized rate of return. Table 1 below shows SDG&E's proposed capital structure and costs for Test Year 2026.

Table 1 – Proposed Capital Structure and Costs

	Proposed Capital Structure	Proposed Costs
Common Equity	54.00%	11.25%[1]
Long-Term Debt	46.00%	4.62%[2]
Preferred Stock	0.00%	0.00%

[1] *See* Prepared Direct Testimony of Valerie A. Bille, Policy Overview (March 20, 2025) ("Ex. SDG&E-01 (Bille)") (presenting SDG&E's return on equity recommendations); *see also* Prepared Direct Testimony of Joshua C. Nowak, Return on Equity (March 20, 2025) ("Ex. SDG&E-03 (Nowak)") (supporting SDG&E's ROE recommendations).

[2] *See* Appendix A for the calculation of SDG&E's embedded cost of debt proposal.

1
II. OVERVIEW OF CAPITAL STRUCTURE AND FINANCIAL RISK

2 As noted, capital structure consists of common equity, long-term debt, and preferred stock.
3 Capital structure is one part of determining a fair and reasonable authorized rate of return ("ROR").[3]
4 The Company's authorized ROR is calculated by applying the Company's ROE and
5 embedded costs of debt and preferred stock (if applicable) to its authorized capital structure. The
6 Commission has recognized that "maintain[ing] investment-grade creditworthiness" is an
7 "important component[] of the Hope and Bluefield decisions."[4] An optimal capital structure can
8 help achieve and maintain a strong credit rating, which lowers borrowing costs for the utility and
9 ultimately ratepayers.[5]

10 The equity component of a utility's capital structure represents the amount of capital
11 covered by shareholders. The common equity ratio reflects how a company is financing its cash
12 needs. It shows the percentage of assets on which the shareholders have a claim. The higher the
13 common equity ratio, the more that shareholders have at stake.

14 Preferred stock is a source of capital that is issued in shares, like common equity, but comes
15 with preferential treatment for dividends. Due to the preferred treatment on dividends, preferred
16 stock generally has a lower cost than common equity. Credit rating agencies, like Standard & Poor's
17 ("S&P"), generally treat preferred stock as a hybrid of debt and equity, assigning a percentage of
18 equity content in accordance with the security's features.

19 Long-term debt is a measurement of a company's financial leverage. Debt is generally less
20 expensive than equity due to its tax advantages and lower risk. A low debt ratio is less then optimal
21 as it fails to take advantage of a tax-deductible source of financing that is lower in cost than equity.

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[3] *See* Decision ("D.") 22-12-031 at 4.

[4] *Id.* at 32.

[5] *See id.*

But the higher the debt ratio, the higher the financial risk, because a company has a higher percentage of its revenues committed to fixed debt payments.[6] The larger the revenues committed to fixed debt payments, the higher the risk of default on those payments to lenders. This, in turn, increases the financial risk exposure to common stockholders, as they are entitled only to revenues available after all fixed obligation payments are satisfied.

A company that is highly leveraged with fixed costs thus requires a higher return on both debt and equity for investors—as the earnings available to shareholders become more volatile and secondary to debt payments, causing shareholders to require a higher return for taking on that increased risk.[7] This increases financial risks—potentially resulting in reduced credit ratings—and results in higher costs of capital over the long-term. As the Commission has thus stated, "as long-term debt ratios are increased, credit ratings tend to be downgraded which results in increased financial risks for common equity holders, thereby requiring greater returns on common equity."[8] Moreover, if a utility's credit ratings are lowered, it results in higher borrowing costs, meaning higher costs that ratepayers are responsible for.

The Commission has thus found that, "[b]ecause the level of financial risk that the utilities face is determined in part by the proportion of their debt to permanent capital, or leverage, we must ensure that the utilities' adopted equity ratios are sufficient to maintain reasonable credit ratings and attract capital."[9] Credit metric guidance provided by the credit rating agencies is an important guide to determining the appropriate amount and use of debt. The major credit rating agencies commonly

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[6] *See* D.19-12-056 at 6.

[7] *See* Roger A. Morin, New Regulatory Finance (2006) at 455.

[8] D.12-12-034 at 8-9.

[9] D.22-12-031 at 4.

1 employ several key metrics to quantify financial risk, such as funds from operations ("FFO") as a
2 percent of total debt and debt as a percentage of total capital.
3 The FFO-to-Total Debt ratio measures funds from operations as a percent of total debt. It
4 indicates how much of its debt a company could retire with annual cash from operations. A higher
5 figure indicates a stronger ability to retire its debt, and thus lower financial risk. Together with their
6 assessment of business risk and regulatory framework, the major credit rating agencies use these
7 financial metrics to help determine the credit ratings they assign.
8 In addition to FFO-to-Total Debt metric, credit rating agencies also employ Debt-to-Total
9 Capital in assessing financial risk. Moody's Rating Methodology for Regulated Electric and Gas
10 Utilities explains its approach to assessing credit risk for regulated electric and gas utilities
11 globally.[10] The report provides a detailed rating grid which can be used as a reference tool to
12 approximate credit profiles within the regulated electric and gas sector. Table 2 below replicates
13 Moody's Debt Ratio benchmarks presented in the report.
14 **Table 2 – Moody's Debt Ratio Benchmarks**

Bond Rating	Debt / Capital[11]
Aaa	< 25%
Aa	25% - 35%
A	35% - 45%
Baa	45% - 55%
Ba	55% - 65%
B	65% - 75%
Caa	≥75%

[10] Moody's Investors Service, Rating Methodology for Regulated Electric and Gas Utilities (August 6, 2024).

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

1 **III. PROPOSED CAPITAL STRUCTURE**

2 SDG&E proposes an authorized capital structure of 54.00% common equity, 46.00% debt,
3 and 0% preferred stock—a change from the Company's currently authorized capital structure of
4 52.00% common equity, 45.25% debt, and 2.75% preferred stock. This is in alignment with
5 SDG&E's actual five-year average capital structure of 54.9% common equity and 45.1% debt.
6 Table 3 below compares SDG&E's proposed capital structure with the Company's currently
7 authorized one.

