

Application: A.21-08-013 (consolidated)

Witness: James M. Coyne

Exhibit: SDG&E-09

PREPARED REBUTTAL TESTIMONY OF

JAMES M. COYNE

EXTRAORDINARY CIRCUMSTANCES

ON BEHALF OF SAN DIEGO GAS & ELECTRIC COMPANY

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



FEBRUARY 14, 2022

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1 on behalf of Wild Tree Foundation (“Wild Tree”) (collectively “intervening witnesses”)
2 submitted on January 31, 2022 with respect to whether extraordinary circumstances warrant
3 the suspension of the Cost of Capital Mechanism (“CCM”) for 2022.

4 My failure to address any individual issue in this rebuttal testimony does not imply my
5 agreement with any argument, position or proposal asserted by parties.

6 **Q. What are your key conclusions?**

7 A. My key conclusions are as follows:

- 8 1. While several intervening witnesses offer an opinion as to what constitutes an
9 extraordinary event as defined by the CCM, no one can dispute that the COVID-19
10 pandemic and the consequent policy response had a significant effect on capital market
11 conditions. The CCM should be suspended because the CCM is based upon a presumed
12 correlated relationship between interest rates and the cost of equity, and these capital
13 costs diverged during the measurement period (October 1, 2020-September 30, 2021).
14 Allowing the CCM adjustment mechanism to trigger would require a change in
15 SDG&E’s cost of equity from 10.20 percent to 9.62 percent, a decrease of 58 basis
16 points. There is no evidence in the record to demonstrate that the cost of equity has
17 decreased by such a significant degree since the Commission authorized SDG&E’s
18 currently authorized ROE in December 2019. In fact, there is evidence to suggest that
19 the cost of equity increased during the CCM measurement period despite the cost of debt
20 reaching historic lows (the average yield on the 10-year Treasury bond was 1.28 percent
21 during the CCM measurement period)¹ as a consequence of the Federal Reserve’s
22 monetary policy response.

¹ Source: Board of Governors of the Federal Reserve System, available at <https://www.federalreserve.gov/datadownload/Choose.aspx?rel=H15>.

1 2. None of the intervening witnesses credibly dispute that utility stock prices, including
2 Sempra Energy, have underperformed the broader market since the onset of the COVID-
3 19 pandemic. From the onset of the pandemic in mid-February 2020 through the end of
4 the CCM measurement period, the S&P 500 increased 29.06 percent, while the S&P 500
5 Utilities Index declined 8.74 percent and Sempra Energy's stock price declined 20.15
6 percent.² While several intervening witnesses point to utility company revenues and
7 earnings remaining relatively consistent throughout the pandemic and the CCM
8 measurement period,³ the underperformance of utility stock prices demonstrates the
9 differential effect on utilities compared to the broader market and an increase in the cost
10 of equity for utilities despite relative earnings stability. That is, investors are requiring
11 higher returns.

12 3. This divergence between interest rates and the cost of equity is reflected in authorized
13 ROEs nationwide. Authorized ROEs for electric and natural gas utilities have remained
14 within a consistent range since December 2019 despite the decline in interest rates.

15 While certain intervening witnesses point to modest declines based on selective reviews
16 of authorized ROEs,⁴ none of these comparisons support a decline by as much as would
17 be required by the CCM adjustment mechanism (58 basis points) in authorized returns.

18 4. In response to the market evidence that I, and other experts, have presented on Betas that
19 demonstrate that the investment risks of utilities are greater (and therefore required
20 returns are higher), several intervening witnesses point to alternative specifications of
21 Beta coefficients to dispute this evidence. However, even adopting shorter study periods

² Source: S&P Capital IQ Pro.

³ *See, e.g.*, CalPA (Woolridge) at 11; EPUC/IS (Gorman) at 24; EDF (McCann) at 10-11; FEA (O'Donnell) at 8-10; PCF (Ellis) at 10-18; and TURN (Dowdell) at 9-13.

