

Application: A.21-08-XXX
Company: San Diego Gas & Electric Company (U 902 M)
Proceeding: 2022 Cost of Capital
Exhibit No.: SDG&E-02

PREPARED DIRECT TESTIMONY OF
MARITZA MEKITARIAN - AUTHORIZED CAPITAL STRUCTURE
ON BEHALF OF
SAN DIEGO GAS & ELECTRIC COMPANY

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**



AUGUST 23, 2021

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**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 2022. 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 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 2022.

Table 1 – Proposed Capital Structure and Costs

	Proposed Capital Structure	Proposed Costs
Common Equity	54.00%	10.55% ¹
Long-Term Debt	46.00%	3.84% ²
Preferred Stock	0.00%	0.00%

II. OVERVIEW OF CAPITAL STRUCTURE AND FINANCIAL RISK

Capital structure consists of common equity, long-term debt, and preferred stock. As the Commission has found, capital structure is one component of determining a fair and reasonable

¹ See Prepared Direct Testimony of Valerie Bille, Policy Overview (August 23, 2021) (“Bille SDG&E-01”) (presenting SDG&E’s return on equity recommendations); *see also* Prepared Direct Testimony of Jim Coyne, Return on Equity (August 23, 2021) (“Coyne SDG&E-04”) (supporting SDG&E’s ROE recommendations).

² See Appendix A, attached hereto, for the derivation of the embedded cost of debt proposal.

1 return on equity (“ROE”) and authorized rate of return (“ROR”).³ The Commission assesses capital
2 structure in conjunction with ROE and the embedded costs of debt and preferred stock, maintaining
3 long-term stability by considering ROE and capital structure together.⁴

4 The Company’s authorized ROR is determined by applying the Company’s ROE and
5 embedded costs of debt and preferred stock (if applicable) to its authorized capital structure. An
6 optimal capital structure is one that supports a strong credit rating, which lowers borrowing costs
7 for both the utility and ratepayers. The Commission has recognized that “maintain[ing] investment-
8 grade creditworthiness” is an “important component[s] of the *Hope* and *Bluefield* decisions.”⁵

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

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

18 Long-term debt is a measurement of a company’s financial leverage. Debt is generally less
19 expensive than equity, due to its tax advantage and lower risk. If a company has a long-term debt
20 ratio that is too low, it is not fully utilizing a tax-deductible source of financing that is lower in cost
21 than equity.

³ Decision (“D.”) 08-05-035, pp. 7-8.

⁴ *Id.*

⁵ D.12-12-034, p. 37 (alteration in original).

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

6 A company that is highly leveraged with fixed costs thus requires a higher return on both
7 debt and equity for investors—as the earnings available to shareholders become more volatile and
8 secondary to debt payments, causing shareholders to require a higher return for taking on that
9 increased risk.⁷ This results in higher costs of capital over the long-term.

10 The Commission has thus found that, “[b]ecause the level of financial risk that the utilities
11 face is determined in part by the proportion of their debt to permanent capital, or leverage, we must
12 ensure that the utilities’ adopted equity ratios are sufficient to maintain reasonable credit ratings and
13 to attract capital.”⁸ Credit metric guidance provided by the credit rating agencies is an invaluable
14 guide to determining the appropriate amount and use of debt. The major credit rating agencies
15 commonly employ several key metrics to quantify financial risk, such as funds from operations
16 (“FFO”) as a percent of total debt and debt as a percentage of total capital.

17 The FFO-to-Total Debt ratio measures funds from operations as a percent of total debt. It
18 indicates how much of its debt a company could retire with annual cash from operations, where a
19 higher figure indicates a stronger ability to retire its debt, and thus lower financial risk. Together
20 with their assessment of business risk and regulatory framework, the major credit rating agencies
21 use these financial metrics to determine the credit ratings they assign.

⁶ See D.19-12-056, p. 5.

⁷ See Roger A. Morin, *New Regulatory Finance* (2006), p. 455.

⁸ See D.12-12-034, p. 5; accord D.19-12-056, p. 5.

In addition to FFO-to-Total Debt metric, credit rating agencies also employ Debt-to-Total Capital in assessing financial risk. Moody's Rating Methodology for Regulated Electric and Gas Utilities⁹ explains its approach to assessing credit risk for regulated electric and gas utilities globally. The report provides a detailed rating grid which can be used as a reference tool to approximate credit profiles within the regulated electric and gas sector. Table 2 below replicates Moody's Debt Ratio benchmarks presented in the report.

Table 2 – Moody's Debt Ratio Benchmarks

Bond Rating	Debt / Capital ¹⁰
Aaa	< 25%
Aa	25% - 35%
A	35% - 45%
Baa	45% - 55%
Ba	55% - 65%
B	65% - 75%
Caa	≥75%

III. PROPOSED CAPITAL STRUCTURE

SDG&E proposes a capital structure comprised of 54.00% common equity, 46.00% debt, and 0% preferred stock—a change from the Company's currently authorized capital structure of 52.00% common equity, 45.25% debt, and 2.75% preferred stock—and more consistent with SDG&E's actual capital structure of 56% common equity and 44% debt. Table 3 below compares SDG&E's proposed capital structure with the Company's currently authorized capital structure.

⁹ Moody's Investors Service, *Rating Methodology for Regulated Electric and Gas Utilities* (June 23, 2017).

¹⁰ Ratios shown are for companies that Moody's has identified to have a standard risk profile.