8 **Table 3 – Current Authorized Capital Structure and Proposed Capital Structure**

	Current Authorized[12]	2026 Proposed	Proposed Change
Common Equity	52.00%	54.00%	2.00%
Long-Term Debt	45.25%	46.00%	0.75%
Preferred Stock	2.75%	0.00%	(2.75%)

9
10 SDG&E's proposed authorized capital structure reflects the fact that SDG&E has
11 maintained an actual average capital structure of nearly 55 percent common equity, 45 percent long-
12 term debt, and zero percent preferred equity for five years

13 Specifically, SDG&E proposes the change to its authorized common equity ratio for three
14 reasons: (1) to better reflect the Company's more recent actual (recorded) capital structure since
15 2015; (2) to reach a more reasonable balance between shareholder and ratepayer interests, since
16 SDG&E shareholders are currently providing a benefit to ratepayers without any return; and (3) to
17 help SDG&E manage its increased business and financial risks and improve its credit ratings. The
18 latter is critical, as SDG&E, after maintaining an A-credit rating for 15 years, has been downgraded
19 by all three credit rating agencies since 2018. Even after Moody's upgraded SDG&E's credit rating

[12] D.22-12-031 at 53.

one notch in March 2021,[13] the Company's credit rating is still at least two notches lower from all three agencies compared to its prior A-ratings. And Moody's in March 2025 cautioned that SDG&E was only "weakly positioned" at its current rating.[14]

The downgrades were primarily due to a perceived increase in business and regulatory risks—namely due to the risk of catastrophic wildfire liability following the state's 2017 and 2018 wildfires—despite SDG&E not being responsible for a catastrophic wildfire since 2007 and being widely lauded for its wildfire mitigation efforts. SDG&E's shareholders currently provide a benefit to ratepayers by maintaining a higher actual common equity structure then SDG&E's authorized one—which supports SDG&E's credit ratings, reducing borrowing costs for ratepayers—without receiving any return on that additional actual common equity above SDG&E's authorized common equity. If SDG&E reduced its actual common equity ratio to reflect its authorized one, it would increase SDG&E's financial and regulatory risks in the eyes of credit rating agencies—putting further downward pressure on SDG&E's credit rating. SDG&E's actual capital structure is also currently buttressing the Company against the increased regulatory and financial risk identified by Moody's.

A. SDG&E's Proposal Tracks the Company's Actual Capital Structure

The Company's recommended change in its authorized capital structure to increase its common equity and long-term debt ratios and remove preferred stock is designed to reflect SDG&E's actual (recorded) capital structure. The Company's currently authorized capital structure has not changed since being adopted in SDG&E's 2012 Cost of Capital decision, D.12-12-034,[15]

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[13] Moody's, Rating Action: Moody's upgrades San Diego Gas & Electric to A3 from Baa1; outlook stable 1 (Mar. 30, 2021) ("Moody's Mar. 30, 2021") at 1.

[14] Moody's, San Diego Gas & Electric Company Credit Opinion (March 10, 2025) ("Moody's Mar. 10, 2025") at 2.

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

1 when the Commission based SDG&E's authorized capital structure on SDG&E's actual capital
2 structure at that time. SDG&E's actual capital structure has since changed, yet its authorized capital
3 structure has not been updated to reflect this.

4 Since 2015, SDG&E has maintained an actual common equity ratio above the authorized of
5 52%. Table 4 below shows SDG&E's actual recorded capital structure for the last ten years, from
6 2015 through 2024.

7 **Table 4 – SDG&E's Historical Capital Structure**

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Five-Year Average
Common Equity	57.55%	57.21%	55.61%	56.15%	58.26%	56.31%	56.43%	53.97%	53.36%	54.43%	54.90%
Long-Term Debt	42.45%	42.79%	44.39%	43.85%	41.74%	43.69%	43.57%	46.03%	46.64%	45.57%	45.10%
Preferred Stock	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%

8
9 The Company has retained earnings in common equity to balance the capital structure above
10 SDG&E's authorized common equity ratio of 52%. In fact, as shown in Table 4 above, SDG&E has
11 been operating well above the 52% authorized common equity ratio. These higher than authorized
12 equity levels have improved credit metrics by reducing debt and mitigating higher business and
13 financial risks with capital provided solely by shareholders that shareholders do not receive a return
14 on, directly benefitting customers by buttressing SDG&E's credit ratings to lower borrowing
15 costs.[16]

16 There is precedent for basing an authorized common equity ratio on a company's actual
17 common equity ratio. As noted, in D.12-12-034, the Commission approved SDG&E's currently

[16] *See, e.g.*, Moody's Investors Service, San Diego Gas & Electric Company, Update to credit analysis following upgrade to A3 (May 10, 2021) ("Moody's May 10, 2021").

1 authorized capital structure that has existed since that time—principally because it reflected the

2 Company's actual capital structure in 2012.[17] As the Commission found in that Decision,

3 [t]he Commission has previously reasoned that the utilities should be given some
4 discretion to manage their capitalization with a view towards a balance between
5 shareholders' interest, regulatory requirements, and ratepayers' interest. In this case,
6 SDG&E seeks a common equity ratio for its revenue requirement which is the same
7 as its actual common equity ratio. We concur with SDG&E and find a 46.25% long-
8 term debt, 2.75% preferred stock and 52.00% common equity capital structure
9 reasonable and we adopt it.[18]

10 Since SDG&E's currently authorized capital structure no longer aligns with its actual capital

11 structure, consistent with that 2012 decision, SDG&E's proposal moves closer to SDG&E's current

12 actual capital structure. As noted, the Commission has previously expressed support for aligning a

13 utility's authorized capital structure with its actual one. In addition to D.12-12-034, in 2023, the

14 Commission adopted common equity ratios for regulated water utilities that used those utilities'

15 actual ratios as the basis for the request.[19] And in June 2021 comments filed at the Federal Energy

16 Regulatory Commission ("FERC"), the Commission noted the benefit of FERC generally providing

17 the utility the ability to have its actual capital structure reflected in its authorized one—affording the

18 utility "through its own financial policies, significant[] influence [on] its credit metrics."[20]

19 SDG&E's proposal also reflects a 2017 Report issued by the Commission's Policy & Planning

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[17] *See* D.12-12-034 at 11 ("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 . . .").