⁴ *See, e.g.*, CalPA (Woolridge) at 11 and 13; EPUC/IS (Gorman) at 26-27; and PCF (Ellis) at 45-48.

1 and alternative measurements the simple conclusion remains: Beta coefficients increased
2 in the CCM measurement period relative to pre-pandemic levels, and Beta coefficients
3 remain above historical levels. Directionally, this provides market-based evidence of an
4 increase in the cost of equity for utility companies despite a decrease in the cost of debt.
5 As such, the CCM adjustment mechanism, which is based on a measurement of the cost
6 of debt, failed to capture the effect of the extraordinary circumstances on the cost of
7 equity as it diverged from the cost of debt during the COVID-19 pandemic and the
8 ensuing recovery period.

- 9 5. Although the economy and financial markets have not fully settled, the evidence
10 presented by intervenor witnesses on the return to more normalized markets in 2022 only
11 reinforces just how extraordinary market conditions were during the measurement period
12 from October 2020 to September 2021 and how not reflective they are for 2022.

13 **Q. Have other regulatory commissions relied on automatic adjustment mechanisms for**
14 **ROEs linked to interest rates?**

- 15 A. Yes. Automatic adjustment mechanisms tied only to bond yields were once prevalent across
16 Canada. At one time, the National Energy Board (“NEB”), British Columbia Utilities
17 Commission (“BCUC”), Public Utilities Board of Manitoba (“PUBM”), Ontario Energy
18 Board (“OEB”), Newfoundland and Labrador Board of Commissioners of Public Utilities
19 (“NL PUB”), Régie de l’énergie du Québec (“Régie”), and Alberta Utilities Commission
20 (“AUC”) all employed automatic adjustment mechanisms, with the vast majority adjusting
21 ROEs by 75 percent of the change in the forecast long Canada bond yield, making it highly
22 sensitive to movements in bond yields. In the United States, as part of a statutory formula
23 rate plan, the Illinois Commerce Commission (“ICC”) authorized ROEs calculated by
24 adding 580 basis points to the 30-year treasury bond yield for Commonwealth Edison and

1 Ameren Illinois. Vermont relies on an ROE adjustment formula linked to 50% of the
2 change in 10 year Treasury bond yields between rate cases.

3 **Q. Have commissions modified their automatic adjustment mechanisms?**

4 A. Yes, they have. In the period following the global economic crisis in 2008-2009 and the
5 ensuing monetary policy response, when government bond yields were at their lowest levels,
6 Canadian regulators began to recognize that ROE could not always be reliably estimated
7 through a simple relationship to bond yields. Today, in Canada, only the OEB currently
8 uses an automatic adjustment mechanism which it periodically examines to check on its
9 performance. The ICC formula rate structure, including the ROE calculation methodology,
10 is expected to expire at the end of 2022.

11 Given the possibility for the direction of the cost of debt and the cost of equity to
12 diverge, especially amidst extraordinary circumstances, such rigid mechanisms are not
13 reliable in all capital market conditions. The CCM appropriately allows for utilities the right
14 to file a cost of capital application in the event of such an extraordinary circumstance where
15 the CCM's presumed relationship between movements in interest rates and the cost of equity
16 falters. The evidence presented in this case demonstrates that it is appropriate for the
17 Commission to suspend the CCM for 2022 and to maintain the current cost of capital for
18 SDG&E; given the extraordinary events that caused the cost of equity to be impacted in
19 ways not reflected in average utility bond yields, as measured in the CCM adjustment

1 mechanism. It would make little sense to assess ROE based upon interest rate movements,
2 when those interest rate movements do not reflect the cost of equity.