Table 3 – Current Authorized Capital Structure and Proposed Capital Structure

	Current Authorized	2022 Proposed
Common Equity	52.00%	54.00%
Long-Term Debt	45.25%	46.00%
Preferred Stock	2.75%	0.00%

SDG&E’s proposed capital structure reflects a balance between the fact that SDG&E has maintained an actual average capital structure of 56 percent common equity, 44 percent long-term debt, and zero percent preferred equity for eight years while being consistent with the Commission’s apparent desire in D.19-12-056 to pair any increase in SDG&E’s common equity layer with an increase in the Company’s authorized long-term debt ratio.¹¹

Specifically, SDG&E proposes the change to its authorized common equity ratio for two primary reasons: (1) to better reflect the Company’s more recent actual (recorded) capital structure since 2013; and (2) to help SDG&E manage its increased business and financial risks and improve its credit ratings. The latter is critical, as SDG&E, after maintaining an A-credit rating for 15 years, has been downgraded by all three credit rating agencies since 2018. Even after Moody’s upgraded SDG&E’s credit rating one notch this spring,¹² the Company’s credit rating is still at least two notches lower from all three agencies compared its prior A-rating.

The downgrades were primarily due to a perceived increase in business and regulatory risks—namely due to the risk of catastrophic wildfire liability—despite SDG&E not being responsible for a catastrophic wildfire since 2007 and being widely lauded for its wildfire mitigation

¹¹ D.19-12-056, p. 11 (“Because SDG&E is not requesting a significant increase in long-term debt, this decision will authorize no modification.”).

¹² Moody’s, *Rating Action: Moody’s upgrades San Diego Gas & Electric to A3 from Baa1; outlook stable* 1 (Mar. 30, 2021), p.1.

1 efforts. If SDG&E’s long-term actual capital structure is not better reflected in its authorized capital
 2 structure, it increases SDG&E’s financial and regulatory risks in the eyes of credit rating agencies;
 3 putting further downward pressure on SDG&E’s credit rating and making it more difficult for
 4 SDG&E to operate at its current actual capital structure, which provides significant benefits to
 5 ratepayers.

6 **A. SDG&E’s Proposal Tracks the Company’s Actual Capital Structure**

7 The Company’s recommended change in its authorized capital structure to increase its
 8 common equity and long-term debt ratios and remove preferred stock is designed to better reflect
 9 SDG&E’s actual (recorded) capital structure. The Company’s currently authorized capital structure
 10 largely reflects the fact that the Commission adopted SDG&E’s actual capital structure in the 2012
 11 Cost of Capital decision, D.12-12-034.¹³ But SDG&E’s actual capital structure has significantly
 12 changed since that time.

13 Since 2013—nearly a decade now—SDG&E has maintained at least a 56 percent average
 14 actual common equity ratio, featuring an actual capital structure of effectively 56% common equity,
 15 44% long-term debt, and 0% preferred equity. Table 4 below shows SDG&E’s actual recorded
 16 capital structure from 2013 through 2020.

17 **Table 4 – SDG&E’s Historical Capital Structure**

	2013	2014	2015	2016	2017	2018	2019	2020	Current Authorized
Common Equity	53.39%	54.44%	57.55%	57.21%	55.61%	56.15%	58.30%	56.31%	52.00%
Long-Term Debt	46.61%	45.56%	42.45%	42.79%	44.39%	43.85%	41.70%	43.69%	45.25%
Preferred Stock	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	2.75%

18
 13 See D.12-12-034, p. 11

1 The Company has retained earnings in common equity to balance the capital structure above
2 SDG&E's authorized common equity ratio of 52%. In fact, as shown in Table 4 above, on a
3 rounded basis, SDG&E has been operating at or above a 56% equity percentage since 2015, with a
4 56.7% five-year historical average. These higher than authorized equity levels have improved credit
5 metrics by reducing debt and mitigating higher business and financial risks with capital provided
6 solely by shareholders, directly benefitting customers.¹⁴

7 SDG&E likewise recommends reducing its authorized preferred equity from 2.75% to 0% to
8 reflect SDG&E's longstanding actual capital structure. In fact, SDG&E has:

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

12 Preferred stock is rarely used by utility operating companies. Only four have issued preferred stock
13 in the last decade.¹⁵ In addition, despite a downward trend in bond rates, the relative cost of issuing
14 preferred stock remains significantly higher than debt financing. A California utility operating
15 company's preferred stock investors may require higher coupon rates due to perceived higher
16 wildfire risk and their relative priority in the capital stack. By contrast, SDG&E has been successful
17 at issuing debt at low bond rates and using common equity to fund its large capital investment plan,
18 further supporting reducing the desirability of preferred stock.

19 As noted, in D.12-12-034, the Commission approved SDG&E's currently authorized capital
20 structure that has existed since that time—principally because it reflected the Company's actual

¹⁴ 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").

¹⁵ Source: Bloomberg Security Search Function as of June 2021 (Search for all active preferred issuances for utilities as classified by Bloomberg Industry Classification Standard).

1 capital structure in 2012.¹⁶ The Commission has likewise previously supported having a utility’s
2 authorized capital structure reflect its actual one. As the Commission noted in D.12-12-034, “[t]he
3 Commission has previously reasoned that the utilities should be given some discretion to manage
4 their capitalization with a view towards a balance between shareholders’ interest, regulatory
5 requirements, and ratepayers’ interest.”¹⁷

6 SDG&E’s proposal also reflects a 2017 Report issued by the Commission’s Policy &
7 Planning Division that states, “[i]n California, a hypothetical capital structure, which is expected to
8 approximate the actual capital structure of the utility over the long run, is used.”¹⁸ In 2018, the
9 Commission likewise adopted common equity ratios for regulated water utilities that reflected those
10 utilities’ actual ratios.¹⁹ And in recent comments filed at the Federal Energy Regulatory
11 Commission (“FERC”), the Commission noted the benefit of FERC generally providing the utility
12 the ability to have its actual capital structure reflected in its authorized one—affording the utility
13 “through its own financial policies, significant[] influence [on] its credit metrics.”²⁰

14 Having the authorized capital structure mirror the recorded capital structure helps limit any
15 divergence between actual and recorded ROR, resulting in a sustainable equilibrium. But SDG&E’s
16 authorized capital structure is now far removed from SDG&E’s longstanding actual capital
17 structure. Since SDG&E’s currently authorized capital structure no longer aligns with its actual

¹⁶ See D.12-12-034, p. 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 . . .”).