[18] *Id.* (citing 33 CPUC2d (1989) 495 at 541 through 545).

[19] D.23-06-025 at 35-37.

[20] Comments of the California Public Utilities Commission and the California Department of Water Resources State Project, FERC Docket No. RM20-10-000 (filed June 25, 2021) at 29 ("CPUC FERC Comments").

Division that states, "[i]n California a hypothetical capital structure, which is expected to approximate the actual capital structure of the utility over the long run is used."[21]

SDG&E similarly recommends reducing its authorized preferred equity from 2.75% to 0% to reflect SDG&E's longstanding actual capital structure. SDG&E has:

- Not issued preferred stock since 1993;
- Redeemed all issued and outstanding shares of its preferred stock in 2013; and
- Does not plan to issue this type of financing.

Preferred stock is rarely used by utility operating companies. SDG&E can only find two utility operating companies that have outstanding preferred stock issued in the last decade. The relative cost of issuing preferred stock remains significantly higher than debt financing. A California utility operating company's preferred stock investors may require higher coupon rates due to perceived higher wildfire risk and their relative priority in the capital stack. By contrast, SDG&E has been successful at issuing debt at low interest rates and using common equity to fund its large capital investment plan, further arguing against using preferred stock.

B. SDG&E Proposal to Reflect its Actual Capital Structure Better Balances Shareholder and Ratepayer Interests

Matching SDG&E's authorized capital structure to its actual one better supports a reasonable balance between ratepayer and shareholder interests. Credit rating agencies assess SDG&E's financial metrics based upon its actual, not authorized, capital structure. So, as noted, under SDG&E's currently authorized capital structure, shareholders have propped up SDG&E's credit ratings—resulting in lower borrowing costs for customers—while not earning a return on the

[21] CPUC, Policy & Planning Division, Utility General Rate Case – A Manual for Regulatory Analysts (November 13, 2017) at 29.

difference between the Company's authorized equity ratio of 52% and its actual five-year average equity ratio of 54.9%.

In other words, shareholders continue to provide additional capital without earning a return, providing a direct benefit to customers that shareholders are not receiving (contrary to the example the Commission cited regarding the benefits of the approach to capital structure at FERC). If SDG&E were to reduce its actual common equity ratio to reflect its currently authorized common equity ratio, then SDGE's financial health would weaken, which could lead to further credit downgrades and potentially higher expenses to ratepayers. SDG&E's prudent management decision of maintaining an actual five-year average common equity ratio of 54.9% to support as strong a credit rating as possible should be recognized and supported by the Commission, rather than continuing to ask equity investors to buttress SDG&E's credit ratings and reduce borrowing costs for ratepayers without receiving a return for that investment.

C. The Proposed Capital Structure Helps the Company Manage its Business and Financial Risks and is Credit Supportive

SDG&E's capital structure proposal is also consistent with the goal of keeping the Company's capital costs reasonable—relative to the costs associated with the authorized ratios—to help maintain its credit rating. SDG&E's historically strong credit ratings reflect, in part, the effective and proactive management of its capital structure—of the type that the Commission lauded at the FERC-ratemaking level.[22] SDG&E now faces significantly increased business, financial, and regulatory risks—reflected most acutely in the equity and credit ratings impact from the January 2025 wildfires in California, as discussed in the testimonies of Josh Nowak and Valerie Bille—and

[22] CPUC FERC Comments at 29.

1 Moody's increased concern regarding SDG&E's regulatory uncertainty following SDG&E's 2024
2 GRC decision.[23]

3 SDG&E's higher actual common equity ratio has helped SDG&E limit financial risk and
4 access the debt markets at reasonable rates—in response to those increased business and regulatory
5 risks. It has mitigated further credit rating downgrades and has allowed SDG&E to issue $2 billion
6 of long-term debt as of December 31, 2024 since the 2023 COC proceeding. As discussed below,
7 SDG&E's proposal thus protects the Company and customers from:

8 • The increased business risk of potentially unrecoverable catastrophic wildfire
9 liability costs;

10 • Lower credit ratings as a result of increased financial risks from carrying
11 larger amounts of costs in balancing and memorandum accounts for longer
12 periods;

13 • The resulting uncertainty regarding SDG&E cash flow from 2025-2027, as
14 identified by Moody's and

15 • Other factors that may increase the Company's cost of debt.

16 **1. SDG&E's Proposed Capital Structure Reflects the Need to Reduce Financial**
17 **Risks to Respond to Increased Business Risks and Lowered Credit Ratings**

18 A prudent financial manager takes proactive steps to manage and mitigate financial risk.
19 SDG&E's current risks drive the need for its proposed capital structure. SDG&E faces unique,
20 ongoing, above-average risks.

21 As noted, SDG&E's credit profile has been downgraded by all three credit rating agencies
22 since 2018—primarily over concerns regarding wildfire and wildfire liability risks in California—
23 despite SDG&E being lauded for its wildfire mitigation programs and not being responsible for a
24 significant wildfire since 2007. In February 2025, S&P revised their outlook for Southern California
25 Edison to negative, stating the outlook "reflect[s] the uncertainty that the California wildfire fund

[23] Moody's Mar. 10, 2025 at 1.

