SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M)
PREPARED REBUTTAL TESTIMONY OF BRUCE MACNEIL
(CCM AND RATING AGENCIES)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

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# TABLE OF CONTENTS

I. INTRODUCTION .................................................................................................................. 1
II. MODIFICATION OF DEAD BAND TRIGGER .................................................................. 1
III. REQUESTED CLARIFICATIONS .................................................................................. 5
IV. CONCLUSION .................................................................................................................. 6
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I. INTRODUCTION

The purpose of my rebuttal testimony is to respond to assertions made in the direct
testimony of California Public Advocates Office (“Cal PA”) witness, Nika Kjensli, regarding
the proposal for an updated Cost of Capital Mechanism (“CCM”) for San Diego Gas & Electric
Company (“SDG&E”). As a preliminary matter, SDG&E and Cal PA agree on extending a
CCM. It should also be noted that none of the other parties to this proceeding presented
testimony contesting the CCM-related proposals put forth in my direct testimony. This is
encouraging and consistent with the Commission’s longstanding support for CCMs. There are,
however two main areas where SDG&E and Cal PA differ: (1) the appropriate “dead band”; and
(2) the items that SDG&E believes should be clarified in the CCM as discussed in my direct
testimony.

II. MODIFICATION OF DEAD BAND TRIGGER

As I explained in my direct testimony, the CCM was originally adopted by the
Commission for SDG&E and other investor-owned utilities (collectively, “California IOUs”) in
Decision (“D.”) 08-05-035 and reaffirmed in subsequent Cost of Capital (“COC”) decisions.3

The California IOUs are generally required to file COC applications every three years. During

1 Nika Kjensli, Report on the Cost of Capital Test Year 2020 on behalf of the Public Advocates Office,
California Public Utilities Commission (August 1, 2019) (“Cal PA Testimony (Kjensli)”).

2 I am also the witness for Southern California Gas Company’s (“SoCalGas”) CCM proposal (Exhibit
SCG-05), which is largely identical to my SDG&E proposal. Therefore, my rebuttal to Cal PA’s
CCM testimony should be applied to SoCalGas’ application (A.19-04-018) as well.

3 In D.96-06-055, the Commission authorized the Market Indexed Capital Adjustment Mechanism
(“MICAM”) for SDG&E’s Cost of Capital ratemaking. The Commission’s 2008 decision, D.08-05-
035, replaced the MICAM with the CCM.
the intervening years, the CCM provides a formula involving a deviation range or “dead band”
tied to utility bond yields that, if triggered, operates to automatically recalibrate the California
IOUs’ authorized Return on Equity (“ROE”) and overall Rate of Return (“ROR”).

The mechanism was designed with several objectives in mind. Key among these is the
need to strike an appropriate balance between the goal of limiting frequent or abrupt changes to
ROE/ROR, while simultaneously ensuring that the mechanism remains sensitive enough to
trigger when fluctuations in the bond markets necessitate an adjustment. To better achieve this
objective, SDG&E proposes to modify the dead band trigger to 50 basis points from the currently
authorized 100 basis points.

In her testimony, Ms. Kjensli opposes SDG&E’s request to modify the current CCM
dead band, stating that Cal PA “supports continuing the cost of capital mechanism (CCM)” at
100 basis points, asserting that the “current 100 basis point dead band has existed and functioned
successfully for approximately ten years as part of the current CCM.” Ms. Kjensli challenges
the conclusion that the dead band trigger should be re-evaluated based on the fact that the six
years between 2012 and 2018 had an average 25-basis point 12-month yield that did not cause a
trigger of the mechanism. She asserts that “the purpose of the dead band trigger is to establish
upper and lower boundaries, not to trigger an adjustment.” Ms. Kjensli claims further that the
100-basis point dead band “has not produced any adverse shareholder or ratepayer impacts” and

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4 See Prepared Direct Testimony of Bruce MacNeil, CCM and Ratings Agencies (April 2019) (“Ex.
SDG&E-06 (MacNeil)”) at 1-3 (discussing the CCM’s background and objectives).
5 Cal PA Testimony (Kjensli) at 3:1.
6 Id. at 4:2-3.
7 Id. at 4:3-11.
that “there is no advantage to ratepayers and shareholder[s] to implement the modifications” proposed.8

Ms. Kjensli’s claim that the purpose of the dead band is to is to “establish upper and lower boundaries” represents an overly-limited view of the CCM.9 As a practical matter, the dead band does, of course, involve the setting of upper and lower boundaries – i.e., the limits within which fluctuations in bond pricing do not cause a triggering of the mechanism – but this setting of upper and lower boundaries is plainly not the purpose of the dead band. Rather, the purpose of the dead band and, more broadly, the CCM as articulated by the Commission, is to effectively balance the interests of shareholders and ratepayers while simplifying and reducing COC proceedings, workload requirements, and regulatory costs.10 An effective CCM is viewed positively by regulatory stakeholders, credit rating agencies, banks, and market participants.