¹⁷ *Id.* (citing 33 CPUC2d (1989) 495 at 541 through 545).

¹⁸ California Public Utilities Commission, Utility General Rate Case – A Manual for Regulatory *Analysts* (November 13, 2017) at 29.

¹⁹ See D.18-03-035, p. 22.

²⁰ Comments of the California Public Utilities Commission and the California Department of Water Resources State Project (“CPUC FERC Comments”), FERC Docket No. RM20-10, p. 29 (filed June 25, 2021).

1 capital structure, consistent with that 2012 decision, SDG&E’s proposal moves closer to SDG&E’s
2 current actual capital structure.

3 Although Moody’s recently asserted that had the Commission increased SDG&E’s “allowed
4 equity layer to 56% (as requested) [it] would have been more credit supportive because it would
5 have contributed to strong credit metrics,”²¹ credit rating agencies assess SDG&E’s financial
6 metrics based upon its actual, not authorized, capital structure. So under SDG&E’s currently
7 authorized capital structure, shareholders have propped up SDG&E’s credit ratings—resulting in
8 lower borrowing costs for customers—while not earning a return on the difference between the
9 Company’s authorized equity ratio of 52% and its actual equity ratio of 56%.

10 In other words, shareholders continue to provide additional capital without earning a fair
11 return, providing a direct benefit to customers that is not being recognized (contrary to the example
12 the Commission cited regarding the benefits of the approach to capital structure at FERC). If
13 SDG&E were to reduce its actual common equity ratio to reflect its currently authorized common
14 equity ratio, then SDGE’s financial health would weaken, which could lead to further credit
15 downgrades and potentially higher expenses to ratepayers. SDG&E’s prudent management decision
16 of maintaining a 56% actual common equity ratio to support as strong a credit rating as possible
17 should be recognized and supported by the Commission; rather than continuing to ask equity
18 investors to buttress SDG&E’s credit ratings and reduce borrowing costs without receiving a return
19 for that investment. SDG&E’s proposal of 54% common equity, 46% debt is a reasonable middle
20 ground that better reflects SDG&E’s actual capital structure while also increasing the Company’s
21 long-term debt.

²¹ Moody’s May 10, 2021 at. 8.

1 **B. The Proposed Capital Structure Helps the Company Manage its Business and**
2 **Financial Risks and is Credit Supportive**

3 SDG&E’s capital structure recommendation is also consistent with the goal of keeping the
4 Company’s capital costs reasonable—relative to the costs associated with the authorized ratios—to
5 help maintain its credit rating. SDG&E’s historically strong credit rating reflects, in part, the
6 effective and proactive management of its capital structure—of the type that the Commission lauded
7 at the FERC-ratemaking level.²² As discussed in the testimony of Ari Beer (Exhibit SDG&E-03),
8 and Jim Coyne (Exhibit SDG&E-04), SDG&E now faces significantly increased business, financial,
9 and regulatory risks. SDG&E’s higher actual common equity ratio has helped SDG&E limit
10 financial risk and access the debt markets at reasonable rates—in response to those increased
11 business and regulatory risks. It has mitigated further credit rating downgrades and has allowed
12 SDG&E to issue \$1.2 billion of long-term debt since the 2019 COC proceeding. As discussed
13 below, SDG&E’s proposal thus protects the Company and customers from:

- 14 • The increased business risk of potentially unrecoverable catastrophic wildfire
15 liability costs;
- 16 • Lower credit ratings as a result of that business risk; and
- 17 • Other factors that may increase the Company’s cost of debt.

18 **1. SDG&E’s Proposed Capital Structure Reflects the Need to Reduce**
19 **Financial Risks to Respond to Increased Business Risks and Lowered**
20 **Credit Ratings**

21 A prudent financial manager takes proactive steps to manage and mitigate financial risk.
22 SDG&E’s current risks drive the need for its proposed capital structure. As Mr. Coyne and Mr.
23 Beers both note, SDG&E faces unique, ongoing, above-average risks. As Mr. Coyne added, lower
24 financial risks should be used to offset higher business risks.²³

²² CPUC FERC Comments, p. 29.

²³ Coyne SDG&E-04, p. JMC-57.

1 As noted, SDG&E’s credit profile has been downgraded by all three credit rating agencies
2 since 2018—primarily over concerns regarding wildfire and wildfire liability risks in California—
3 despite SDG&E being lauded for its wildfire mitigation programs and not being responsible for a
4 significant wildfire since 2007. As S&P states, even while calling SDG&E a “global leader” in
5 wildfire mitigation, the credit rating agency asserted that it is “unlikely to raise ratings for utilities
6 with meaningful wildfire-related risks in the near term” so long as inverse condemnation exists that
7 can make utilities responsible for wildfire liability regardless of fault and climate change is
8 exacerbating the risk of wildfires.²⁴ Yet the credit rating agency added that, despite this increased
9 risk that is pushing down SDG&E’s credit ratings, it could upgrade SDG&E or other California
10 electric utilities if their “financial measures are consistently above the upgrade threshold.”²⁵
11 SDG&E’s proposed common equity ratio is thus a prudent measure to counteract its increased
12 business risks and improve its credit ratings, reducing costs for consumers.