1 could materially deplete given the number and value of the structures that have been damaged or
2 destroyed (over 10,000) due to the Eaton fire, and the possibility that SCE's equipment may be
3 linked to the fire. The negative outlooks also reflect potential for a more challenging operating
4 environment going forward for Edison and SCE due to wildfire risk, which could weaken credit
5 quality. [24]

6 The concern over the durability of the wildfire fund is putting pressure on SDG&E's credit
7 ratings, despite SDG&E not having any alleged role in the January 2025 wildfires. In spite of
8 calling SDG&E a "global leader" in wildfire prevention and mitigation, S&P reaffirmed its BBB+
9 rating for SDG&E stating, "our stable outlook on SDG&E reflects its track record of not causing a
10 significant wildfire and our expectation that SDG&E can continue to sustain such performance
11 while maintaining stand-alone financial measures that remain sufficient for the ratings."[25] Yet S&P
12 has also repeatedly emphasized that SDG&E faces above-average physical risk compared with
13 peers because of wildfires in California," which puts downward pressure on SDG&E's credit
14 ratings.[26] According to a recent third-party study,[27] a one-notch downgrade of SDG&E by each
15 rating agency could raise borrowing rates by up to 12 basis points, increasing ratepayer burden. This
16 would result in an estimated $95 million increase in borrowing costs over the life of the 30-year
17 bonds forecasted in this cost of capital cycle. SDG&E's proposed common equity ratio is thus a

[24] S&P, Research Update: Edison International and Subsidiary SoCalEdison Outlooks Revised To Negative From Stable On Potential Risk For WildFire Fund Depletion: Ratings Affirmed (February 3, 2025).

[25] S&P, Research Update: Sempra Outlook Revised To Negative, Ratings Affirmed; Southern California Gas Downgraded, Outlook Stable (January 9, 2025) at 2.

[26] S&P: Tear Sheet: Sand Diego Gas & Electric Co. Monitored Due to Risk of Material Draw on Wildfire Fund (Feb. 11, 2025) at 4 (emphasis added) ("S&P Feb. 11, 2025").

[27] Source: Academy Securities, March 13, 2025. Based on senior secured credit ratings for 30-year first mortgage bonds.

prudent measure to counteract its increased business risks and improve its credit ratings, reducing costs for customers.

2. SDG&E Faces Increased Financial Risks

The Company's lower credit ratings as a result of the business risks of potentially unrecovered catastrophic wildfires costs, political risks, and others are also exacerbated by additional financial risks—namely SDG&E's increasing responsibility to carry larger amounts of costs in balancing and memorandum accounts for years without recovery, additional debt to fund its robust capital program, and debt equivalence related to Power Purchase Agreements ("PPA") and Resource Adequacy ("RA") obligations. S&P recently rated SDG&E's financial risk as "significant," which is the fourth highest level on the rating agency's scale.[28]

a. Increased Financial Risks from Carrying Larger Costs for Longer Periods in Balancing and Memorandum Accounts

As noted, Moody's stated in March 2025 that SDG&E's final 2024 general rate case ("GRC") decision has "introduced some regulatory uncertainty" that "will affect the utility's cash flow visibility and tempers [SDG&E's] A3 credit rating."[29] The ratings agency continued that "there is considerable uncertainty regarding the utility's 2025-2027 cash flow arising from":

> (i) CPUC's pending decisions in connection with intervenor requests for re-hearing of the 2024 GRC and SDG&E's Track 2 and Track 3 to address the deferred recovery of the wildfire costs and investments in excess of the amounts authorized in the 2019 GRC; (ii) the CPUC's decision on the treatment of balancing accounts that could affect the timeliness of true-ups for recovering under-collected amounts and heighten the utility's exposure to regulatory lag; (iii) management's ability to offset some of the regulatory headwinds with the cost saving initiatives announced at the end of February 2025. This uncertainty positions the utility weakly at the A3 rating level.[30]

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[28] S&P, Tear Sheet: San Diego Gas & Electric Co. Monitored Due To Risk Of Material Draw On Wildfire Fund (February 11, 2025) at 2.

[29] Moody's Mar. 10, 2025 at 1.

[30] *Id.*

Specifically, in D.24-12-074, the Commission approved for SDG&E interim rate relief for critical and necessary wildfire mitigation costs for 2019-2022.[31] Yet as of December 31, 2024, the wildfire mitigation undercollected balance was approximately $808 million.[32] The high level of uncollected balances leaves SDG&E carrying extensive debt far beyond typical rate recovery cycles, causing SDG&E to be responsible for hundreds of millions in additional debt for years until recovery is authorized.

SDG&E is thus having to finance costs subject to cost recovery—including those in balancing and memorandum accounts—for longer terms, with more expensive long-term financing. As of the end of December 2024, SDG&E's undercollected balances were $924 million compared to a historical average closer to $300 million. This risk of carrying large balances for long periods may continue to grow. Moody's recently found that the 2024 "den[ying] two-way balancing account treatment for several regulatory accounts and convert[ing] some existing two-way accounts to one-way accounts" increases uncertainty regarding recovery.[33]

The 2024 GRC decision also shifted recovery of capital programs from being included in GRC rate base to recovery through filings separate from the GRC, delaying timely recovery of costs. In their recent credit opinion, Moody's acknowledged this in comparing SDG&E's request compared to the authorized stating,

> other drivers of the difference include the CPUC's postponement of the decision about authorizing incremental revenues to future rate proceedings, namely through (i) the so called advice letter filings to reflect certain projects in the rate base (for example, SDG&E's Moreno compressor station project with an expected in service date of 2026), or (ii) separate applications for the cost recovery of specific items (for example, SDG&E's advanced metering infrastructure replacement and mobile home

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[31] D.24-12-074 at 22.

[32] Sempra, 2024 SEC Form 10-K (February 25, 2025) at F-57, available at https://investor.sempra.com/static-files/b0e6f794-b5d0-428f-aa4a-a56c912e6edd.

[33] Moody's Mar. 10, 2025 at 6.

park and integrity management program. The failure of the CPUC to make timely decisions on these matters creates regulatory uncertainty.[34]

And as of December 2024, SDG&E's customer delinquent account undercollections were $200 million, approximately three times higher compared to 2019 customer undercollections. The debt to fund the incremental delinquent account balances decreases SDG&E's ability to be financially well-positioned to continue to fund the growing delinquent account balances.