3 **III. THE EFFECT OF COVID-19 ON THE EQUITY MARKET PERFORMANCE OF**
4 **UTILITIES**

5 **Q. Have any of the intervening witnesses disputed your finding that utility stock**
6 **performance has significantly lagged the broader market compared to pre-pandemic**
7 **levels?**

8 A. As described in my Opening Testimony, utility stocks, as measured by the S&P Utilities
9 Index, significantly lagged the broader market compared to pre-pandemic levels. Further,
10 Sempra Energy’s stock price was more than 20 percent below its pre-pandemic level on
11 September 30, 2021 (the end of the measurement period) and more than 10 percent below its
12 pre-pandemic level on December 31, 2021.⁵ A decline in the stock price translates to an
13 increase in the ROE when measured in the DCF model, as the Commission has relied upon
14 in the past.⁶ This is evidence that the cost of equity for utilities has diverged from declining
15 interest rates, rendering the CCM adjustment mechanism inappropriate under these
16 circumstances.⁷ Only Mr. O’Donnell disputes this finding, as he concludes “the utility
17 equity market, as represented by the DJUA, has tracked the overall market, as represented
18 by the DJIA, quite closely.”⁸ No other intervening witness makes this claim.

⁵ Prepared Opening Testimony of James M. Coyne (January 18, 2022) (“SDG&E-06 (Coyne) at JMC-10 – JMC-11.

⁶ See Decision (“D.”)19-12-056 at 20 and 24-25.

⁷ See S&P, The Big Picture: 2022 Electric, Natural Gas and Water Utilities Outlook (Oct 2021) (“S&P Oct. 2021”) at 5 (“While authorized ROEs generally move directionally with Treasury Bond yields, over the past several years, state commissions have approved ROEs that contain a higher premium over Treasury bond yields than have historically prevailed. State utility commissions have recognized that long-term bond yields have been artificially suppressed due to the Fed’s unprecedented intervention in the markets. As such, authorized returns have been somewhat resistant to the decline in interest rates, with the spread increasing as interest rates decline.”).

⁸ FEA (O’Donnell) at 11.

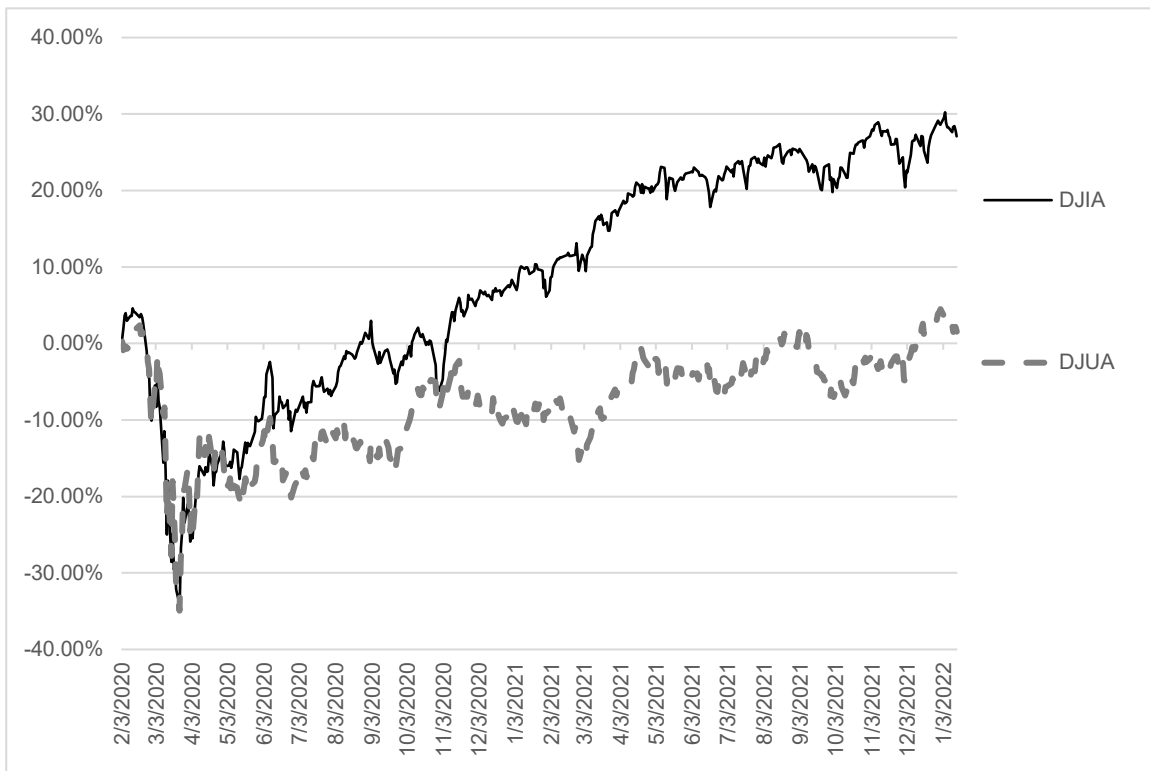
1 **Q. What is Mr. O’Donnell’s basis for his conclusion that the utility equity market has**
2 **tracked the overall market?**