The Commission has made clear that a dead band that is set at a level that never results in triggering of a change is problematic, observing that “[a] deadband that is overly sensitive to interest rates cause needless volatility in revenues and rates. Conversely, a deadband that never triggers can impose unnecessary costs on shareholders or ratepayers, depending on which direction interest rates move.”11 Thus, an effective dead band must achieve both of the aims described in D.08-05-035. It must provide a reasonable level of stability, and it must at the same time be sensitive enough that it can serve its intended purpose of adjusting the ROE/ROR when necessary to achieve the objectives articulated by the Commission. A CCM that never

8 Id. at 4:12-15.
9 Id. at 4:8-9.
10 Ex. SDG&E-06 (MacNeil) at 2:24-3:2 (citing D.13-03-015).
11 D.08-05-035 at 11 (emphasis added).
triggers or does so only very rarely is tantamount to having no CCM at all. The current 100 basis point dead band fails to achieve the equilibrium envisioned by the Commission. It does not, in other words, strike a reasonable balance between triggering too often and not triggering often enough.\(^\text{12}\)

Based upon the analysis I present in my direct testimony regarding average yields over the past six years, it is clear that a 50 basis point dead band would continue to serve the objective of providing stability. As discussed above, the 12-month average change in yield from 2012-2018 period was 25 basis points. It thus would not have triggered the proposed 50 basis point dead band range. It is also important to note that the proposed 50% adjustment ratio of a 50 basis point dead band allows for a smaller adjustment should a trigger event occur, thereby reducing ROE volatility as the result of triggering of the CCM and preserving stability.

At the same time, a 50 basis point dead band is more responsive to changes in utility bond yields than the current 100 basis point dead band and therefore would better protect shareholders and ratepayers, consistent with the Commission’s stated goal. In fact, as discussed in my direct testimony, since 2001 “all additional triggers using a 50 basis point dead band . . . were downward triggers that would have led to a timelier reduction in ROE benefitting ratepayers.”\(^\text{13}\) Thus, Ms. Kjensli’s suggestion that “there is no advantage to ratepayers and shareholder[s] to implement the modifications . . . proposed,” is not supported by any evidence or analysis.\(^\text{14}\) Modifying the current CCM dead band to enhance its responsiveness to changes in utility bond yields is consistent with Commission guidance and will provide assurance that the

\(^{12}\) See Ex. SDG&E-06 (MacNeil) at 8.

\(^{13}\) Id. at 8:10-13.

\(^{14}\) Cal PA Testimony (Kjensli) at 4:14-15.
mechanism will operate as intended, and more effectively regulate a utility’s authorized COC (either upward or downward).

III. REQUESTED CLARIFICATIONS

In addition, SDG&E requests clarification regarding specific aspects of the current CCM, including:

- The selection of a CCM benchmark index when the utility has split ratings;
- The approach when SDG&E’s credit ratings change during CCM years; and
- Guidance for utilities with non-investment grade ratings.\footnote{Ex. SDG&E-06 (MacNeil) at 7:8-14.}

These recommended changes directly address and clarify specific conceivable outcomes that are not defined or contemplated in the existing CCM framework, but which are very real possibilities today. In other words, these modifications simply address omissions in the existing framework.

Ms. Kjensli does not explain why she does not agree with SDG&E’s request for clarification of certain aspects of the current mechanism. These requests simply seek more explicit guidance on how the CCM should be understood by the Commission and all stakeholders. Such direction is necessary to avoid after-the-fact questions and later requests for clarification. I believe that the request for Commission guidance is adequately supported by my direct testimony and is appropriate given the recent bond market history and credit rating downgrades at SDG&E and other California IOUs, and the future uncertainties around the Company’s credit ratings going forward.\footnote{Id. at 8-12 (detailing SDG&E’s multiple credit rating downgrades).} Ignoring these issues simply for the sake of adopting a CCM with no changes at this time, as Cal PA suggests, is not a reasonable approach. That
approach would gloss over important considerations regarding the CCM that should be addressed by the Commission in this proceeding.

IV. CONCLUSION

SDG&E maintains that the requested CCM modification and clarifications are reasonable and appropriate, promote the long-term sustainability and ease of use of the mechanism, and serve the interests of ratepayers and shareholders alike. Therefore, SDG&E respectfully requests that the Commission approve the continuation of the CCM with the proposed clarifications and a 50-basis point dead band.

This concludes my rebuttal testimony.