Because of this, Moody's stated that SDG&E is now only "weakly positioned at the A3 rating level" for the reasons discussed above.[35] Moody's added that it could again downgrade SDG&E's credit rating if SDG&E did not maintain a ratio above 20 percent or "if there is a further decrease in the level of regulatory support for the utility, including credit negative outcomes of any pending regulatory proceedings."[36] Conversely, Moody's stated that it could upgrade SDG&E's credit rating if it maintains a ratio in excess of 24 percent.[37]

If SDG&E must continue to carry large costs such as these for years, it will harm SDG&E's debt ratio and enshrine a principle that could result in SDG&E having to carry even more debt that would push SDG&E below that 20 percent ratio. This could reduce SDG&E's credit ratings, impacting SDG&E's ability to access capital markets at low rates and further increasing costs for ratepayers. SDG&E's proposed common equity ratio is thus critical to counterbalance this increased financial risk. It will help maintain the robust credit metrics recognized by Moody's. By contrast, if the Commission continues to not recognize SDG&E's actual common equity ratio in its authorized one, SDG&E may have to reduce its actual common equity ratio towards its authorized one—given

[34] *Id.* at 5.

[35] *Id.* at 2.

[36] *Id.* at 3.

[37] *Id.*

that shareholders are not receiving any benefit for that additional common equity infusion—putting further pressure on SDG&E's credit ratings.

b. Elevated Levels of Capital Investment

SDG&E faces an additional credit risk as it will require incremental debt to support its robust capital investment plan of $12.7 billion over the 2025-2029 period. As approved in SDG&E's 2024 GRC,[38] SDG&E will make significant capital investments to support modernizing transmission and distribution infrastructure, along with fire hardening measures to protect against extreme weather events and support public safety. These investments support the State's energy and environmental policies, such as reducing greenhouse gas emissions, enabling access to renewable energy, and reinforcing SDG&E's commitment to provide safe and reliable service to its customers.

This elevated level of capital investment will require substantial funding, both internally and externally. SDG&E may fund its capital investments through a combination of debt issuances, internally generated cash flow, and retained earnings. As the Company funds the additional capital investments, it will become more leveraged which, in turn, will create additional financial risk. Therefore, SDG&E recommends that its proposed capital structure be adopted so that SDG&E has ready access to capital at a reasonable cost.

c. Debt Equivalence

Debt equivalence is a concept used by credit rating agencies to describe the financial risk resulting from signing long-term contracts, such as PPAs. Although PPAs (excluding finance leases) are not reported on a utility's balance sheet as debt, S&P treats the utility's commitments under PPAs as debt-like financial obligations in their credit analysis or when assessing a Company's credit rating. The Commission is cognizant of the risks associated with debt

[38] D.24-12-074.

equivalence, which are spelled out in detail in a 2017 Report issued by the Commission's Policy & Planning Division.[39]

As the Commission has held, debt equivalence impacts utility credit ratings and must be balanced in both the adopted capital structures and ROEs.[40] Because debt equivalence "does have an impact on the financial risk" and is "reflected in the utilities' credit ratings since at least 1990," it must be "considered in arriving at an overall ROE."[41] SDG&E's proposed capital structure and ROE are intended to comprehensively manage the impact of these circumstances. Since PPAs represent an ongoing component of the Company's overall energy portfolio, these agreements will continue to negatively impact SDG&E's credit profile and must be appropriately factored into the authorized capital structure.

3. SDG&E's Capital Structure Proposal is a Prudent Counter to the Company's Unique Business and Financial Risks and Supports its Credit Ratings

SDG&E's capital structure proposal is thus a prudent counter to its unique, above-average business, financial, and regulatory risks to help SDG&E bolster its credit ratings. S&P asserted that strong financial metrics could result in an upgrade in SDG&E's credit ratings despite the increased risks from wildfire liability and other risks that is otherwise preventing any increase in SDG&E's current rating. Specifically, S&P noted that it could "raise [its] rating on SDG&E if its stand-alone FFO to debt remains consistently at 21% or above and the company did not cause a significant

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39 *See* CPUC, Policy & Planning Division, An Introduction to Debt Equivalency (August 4, 2017), available at https://www.cpuc.ca.gov/-/media/cpuc-website/files/uploadedfiles/cpuc_public_website/content/about_us/organization/divisions/policy_and_planning/ppd_work/ppd_work_products_-2014_forward-/ppd-intro-to-debt-equivalency-1-.pdf

40 D.19-12-056 at 26 (The Commission's goal in considering debt equivalence is to "provide reasonable confidence in the utilities' financial soundness, to maintain and support investment-grade credit ratings, and provide utilities the ability to raise money necessary for the proper discharge of their public duty.").

41 *Id.*

1 wildfire."[42] As noted, Moody's added that SDG&E's credit ratings could be further upgraded if
2 SDG&E can run a "CFO pre-W/C to debt ratio in excess of 24%" on a sustained basis, if its
3 relationship with regulators and other stakeholders remains credit supportive, and if the utility's
4 wildfire risk exposure continues to be manageable.[43]

5 Moody's statement is consistent with SDG&E regaining its long-held A credit rating. Table
6 2 above suggests that for SDG&E to maintain its single "A" bond rating at Moody's, it must
7 maintain a debt ratio in the range of 35%-45%; reflective of SDG&E's actual debt ratio of 44%.
8 The fact that SDG&E has not regained an A rating since the Commission's 2019 Decision indicates
9 that SDG&E's currently authorized capital structure is insufficient to regain that rating.

10 By contrast, debt utilization beyond the levels indicated by the target credit metrics defined
11 above would put downward pressure on SDG&E's credit rating. In its most recent credit opinion of
12 SDG&E, Moody's stated, "[a] downgrade of SDG&E's ratings is possible if the company generates
13 weaker credit metrics in the aftermath of the implementation of the 2024 GRC such that its ratio of
14 CFO pre-WC to debt falls below 20%."[44] The credit rating agency earlier added that "SDG&E
15 recorded a ratio of CFO pre-W/C to debt of around 23% for the last twelve-month period ending
16 September 2024."[45]

17 Moody's likewise stated that SDG&E's actual equity ratio is a factor in determining the
18 current rating and forecasts SDG&E to maintain an equity ratio between 55%-60% during the next

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42 S&P, Ratings Direct® San Diego Gas & Electric Co. (June 26, 2024) at 2.