13 2. SDG&E Faces Increased Financial Risks

14 The Company’s lower credit ratings as a result of the business risks of potentially
15 unrecovered catastrophic wildfires costs, political risks, and others are also exacerbated by
16 additional financial risks; in the form of additional debt to fund its robust capital program and debt
17 equivalence related to Power Purchase Agreements (“PPA”) and Resource Adequacy (“RA”)
18 obligations. S&P recently rated SDG&E’s financial risk as “significant,” which is the fourth highest
19 level on the rating agency’s scale.²⁶

²⁴ S&P, *How are California’s Wildfire Risks Affecting Utilities’ Credit Quality* (Jun. 3, 2021), p. 10.

²⁵ *Id.*

²⁶ S&P, “San Diego Gas & Electric Co.” (July 9, 2021), p. 6.

1 **a. Elevated Levels of Capital Investment**

2 As Moody’s recently noted, in addition to the risks cited by Messrs. Beer and Coyne,
3 SDG&E faces an additional credit risk in that its “[m]aterial capital investment program” will
4 “require incremental debt,”²⁷ As approved in SDG&E’s 2019 General Rate Case (“GRC”)²⁸ and
5 presented in the Wildfire Risk Mitigation Plan,²⁹ SDG&E will make significant capital investments
6 to support modernizing transmission and distribution infrastructure, along with fire hardening
7 measures to protect against extreme weather events and support public safety. These investments
8 support the State’s energy and environmental policies, such as reducing greenhouse gas emissions,
9 enabling access to renewable energy, and reinforcing SDG&E’s commitment to provide safe and
10 reliable service to its customers.

11 This elevated level of capital investment will require substantial funding, both internally and
12 externally. SDG&E may fund its capital investments through a combination of debt issuances,
13 internally generated cash flow, and retained earnings. The elevated level of capital investment will
14 create additional financial risk if funded at the Company’s current authorized capital structure.
15 Therefore, SDG&E recommends that its proposed capital structure be adopted so that SDG&E has
16 ready access to capital at a reasonable cost.

17 **b. Debt Equivalence**

18 Debt equivalence is a concept used by credit rating agencies to describe the financial risk
19 resulting from signing long-term contracts, such as PPAs. Although PPAs (excluding finance
20 leases) are not reported on a utility’s balance sheet as debt, S&P treats the utility’s commitments

²⁷ Moody’s May 10, 2021 at .2

²⁸ See D.19-09-051.

²⁹ See Rulemaking (“R.”) 18-10-007, *San Diego Gas & Electric Company’s 2020-2022 Wildfire Mitigation Plan* (February 5, 2021).

1 under PPAs as debt-like financial obligations in their credit analysis or when assessing a
2 Company’s credit rating. The Commission is cognizant of the risks associated with debt
3 equivalence, which are spelled out in detail in a 2017 Report issued by the Commission’s Policy &
4 Planning Division.³⁰ As the Commission has held, debt equivalence impacts utility credit ratings
5 and must be balanced in both the adopted capital structures and ROEs.³¹ Because debt equivalence
6 “does have an impact on the financial risk” and is “reflected in the utilities’ credit ratings since at
7 least 1990,” it must be “considered in arriving at an overall ROE.”³²

8 SDG&E’s proposed capital structure and ROE are intended to comprehensively manage the
9 impact of these circumstances. Since PPAs represent an ongoing component of the Company’s
10 overall energy portfolio, these agreements will continue to negatively impact SDG&E’s credit
11 profile and must be appropriately factored into the authorized capital structure.

12 **c. Elevated Levels of Delinquent Accounts due to COVID-19**
13 **Pandemic**

14 Financial health is not just relevant to infrastructure investment. The extraordinary events
15 that occurred in 2020 due to the COVID-19 pandemic demonstrate yet another reason why SDGE’s
16 financial health is imperative. In March 2020, the Commission required SDG&E and other
17 California utilities to implement several emergency customer protections, including suspended
18 service disconnections and waivers of late fees,³³ which have been extended through September
19 2021.³⁴ Although the Commission has stated that it “appreciate[s] the careful, and tireless efforts of

³⁰ California Public Utilities Commission, *An Introduction to Debt Equivalency* (August 4, 2017).

³¹ D.12-12-034, p. 29 (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.”).

³² D.19-12-056 p. 26.

³³ Email Letter from Alice Stebbins, Executive Director, CPUC to the utilities (March 17, 2020).

³⁴ See D.21-06-036.

1 the utilities to protect their employees and customers over this period,”³⁵ as a result, as Moody’s
2 noted, SDG&E’s delinquent account balances more than doubled in 2020 and 2021 as compared to
3 2019 average levels and are expected to continue to grow.³⁶ The debt to fund the incremental
4 delinquent account balances decreases SDG&E’s Moody’s FFO-to-Total Debt ratio by
5 approximately 20 basis points. As RRA added, deferring how to address recovering these costs “is
6 not a guarantee of recovery,” and the “longer the moratoriums remain in place, the more these
7 deferred balances will rise, and the more problematic achieving cost recovery will become.”³⁷
8 Utilities such as SDG&E need to be financially well-positioned to continue to fund the growing
9 undercollection of delinquent account balances during this or future emergencies.