3 A. Mr. O’Donnell relies on a chart with “a double-y axis” displaying the Dow Jones Industrial
4 Average (“DJIA”) and the Dow Jones Utility Average (“DJUA”), from February 1, 2020
5 through January 14, 2022. Importantly, the use of a “double-y axis” obscures the
6 relationship between the DJIA and the DJUA. Each index has substantially different values
7 - the DJIA is in the range of 18,000 to 37,000 and the DJUA is in the range of 600 to 1,000.
8 As a result, the scales that Mr. O’Donnell chooses to display on each axis for each index
9 biases the conclusions one can make based on a visual observation. Significantly, Mr.
10 O’Donnell relies on this visualization in his conclusion as he states “[a]s can be seen in this
11 chart, the utility equity market, as represented by the DJUA, has tracked the overall market,
12 as represented by the DJIA, quite closely.”⁹ To provide an unbiased view of the relationship
13 between the DJIA and the DJUA, I have normalized the index data relied on by Mr.
14 O’Donnell in his development of Chart 1 and presented the daily change in price since
15 February 1, 2020 for each respective index such that they can be viewed on the same axis.
16 As shown in Figure 1 below, since February 1, 2020, the utility industry has significantly
17 underperformed the broader market. In fact, DJUA has not tracked the overall market (as
18 represented by the DJIA) quite closely; it has underperformed by more than 25 percent since
19 February 1, 2020. This unbiased view of Mr. O’Donnell’s comparison of the DJIA and the
20 DJUA confirms my findings in my Opening Testimony.

⁹ *Id.*

1

Figure 1: DJUA vs. DJIA February 1, 2020 through January 14, 2022¹⁰



2

3 **Q. What evidence do the intervening witnesses provide in support of their argument that**

4 **COVID-19 does not constitute an extraordinary event as it relates to utilities?**

5 A. Several intervening witnesses point to utility revenues, earnings, and credit ratings
6 remaining relatively consistent throughout the pandemic. For example, Dr. Woolridge
7 points to ratemaking safeguards that protect utilities from economic events and concludes
8 “the revenues and earnings of utilities were not significantly impacted to any significant
9 degree.”¹¹ Similarly, Mr. Gorman points to regulatory mechanisms that protect utilities
10 from the effects of the COVID-19 pandemic and compares utilities to non-regulated
11 companies. He concludes that “utilities’ risk is not increasing relative to the overall market
12 due to the COVID-19 pandemic, but rather the utilities’ risk likely has decreased during the

¹⁰ Source: S&P Capital IQ Pro.

¹¹ CalPA (Woolridge) at 11.

1 pandemic, relative to that of the overall market.”¹² However, such claims are either
2 unrelated to utilities’ cost of equity, or unsupported by market-based evidence.