43 Moody's Mar. 10, 2025 at 3.

44 *Id.*

45 Moody's, Announcement of Periodic Review: Moody's Ratings announces completion of a periodic review of ratings of Southern California Gas Company and San Diego Gas & Electric Company (November 28, 2024) at 2.

12-18 months.[46] If SDG&E does not maintain this level of equity it may face downward ratings pressure by Moody's. But SDG&E will need additional debt financing to fund the business and to cover wildfire mitigation efforts and will be required to carry such additional debt for years. The incremental debt will need to be countered with a higher equity ratio in order to maintain a strong FFO-to-Total Debt ratio. As noted, if SDG&E's authorized capital structure is not updated to better reflect its actual five-year average capital structure—meaning that shareholders continue to provide a benefit without a return—SDG&E may face pressure to lower its actual equity ratio, which could put pressure on its credit ratings and result in higher costs for customers.

IV. EMBEDDED COST OF DEBT AND PREFERRED STOCK RECOMMENDATIONS

The embedded cost of debt represents all the costs associated with the issuance and servicing of debt, expressed as a percentage of the net proceeds received from debt issuances. Table 7 below summarizes the currently authorized and the forecasted embedded costs of long-term debt and preferred stock for SDG&E.

Table 5 – Embedded Cost of Debt and Preferred Stock

	Current Authorized[47]	2026 Forecast
Long-Term Debt	4.34%	4.62%
Preferred Stock	6.22%	6.22%

Consistent with previous Commission cost of capital decisions, SDG&E recommends setting the authorized cost of debt equal to the forecasted embedded cost of debt during Test Year 2026.[48] The Commission found SDG&E's previous proposed cost of debt, equal to the forecasted

46 Moody's, San Diego Gas & Electric Company Update to credit analysis (December 4, 2023).

47 D.22-12-031 at 53.

48 *Id.* at 12.

1 embedded cost of debt, to be reasonable.[49] SDG&E's forecasted embedded cost of long-term debt is
2 4.62%.[50] This forecast accounts for $2 billion of long-term debt that SDG&E has issued since the
3 last cost of capital proceeding was conducted in 2022. As a result of the Company's robust capital
4 investment program discussed above, the Company plans to raise $1.2 billion in 2025 and $900
5 million in 2026 of new long-term debt.

6 The embedded cost of debt calculations includes actual debt issued through December 2024,
7 in addition to forecasted debt issuances for the remainder of 2025 and 2026. Pricing is based on
8 February 2025 Global Insights treasury forecast for applicable debt instruments, plus a forecast of
9 the SDG&E-specific credit spread. In Appendix A, I have included a detailed showing of the
10 embedded cost of debt forecast.

11 The Commission has stated that, "[c]onsistent with past practice, we conclude that the latest
12 available interest rate forecast should be used to determine embedded debt cost in cost of capital
13 proceedings."[51] In accordance with that guidance, SDG&E plans to submit an embedded cost
14 update during the course of this proceeding that reflects the latest available forecast as well as any
15 changes to SDG&E's Long-Term Debt forecast that may take place between the preparation of this
16 testimony and the submittal of the update.

17 As explained above, SDG&E no longer uses preferred stock as a source of financing.
18 SDG&E redeemed all issued and outstanding shares of its preferred stock in 2013 and does not

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[49] *Id.* ("Long-term debt and preferred equity costs are based on actual, or embedded, costs. Future interest rates must be anticipated to reflect projected changes in a utility's cost caused by the issuance and retirement of long-term debt and preferred equity during the year.").

[50] *See supra* n.2.

[51] D.22-12-031 at 12 ("Consistent with past practice, we conclude that the latest available interest rate forecast should be used to determine embedded debt cost in cost of capital proceedings."); *see* D.07-12-049, Conclusion of Law 33 at 56 ("[t]he latest available interest rate forecast should be used to determine embedded long-term debt and preferred stock costs in ROE proceedings.").

anticipate issuing any preferred stock in the foreseeable future, as reflected in its actual capital structure. That said, if the Commission again orders SDG&E to include preferred equity in its authorized capital structure, SDG&E puts forth an embedded cost of preferred stock of 6.22%, consistent with SDG&E's previously authorized methodology and cost of preferred stock.[52]

V. CONCLUSION

SDG&E seeks a Test Year 2026 authorized capital structure of 54% equity, 46% long-term debt, and 0% preferred stock. The proposed capital structure reflects SDG&E's actual capital structure and increases the equity ratio to mitigate above-average business and financial risk.

SDG&E also seeks a Test Year 2026 embedded cost of debt and preferred stock of 4.62% and 0%, respectively. These reflect the forecasted embedded costs for the 2026 test year. Yet if the Commission requires SDG&E to include preferred equity in its authorized capital structure, SDG&E proposes a cost of preferred equity of 6.22%. SDG&E respectfully requests the Commission adopts these recommendations for 2026.

This concludes my prepared direct testimony.

[52] SDG&E Advice Letter 3499-E/2836-G, approved as March 20, 2020, and effective March 24, 2020.

VI. WITNESS QUALIFICATIONS

My name is Maritza Mekitarian. I am employed by SDG&E as Senior Director and Assistant Controller. My business address is 8680 Balboa Ave, San Diego, CA 92123.

I received a Bachelor of Science in Business Administration with Accounting emphasis from San Diego State University and am a Certified Public Accountant in the state of California. I have been employed by SDG&E and Sempra Energy since 2000. In addition to my current position, I have held various Accounting and Finance positions within the organization, including Financial Accounting Manager, Financial and Strategic Planning Manager, and Director of Financial Planning.

In my current role, I am responsible for overseeing financial accounting, accounting operations and regulatory balancing accounts.

I have previously testified before this Commission, including testimony supporting SDG&E's Test Year 2023 Cost of Capital Application (A.22-04-012).