10 **C. SDG&E’s Capital Structure Proposal is a Prudent Counter to the Company’s**
11 **Unique Business and Financial Risks and Better Reflects its Actual Capital**
12 **Structure**

13 SDG&E’s capital structure proposal is thus a prudent counter to its unique, above-average
14 business and regulatory risks and a method to help SDG&E bolster its credit ratings. As noted, S&P
15 asserted that strong financial metrics could result in an upgrade in SDG&E’s credit ratings despite
16 the increased risks from wildfire liability and other risks that is otherwise preventing any increase in
17 SDG&E’s current rating.³⁸ Specifically, S&P recently noted that it could “raise [its] rating on
18 SDG&E if its stand-alone FFO to debt remains consistently at 21% or above.”³⁹ As Moody’s latest
19 credit rating opinion likewise noted, an “increase in [SDG&E’s] allowed equity layer to 56% (as
20 requested) would have been more credit supportive because it would have contributed to stronger

³⁵ Rulemaking 21-02-014, *Order Instituting Rulemaking to Address Energy Utility Customer Bill Debt Accumulated During the COVID-19 Pandemic* (February 11, 2021), p. 3.

³⁶ Moody’s May 10, 2021 at 7.

³⁷ S&P, RRA Regulatory Focus, *2021 Energy Utility Regulatory Outlook*, (February 11, 2021), p. 4.

³⁸ S&P, *How are California’s Wildfire Risks Affecting Utilities’ Credit Quality?* (Jun. 3, 2021), p. 10.

³⁹ S&P, *San Diego Gas & Electric Co.* (July 9, 2021), p. 4.

1 credit metrics.”⁴⁰ Moody’s added that SDG&E’s credit ratings could be further upgraded if
2 SDG&E’s can run a “CFO pre-W/C to debt in excess of 24%” on a sustained basis.⁴¹

3 Moody’s statement is consistent with SDG&E regaining its long-held A credit rating. Table
4 2 above suggests that for SDG&E to maintain its single “A” bond rating at Moody’s, it must
5 maintain a debt ratio in the range of 35%-45%; reflective of SDG&E’s actual debt ratio of 44.00.
6 The fact that SDG&E has not regained an A rating since the Commission’s 2019 decision indicates
7 that SDG&E’s currently authorized capital structure is insufficient to regain that rating.

8 By contrast, debt utilization beyond the levels indicated by the target credit metrics defined
9 above would put downward pressure on SDG&E’s credit rating. In its most recent credit opinion of
10 SDG&E,⁴² Moody’s calculated an adjusted FFO-to-Total Debt for SDG&E as of December 2020 of
11 20.2% and specified a lower bound FFO-to-Total Debt ratio of 20% for SDG&E to avoid a
12 downgrade from its current A3 rating.

13 Moody’s likewise stated that SDG&E’s actual equity ratio is a factor in determining the
14 current rating and forecasts SDG&E to maintain an equity ratio between 55%-60% during the next
15 12-18 months.⁴³ If SDG&E does not maintain this level of equity it may face downward ratings
16 pressure by Moody’s. Therefore, for SDG&E to maintain a strong adjusted FFO-to-Total Debt ratio,
17 additional debt issuances to fund the business will need to be countered with a higher equity ratio. If
18 SDG&E’s authorized capital structure does not better reflect its longstanding actual capital
19 structure—meaning that shareholders continue to provide a benefit without a return—SDG&E may

⁴⁰ Moody’s May 10, 2021 at 8.

⁴¹ *Id.* at 3.

⁴² *Id.* at 1.

⁴³ *Id.* at 8-9.

1 face pressure to lower its actual equity ratio, which could put pressure on its credit ratings and result
2 in higher costs for customers.

3 In sum, the Commission should recognize and reward SDG&E's prudent management of
4 maintaining an actual equity ratio of 56 percent. That said, while SDG&E believes that its actual
5 capital structure reflects best business practices, the Company's proposal of 54 percent common
6 equity, 46 percent debt is a reasonable response to the Commission's concerns in D.19-12-056.
7 There, the Commission declined to adopt SDG&E's actual capital structure as its authorized
8 structure, suggesting that SDG&E "could maintain its proposed leverage through the authorization
9 of preferred equity,"⁴⁴ while indicating that it would not increase SDG&E's common equity ratio
10 without also increasing the Company's long-term debt.⁴⁵

11 Here, SDG&E is not proposing to adopt its actual capital structure as its authorized one.
12 Instead, it is reasonably balancing the reality and benefits of its longstanding actual capital structure
13 with the Commission's findings in its 2019 decision. Although, as noted, SDG&E has not issued
14 preferred equity since 1993 and it is not realistic for SDG&E to issue preferred equity now,
15 SDG&E's proposal does move SDG&E closer to its actual capital structure, eliminated its phantom
16 preferred equity ratio, while also increasing SDG&E's authorized long-term debt.⁴⁶ By contrast,
17 adopting a common equity ratio that continues to include a preferred equity layer that does not exist
18 is a fictitious exercise that lacks any relationship to SDG&E's actual management.

19 Moreover, SDG&E's 54 percent common equity proposal both responds to the Company's
20 above-average risks and is well within the range of authorized common equity ratios nationwide.
21 Mr. Coyne calculated the weighted average capital structure for each of SDG&E's proxy group

⁴⁴ D.19-12-056, p. 10.

⁴⁵ *Id.* at 11.

⁴⁶ *See id.*

1 operating companies on a quarterly basis for the eight quarters through Q4 2020. He found that
2 SDG&E’s proposed “54 percent is well within the range of actual common equity ratios of 47.30
3 percent to 59.27 percent for the operating companies held by the proxy group over this period.”⁴⁷

4 Although the Commission in its 2019 Decision noted that SDG&E’s 56 percent common
5 equity request was “larger than 70.5% of all authorized common-equity ratios”⁴⁸ between 2017
6 through July 2019, SDG&E needs an above-average common equity ratio to counteract its above
7 average risks compared to utilities nationwide. The fact that nearly 30 percent of authorized
8 common equity ratios during that period were 56 percent and larger indicates that SDG&E’s request
9 (and actual common equity ratio) is within the mainstream of authorized common equity ratios.
10 And, presumably, an even higher percentage of utilities had an authorized common equity ratio of
11 54 percent or above during that period.