APPENDIX A

EMBEDDED COST OF DEBT

Appendix A
San Diego Gas & Electric Company
Embedded Cost of Debt
Test Year 2026
(in Thousands)

Line Number	Description	A Principal	B Total Discount and Expense	C Net Proceeds (A - B)	D Annual Interest Payment	E Total Amortization	F Effective Rate [(D + E) ÷ C]
1	SERIES BBB	250,000	3,005	246,995	13,375	100	
2	SERIES DDD	250,000	3,547	246,454	15,000	177	
3	SERIES FFF	250,000	3,336	246,664	15,313	111	
4	SERIES GGG	300,000	4,438	295,562	18,000	148	
5	SERIES HHH	250,000	2,822	247,178	13,375	94	
6	SERIES III	500,000	10,559	489,441	22,500	352	
7	SERIES LLL	250,000	2,990	247,010	9,875	100	
8	SERIES MMM	250,000	3,867	246,133	10,750	129	
9	SERIES QQQ	500,000	5,904	494,096	12,500	590	
10	SERIES RRR	400,000	5,822	394,178	15,000	194	
11	SERIES SSS	400,000	5,840	394,160	16,600	195	
12	SERIES TTT	400,000	4,766	395,234	16,400	159	
13	SERIES UUU	400,000	4,997	395,003	13,280	167	
14	SERIES VVV	800,000	8,080	791,920	13,600	808	
15	SERIES WWW	750,000	13,020	736,980	22,125	434	
16	SERIES XXX	500,000	5,696	494,304	15,000	570	
17	SERIES YYY	500,000	8,193	491,807	18,500	273	
15	SERIES ZZZ	800,000	17,433	782,567	42,800	581	
16	SERIES AAAA	600,000	7,506	592,494	29,700	1,501	
17	SERIES BBBB	600,000	12,698	587,302	33,300	423	
18	Amortization of call premiums	-	3,124	(3,124)	-	672	
19	First mortgage bonds	8,950,000	137,642	8,812,358	366,993	7,778	4.25%
20	Amortization of call premiums	-	-	-	-	-	
21	Unsecured bonds	-	-	-	-	-	
22	Other expense and amortization	-	-	-	-	-	
23	December 31, 2024 total long-term debt	8,950,000	137,642	8,812,358	366,993	7,778	4.25%
24	Change in interest and amortization in 2025	-	(484)	484	-	-	
25	Forecasted debt to be issued in 2025:	1,200,000	19,686	1,180,314	70,253	656	
26	December 31, 2025 total long-term debt	10,150,000	156,844	9,993,156	437,246	8,434	4.46%
27	Change in interest and amortization in 2026	(750,000)	(9,935)	(740,065)	(27,500)	(768)	
28	Forecasted debt to be issued in 2026:	900,000	14,848	885,152	50,033	495	
29	December 31, 2026 total long-term debt	10,300,000	161,758	10,138,242	459,778	8,161	4.62%
30	Forecasted 2026 Embedded Cost of Long-Term Debt						4.62%

SAN DIEGO GAS & ELECTRIC

EMBEDDED COST OF DEBT
DECEMBER 2026 - PROJECTED
(IN DOLLARS UNLESS OTHERWISE STATED)

DESCRIPTION FIRST MORTGAGE BONDS	INTEREST RATE (1)	DATE OF ISSUE	MATURE/ DUE DATE	LIFE OF BOND (2)	LTD A/C 23130xxx/ 23300xxx PRINCIPAL (3)	ISSUE DISCOUNT/ PREMIUM (4)	DEF CHG & OA A/C 13300xxx (OLD) 23440xx (NEW) ISSUE EXPENSE (5)	NET OF TAX SCHEDULES REMAINING LOSS ON REACQ. (6)	(7) NET PROCEEDS (3-4-5-6)	(8) ANNUAL INTEREST EXPENSE (1 X 3)	(9) ANNUAL AMORTIZATION DISCOUNT (4 / 2)	(10) ANNUAL AMORTIZATION EXPENSE (5 / 2)	(11) ANNUAL AMORTIZATION REACQUISITION LOSS	(12) ANNUAL TOTAL COST (8+9+10+11)	NET EMBED COST (12 / 7)
SERIES OO-1	0.0000%	Dec-92	Dec-27	35.0	-	-	-	52,914	(52,914)	-	-	-	88,171	88,171	-
SERIES OO-2	5.0000%	Dec-92	Dec-27	35.0	-	-	-	72,157	(72,157)	-	-	-	120,235	120,235	-
SERIES OO-3	5.2500%	Dec-92	Dec-27	35.0	-	-	-	38,067	(38,067)	-	-	-	57,665	57,665	-
SERIES OO-4	5.0000%	Dec-92	Dec-27	35.0	-	-	-	54,117	(54,117)	-	-	-	90,176	90,176	-
SERIES OO-5	0.0000%	Dec-92	Dec-27	35.0	-	-	-	4,370	(4,370)	-	-	-	6,619	6,619	-
SERIES VV (CV2004A)	5.8750%	Jun-04	Feb-34	29.6	-	-	-	272,359	(272,359)	-	-	-	53,080	53,080	-
SERIES WW (CV2004B)	5.8750%	Jun-04	Feb-34	29.6	-	-	-	249,979	(249,979)	-	-	-	48,718	48,718	-
SERIES XX (CV2004C)	5.8750%	Jun-04	Feb-34	29.6	-	-	-	218,951	(218,951)	-	-	-	42,671	42,671	-
SERIES YY (CV2004D)	5.8750%	Jun-04	Jan-34	29.5	-	-	-	148,220	(148,220)	-	-	-	29,402	29,402	-
SERIES ZZ (CV2004E)	5.8750%	Jun-04	Jan-34	29.5	-	-	-	207,614	(207,614)	-	-	-	41,184	41,184	-
SERIES AAA (CV2004F)	4.0000%	Jun-04	May-39	34.9	-	-	-	837,131	(837,131)	-	-	-	94,251	94,251	-
SERIES BBB	5.3500%	May-05	May-35	30.0	250,000,000	295,000	2,709,950		246,995,050	13,375,000	9,833	90,332		13,475,165	5.46%
SERIES FFF	6.1250%	Sep-07	Sep-37	30.0	250,000,000	780,000	2,556,327		246,663,673	15,312,500	26,000	85,211		15,423,711	6.25%
SERIES GGG	6.0000%	May-09	Jun-39	360.5	300,000,000	1,380,000	3,057,571		295,562,429	18,000,000	45,936	101,778		18,147,714	6.14%
SERIES HHH	5.3500%	May-10	May-40	30.0	250,000,000	335,000	2,486,955		247,178,045	13,375,000	11,167	82,899		13,469,066	5.45%
SERIES III	4.5000%	Aug-10	Aug-40	30.0	500,000,000	5,515,000	5,044,008		489,440,992	22,500,000	183,833	168,134		22,851,967	4.67%
SERIES LLL	3.9500%	Nov-11	Nov-41	30.0	250,000,000	350,000	2,639,787		247,010,213	9,875,000	11,667	87,993		9,974,660	4.04%
SERIES MMM	4.3000%	Mar-12	Apr-42	360.5	250,000,000	1,297,500	2,569,738		246,132,762	10,750,000	43,190	85,539		10,878,729	4.42%
SERIES RRR	3.7500%	Jun-17	Jun-47	30.0	400,000,000	1,784,000	4,038,478		394,177,522	15,000,000	59,486	134,661		15,194,147	3.85%
SERIES SSS	4.1500%	May-18	May-48	30.0	400,000,000	1,768,000	4,072,043		394,159,957	16,600,000	58,933	135,735		16,794,668	4.26%
SERIES TTT	4.1000%	May-19	Jun-49	30.0	400,000,000	420,000	4,345,931		395,234,069	16,400,000	14,000	144,864		16,558,864	0.00%
SERIES UUU	3.3200%	Apr-20	Apr-50	30.0	400,000,000	532,000	4,464,828		395,003,172	13,280,000	17,733	148,828		13,446,561	0.00%
SERIES VVV	1.7000%	Sep-20	Oct-30	10.0	800,000,000	1,392,000	6,688,168		791,919,832	13,600,000	139,200	668,817		14,408,017	1.82%
SERIES WWW	2.9500%	Aug-21	Aug-51	30.0	750,000,000	4,740,000	8,279,683		736,980,317	22,125,000	158,000	275,989		22,558,989	3.06%
SERIES XXX	3.0000%	Mar-22	Mar-32	10.0	500,000,000	1,415,000	4,281,230		494,303,770	15,000,000	141,500	428,123		15,569,623	3.15%
SERIES YYY	3.7000%	Mar-22	Mar-52	30.0	500,000,000	2,785,000	5,407,595		491,807,405	18,500,000	92,833	180,253		18,773,086	3.82%
SERIES ZZZ	5.3500%	Mar-23	Apr-53	30.0	800,000,000	8,416,000	9,016,661		782,567,339	42,800,000	280,533	300,555		43,381,088	5.54%
SERIES AAAA	4.9500%	Aug-23	Aug-28	5.0	600,000,000	2,580,000	4,925,820		592,494,180	29,700,000	516,000	985,164		31,201,164	5.27%
SERIES BBBB	5.5500%	Mar-24	Apr-54	30.0	600,000,000	6,096,000	6,602,281		587,301,719	33,300,000	203,200	220,076		33,723,276	5.74%
2025 Debt Issuance	5.8544%	2025	2055	30.0	1,200,000,000	6,128,854	13,557,533		1,180,313,614	70,253,181	204,295	451,918		70,909,394	6.01%
2026 Debt Issuance	5.5592%	2026	2056	30.0	900,000,000	4,596,640	10,251,196		885,152,164	50,032,568	153,221	341,707		50,527,496	5.71%
TOTAL FIRST MORTGAGE BONDS					**10,300,000,000**	**52,605,994**	**106,995,784**	**2,155,879**	**10,138,242,344**	**459,778,249**	**2,370,560**	**5,118,576**	**672,171**	**467,939,556**	**4.62%**
UNSECURED BONDS					-	-	-	-	-	-	-	-	-	-	
TOTAL UNSECURED BONDS					**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	
					-	-	-	-	-	-	-	-	-	-	-
					-	-	-	-	-	-	-	-	-	-	-
TOTAL LT BANK LOANS AND OTHER DEBT					**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	
TOTAL LONG-TERM DEBT					**10,300,000,000**	**52,605,994**	**106,995,784**	**2,155,879**	**10,138,242,344**	**459,778,249**	**2,370,560**	**5,118,576**	**672,171**	**467,939,556**	**4.62%**

San Diego Gas & Electric Company
Issuance Cost Summary
(in Dollars)

	Actual [1]	Forecast	
Bond Issuance	2024	2025	2026
	Series BBBB	Series TBD	Series TBD
Life	30-Year	30-Year	30-Year
Principal issued	**600,000,000**	**1,200,000,000**	**900,000,000**
Up-front issuance fees			
Underwriter [2]	5,250,000	10,500,000	7,875,000
Legal	175,000	180,050	185,460
Rating agency [3]	1,035,000	2,070,000	1,552,500
Trustee	40,400	74,600	57,500
Auditor	75,000	77,164	79,483
CPUC	226,495	452,990	339,742
SEC	68,468	183,720	141,930
Printing	18,475	19,008	19,579
Total up-front cost	6,888,838	13,557,533	10,251,196

(1) Up-front costs based on actual results through December 2024.
(2) Based on 87.5 basis points of principal issued for 30-year bonds.
(3) Based on 17.25 basis points of principal issued.

San Diego Gas & Electric Company
Proposed Debt Capital Markets Issuance
2025 & 2026 Projected Activity

	Actual	Forecast	
	2024	2025	2026
	Series BBBB	Series TBD	Series TBD
	30-Year	30-Year	30-Year
SDG&E Issued Bond Trading Spread		1.13%	1.13%
New Issuance Concession		0.05%	0.05%
Indicative New Issuance Credit Spread		**1.18%**	**1.18%**
Benchmark Treasury Yield		4.67%	4.37%
Coupon	**5.55%**	**5.85%**	**5.56%**

Notes:
(1) Coupon for Series BBBB based on actual bond issuance in March 2024.
(2) Coupon for 30-Year Bond Issuances based on © 2025 S&P Global Market Intelligence, plus forecasted credit spread.