12 Moreover, as RRA, an arm of S&P has recently noted, the average authorized equity ratios
13 adopted by utility commissions have steadily increased every year from 2017 through the first half
14 of 2021.⁴⁹ In other words, SDG&E’s 54 percent request now is closer to the average authorized
15 common equity ratio now compared to 2019—just as its authorized 52 percent would be even lower
16 relative to the nationwide average today than it was in the Commission’s 2019 decision.

17 In short, a higher equity ratio is necessary to mitigate the increased investment risks that
18 SDG&E faces and prevent downgrades in the Company’s credit rating. SDG&E believes that its
19 actual capital structure reflects a prudent policy to manage long-term debt so that SDG&E remains
20 at investment-grade credit levels, while protecting against short-term fluctuations and disruptions to
21 credit markets and the business environment. SDG&E recommends that the Commission realign its

⁴⁷ Coyne SDG&E-04, p. JMC-80.

⁴⁸ D.19-12-056, p. 10.

⁴⁹ S&P, RRA Regulatory Focus, *Major Rate Case Decisions, Jan.-March 2021* (April 28, 2021), pp. 3-4.

1 capital structure to better reflect its actual capital structure and help lower financial risks—thus
2 mitigating the credit rating agencies’ belief that SDG&E is now a riskier investment—by adopting
3 an authorized capital structure that removes preferred equity that SDG&E no longer has, while
4 increasing its common equity and long-term debt ratios to 54% and 46%, respectively.

5 **IV. EMBEDDED COST OF DEBT AND PREFERRED STOCK RECOMMENDATIONS**

6 The embedded cost of debt represents all the costs associated with the issuance and
7 servicing of debt, expressed as a percentage of the net proceeds received from debt issuances.

8 Table 5 below summarizes the currently authorized and the forecasted embedded costs of long-term
9 debt and preferred stock for SDG&E.

10 **Table 5 – Embedded Cost of Debt and Preferred Stock**

	Current Authorized	2022 Forecast
Long-Term Debt	4.59%	3.84%
Preferred Stock	6.22%	0.00%

11
12 SDG&E’s forecasted embedded cost of long-term debt is 3.84%, as of June 2021.⁵⁰ This
13 forecast accounts for \$1.2 billion of low interest long-term debt that SDG&E has issued since the
14 last cost of capital proceeding was conducted in 2019. As a result of the Company’s robust capital
15 investment program discussed above, the Company plans to raise \$1.2 billion in 2021 and \$800
16 million in 2022 of new long-term debt. Consistent with previous COC proceedings, SDG&E
17 recommends setting the authorized cost of debt equal to the forecasted embedded cost of debt
18 during Test Year 2022.

19 The embedded cost of debt calculations use the June 2021 IHS Markit Global Insight
20 forecast of the 10-year Treasury bond yield for 2021 and the 30-year Treasury bond yield for 2021

⁵⁰ The derivation of this figure is contained in Appendix A, attached hereto.

1 and 2022, plus a forecast of the SDG&E-specific credit spread for 10-year and 30-year bonds of
2 0.71% and 0.94%, respectively. This is the current trading level of SDG&E's 10-year and 30-year
3 bonds of 66 and 89 basis points, respectively, plus a new issuance concession of five basis points, as
4 of June 2021.⁵¹

5 As explained above, SDG&E no longer uses preferred stock as a source of financing.
6 SDG&E redeemed all issued and outstanding shares of its preferred stock in 2013 and does not
7 anticipate issuing any preferred stock in the foreseeable future, as reflected in its actual capital
8 structure. As such, SDG&E puts forth an embedded cost of preferred stock of 0%.

9 **V. CONCLUSION**

10 SDG&E seeks a Test Year 2022 authorized capital structure of 54% equity, 46% long-term
11 debt, and 0% preferred stock. The proposed capital structure better reflects SDG&E's actual capital
12 structure and increases the equity ratio to mitigate above-average business and financial risk, while
13 attempting to satisfy D.19-12-056.

14 SDG&E also seeks a Test Year 2022 embedded cost of debt and preferred stock of 3.84%
15 and 0%, respectively. These reflect the forecasted embedded costs for the 2022 test year. SDG&E
16 respectfully requests the Commission adopts these recommendations for 2022.

17 This concludes my prepared direct testimony.

⁵¹ New issue concession is the difference between the spread at which new bonds are issued and the spread at which corresponding bonds of the same issuer are traded in the secondary market.

1 **VI. STATEMENT OF QUALIFICATIONS**

2 My name is Maritza Mekitarian. I am employed by SDG&E as the Financial and Strategic
3 Planning Manager. My business address is 8330 Century Park Court, San Diego, California 92123.

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

9 In my current role, I am responsible for the development of SDG&E's financial plan and
10 numerous treasury related functions.

11 I have previously testified before this Commission, including testimony supporting
12 SDG&E's Test Year 2020 Cost of Capital Application (A.19-04-017).

APPENDIX A
SAN DIEGO GAS & ELECTRIC COMPANY
EMBEDDED COST OF DEBT
TEST YEAR 2022
(in Thousands)

Line Number	Description	A	B	C	D	E	F
		Principal	Total Discount and Expense	Net Proceeds (A - B)	Annual Interest Payment	Total Amortization	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 JJJ	350,000	4,571	345,429	10,500	457	
8	SERIES LLL	250,000	2,990	247,010	9,875	100	
9	SERIES MMM	250,000	3,867	246,133	10,750	129	
10	SERIES NNN	450,000	3,742	446,258	16,200	376	
11	SERIES PPP	27,214	872	26,342	521	127	
12	SERIES QQQ	500,000	5,904	494,096	12,500	590	
13	SERIES RRR	400,000	5,822	394,178	15,000	194	
14	SERIES SSS	400,000	5,840	394,160	16,600	195	
15	SERIES TTT	400,000	4,766	395,234	16,400	159	
16	SERIES UUU	400,000	4,997	395,003	13,280	167	
17	SERIES VVV	800,000	8,080	791,920	13,600	808	
18	Amortization of call premiums	-	5,348	(5,348)	-	1,097	
19	First mortgage bonds	6,027,214	84,505	5,942,709	232,788	5,380	4.01%
20	Amortization of call premiums	-	231	(231)	-	312	
21	Unsecured bonds	-	231	(231)	-	312	
22	Other expense and amortization	-	-	-	747	-	
23	December 31, 2020 total long-term debt	6,027,214	84,736	5,942,478	233,536	5,692	4.03%
24	Change in interest and amortization in 2021	(361,779)	(5,619)	(356,159)	(10,725)	(1,013)	-
25	Forecasted debt to be issued in 2021:	1,200,000	12,264	1,187,736	34,271	955	-
26	December 31, 2021 total long-term debt	6,865,435	91,381	6,774,054	257,082	5,634	3.88%
27	Change in interest and amortization in 2022	(15,435)	(1,297)	(14,138)	(295)	(227)	-
28	Forecasted debt to be issued in 2022:	800,000	8,724	791,276	27,765	291	-
29	December 31, 2022 total long-term debt	7,650,000	98,807	7,551,193	284,551	5,697	3.84%
30	Forecasted 2022 Embedded Cost of Long-Term Debt						3.84%

SAN DIEGO GAS & ELECTRIC COMPANY
EMBEDDED COST OF DEBT
DECEMBER 2022 - PROJECTED
(IN DOLLARS UNLESS OTHERWISE STATED)

DESCRIPTION	REF #	(1)		(2)	(3)	(4)		(5)	(6)	(7)	(8)	(9) ANNUAL AMORTIZATION		(11)	(12)	
		INTEREST RATE	DATE OF ISSUE	DUE DATE	LIFE OF BOND	PRINCIPAL	ISSUE DISCOUNT	ISSUE EXPENSE	REMAINING OSS ON REACC	NET PROCEEDS (3-4-5-6)	ANNUAL INTEREST EXPENSE (1 X 3)	DISCOUNT (4 / 2)	EXPENSE (5 / 2)	REACQUISITION LOSS	ANNUAL TOTAL COST (8+9+10+11)	
FIRST MORTGAGE BONDS																
SERIES II	(1)	-	9/01/87	3/01/23	-	-	-	-	4,256	(4,256)	-	-	-	-	35,457	35,457
SERIES OO-1	(1)	-	12/01/92	12/01/27	35.0	-	-	-	306,902	(306,902)	-	-	-	-	88,171	88,171
SERIES OO-2		5.000%	12/01/92	12/01/27	35.0	-	-	-	418,509	(418,509)	-	-	-	-	120,235	120,235
SERIES OO-3		5.250%	12/01/92	12/01/27	35.0	-	-	-	204,180	(204,180)	-	-	-	-	57,665	57,665
SERIES OO-4		5.000%	12/01/92	12/01/27	35.0	-	-	-	313,881	(313,881)	-	-	-	-	90,176	90,176
SERIES OO-5	(1)	-	12/01/92	12/01/27	35.0	-	-	-	23,438	(23,438)	-	-	-	-	6,619	6,619
SERIES VV (CV2004A)	(1)	5.875%	6/17/04	2/15/34	29.6	-	-	-	425,262	(425,262)	-	-	-	-	53,080	53,080
SERIES WW (CV2004B)	(1)	5.875%	6/17/04	2/15/34	29.6	-	-	-	390,317	(390,317)	-	-	-	-	48,718	48,718
SERIES XX (CV2004C)	(1)	5.875%	6/17/04	2/15/34	29.6	-	-	-	341,870	(341,870)	-	-	-	-	42,671	42,671
SERIES YY (CV2004D)	(1)	5.875%	6/17/04	1/01/34	29.5	-	-	-	232,917	(232,917)	-	-	-	-	29,402	29,402
SERIES ZZ (CV2004E)	(1)	5.875%	6/17/04	1/01/34	29.5	-	-	-	326,250	(326,250)	-	-	-	-	41,184	41,184
SERIES AAA (CV2004F)	(1)	4.000%	6/17/04	5/01/39	34.9	-	-	-	1,108,633	(1,108,633)	-	-	-	-	94,251	94,251
SERIES BBB		5.3500%	5/19/05	5/15/35	30.0	250,000,000	295,000	2,709,950	-	246,995,050	13,375,000	9,833	90,332	-	13,475,165	
SERIES DDD		6.0000%	6/8/06	6/1/26	20.0	250,000,000	1,117,500	2,429,000	-	246,453,500	15,000,000	55,875	121,450	-	15,177,325	
SERIES FFF		6.1250%	9/20/07	9/15/37	30.0	250,000,000	780,000	2,556,327	-	246,663,673	15,312,500	26,000	85,211	-	15,423,711	
SERIES GGG	(3)	6.0000%	5/14/09	6/1/39	360.5	300,000,000	1,380,000	3,057,571	-	295,562,429	18,000,000	45,936	101,778	-	18,147,714	
SERIES HHH		5.3500%	5/13/10	5/15/40	30.0	250,000,000	335,000	2,486,955	-	247,178,045	13,375,000	11,167	82,899	-	13,469,066	
SERIES III		4.5000%	8/29/10	8/15/40	30.0	500,000,000	5,515,000	5,044,008	-	489,440,992	22,500,000	183,633	168,134	-	22,851,967	
SERIES LLL		3.9500%	11/17/11	11/15/41	30.0	250,000,000	350,000	2,639,787	-	247,010,213	9,875,000	11,667	87,993	-	9,974,660	
SERIES MMM	(3)	4.3000%	3/22/12	4/1/42	360.5	250,000,000	1,297,500	2,569,738	-	246,132,762	10,750,000	43,190	85,539	-	10,878,729	
SERIES NNN	(3)	3.6000%	9/9/13	9/1/23	119.5	450,000,000	72,000	3,670,004	-	446,257,996	16,200,000	7,230	368,536	-	16,575,766	
SERIES QQQ		2.5000%	5/19/16	5/15/26	10.0	500,000,000	1,625,000	4,279,086	-	494,095,914	12,500,000	162,500	427,909	-	13,090,409	
SERIES RRR		3.7500%	6/8/17	6/1/47	30.0	400,000,000	1,784,000	4,038,478	-	394,177,522	15,000,000	59,486	134,661	-	15,194,147	
SERIES SSS		4.1500%	5/15/18	5/15/48	30.0	400,000,000	1,768,000	4,072,043	-	394,159,957	16,600,000	58,933	135,735	-	16,794,668	
SERIES TTT		4.1000%	5/31/19	6/15/49	30.0	400,000,000	420,000	4,345,931	-	395,234,069	16,400,000	14,000	144,864	-	16,558,864	
SERIES UUU		3.3200%	4/7/20	4/15/50	30.0	400,000,000	532,000	4,464,828	-	395,003,172	13,280,000	17,733	145,828	-	13,446,561	
SERIES VVV		1.7000%	9/22/20	10/1/30	10.0	800,000,000	1,392,000	6,688,168	-	791,919,832	13,600,000	139,200	668,817	-	14,408,017	
2021 ISSUANCE		3.2054%	2021	2051	30.0	750,000,000	-	8,195,875	-	741,804,125	24,040,461	-	819,588	-	24,860,049	
2021 ISSUANCE		2.2735%	2021	2031	10.0	450,000,000	-	4,068,445	-	445,931,555	10,230,891	-	135,615	-	10,366,506	
2022 ISSUANCE		3.4706%	2022	2052	30.0	800,000,000	-	8,723,684	-	791,276,316	27,765,094	-	290,789	-	28,055,883	
TOTAL FIRST MORTGAGE BONDS						7,650,000,000	18,663,000	76,039,879	4,096,416	7,551,200,705	283,803,946	846,583	4,098,678	707,628	289,456,835	
UNSECURED BONDS																
CV97A		4.900%	10/31/97	3/01/23	25	-	-	-	7,982	(7,982)	-	-	-	-	44,336	44,336
TOTAL UNSECURED BONDS						-	-	-	7,982	(7,982)	-	-	-	-	44,336	44,336
LINE OF CREDIT			4/30/19	4/30/24		-	-	-	-	-	747,352	-	-	-	-	747,352
TOTAL OTHER DEBT						-	-	-	7,982	(7,982)	747,352	-	-	-	44,336	791,689
TOTAL LONG-TERM DEBT						7,650,000,000	18,663,000	76,039,879	4,104,399	7,551,192,722	284,551,298	846,583	4,098,678	751,964	290,248,523	

(1) REACQUIRED BONDS
(2) TENDER OFFERS ON THESE ISSUES MADE DURING 5/98, REDUCTIONS TOTAL \$130,614,000.
(3) SERIES GGG, SERIES MMM, AND SERIES NNN - LIFE IS EXPRESSED IN MONTHS RATHER THAN YEARS.

San Diego Gas & Electric Company
Issuance Cost Summary
Taxable First Mortgage Bonds
(in Dollars)

Bond Issuance	2021	2021	2022
Life	30-Year	10-Year	30-Year
Principal issued	750,000,000	450,000,000	800,000,000
Up-front issuance fees			
Underwriter ⁽¹⁾	6,562,500	2,925,000	7,000,000
Legal	105,893	105,893	108,166
Printing	18,290	18,290	18,683
Rating agency ⁽²⁾	1,100,250	660,150	1,173,600
Trustee ⁽³⁾	48,250	31,150	51,100
Auditor	46,472	46,472	47,470
CPUC	232,395	232,395	237,385
SEC	81,825	49,095	87,280
Total up-front cost	<u>8,195,875</u>	<u>4,068,445</u>	<u>8,723,684</u>

(1) Based on 65.0 basis points of principal issued for 10-year bonds and 87.5 basis points of principal issued for 30-year bonds.

(2) Based on 14.67 basis points of principal issued.

(3) Based on 0.57 basis points of principal issued plus \$5,500 fixed fees.

**San Diego Gas & Electric Company
Proposed Debt Capital Markets Issuance
2021 & 2022 Projected Activity**

10-Year:

SDG&E Issued Bond Trading Spread ⁽¹⁾	0.66%
New Issuance Concession	<u>0.05%</u>
Indicative New Issuance Credit Spread	<u>0.71%</u>

2021 Issue Year	
Global Insight Treasury Forecast - June 2021	<u>1.56%</u>
Estimated Coupon	<u>2.27%</u>

30-Year:

SDG&E Issued Bond Trading Spread ⁽²⁾	0.89%
New Issuance Concession	<u>0.05%</u>
Indicative New Issuance Credit Spread	<u>0.94%</u>

2021 Issue Year	
Global Insight Treasury Forecast - June 2021	<u>2.27%</u>
Estimated Coupon	<u>3.21%</u>

2022 Issue Year	
Global Insight Treasury Forecast - June 2021	<u>2.53%</u>
Estimated Coupon	<u>3.47%</u>

(1) Pricing information for Series VVV as of June 2021.

(2) Pricing information for Series UUU as of June 2021.