3 The relevant question in this proceeding is whether the CCM adjustment mechanism
4 should apply, based upon whether it would provide an accurate assessment in the change in
5 SDG&E’s cost of capital. The primary evidence we must consider is the effect of the
6 extraordinary event of COVID-19 on SDG&E and other utilities’ cost of capital, not
7 revenues, earnings, or the presence of regulatory safeguards. To measure the effect of
8 COVID-19 on utilities’ cost of capital, market-based evidence provides a clear indication as
9 to investors’ required returns. As shown in Figure 1, above, and Figure 5 of my Opening
10 Testimony, the utility industry equity market has underperformed the broader equity
11 market—demonstrating that the cost of equity has increased on a relative basis despite the
12 decline in interest rates resulting from the Federal Reserve’s actions and undermining the
13 CCM’s premise that interest rates and the cost of equity move together. As discussed in
14 more detail in Section V, below, this is confirmed by an analysis of utility Beta coefficients.

15 **Q. Have utilities been able to access capital markets during the CCM measurement**
16 **period?**

17 A. Yes, they have. As noted by several intervening witnesses, utilities have been able to raise
18 equity and debt since the onset of the COVID-19 pandemic.¹³ In addition, certain
19 intervening witnesses point to low debt costs as evidence of low capital costs. As a
20 preliminary matter, the issue at hand is not whether or not utilities are able to access capital
21 markets, it is at what cost they are able to access capital markets. Further, evidence of a

¹² EPUC/IS (Gorman) at 24-25.

¹³ CalPA (Woolridge) at 5-6; EPUC/IS (Gorman) at 29-30; FEA (O’Donnell) at 5 and 7; TURN (Dowdell) at 10-11.

1 lower cost of debt is not evidence of a lower cost of equity. The fact that debt costs have
2 declined is not in dispute – it is the Moody’s bond index that is causing the CCM adjustment
3 mechanism to be triggered. Rather, it is whether or not the cost of equity has diverged from
4 the cost of debt given the extraordinary event of the COVID-19 pandemic. As described
5 throughout my Opening Testimony, following the extraordinary circumstances associated
6 with COVID-19, the monetary and fiscal policy responses caused the cost of equity for
7 utilities to diverge from declining interest rates, rendering the CCM adjustment mechanism
8 inappropriate under these circumstances.

9 **IV. MEASURES OF THE COST OF EQUITY SINCE THE ONSET OF COVID-19**

10 **Q. Have the intervening witnesses discussed how measures of the cost of equity have**
11 **changed since the onset of COVID-19?**

12 A. Several of the intervening witnesses point to estimates of Beta coefficients as a measure of
13 the cost of equity. Dr. Woolridge criticizes my use of Value Line and Bloomberg Beta
14 estimates, noting that alternative sources produce lower estimates of Beta.¹⁴ Mr. Ellis and
15 Ms. Dowdell criticize the five-year Beta measurements that I have used and conclude that
16 Beta coefficients have recovered to pre-pandemic levels.¹⁵ Finally, Mr. Gorman observes
17 that current Beta estimates are anomalous and should be disregarded.¹⁶

18 **Q. How do you respond to Dr. Woolridge’s criticism that alternative sources of Beta**
19 **estimates are currently producing lower estimates of Beta?**

20 A. As a preliminary matter, I observe that Value Line and Bloomberg are common sources of
21 Beta coefficients that are relied on by investors, and regulators in numerous applications. In

¹⁴ See CalPa (Woolridge) at 7-9.

¹⁵ PCF (Ellis) at 61-63; TURN (Dowdell) at 15-16.

¹⁶ See EPUC/IS (Gorman) at 23.

1 fact, in Dr. Woolridge’s very recent testimony in New Hampshire, he states “I have
2 traditionally used the betas as provided in the *Value Line Investment Survey*.” He discusses
3 the market volatility, and differences in betas and measurement periods from other sources,
4 but ultimately concludes “[a]t present, I will continue to use Value Line betas in my CAPM,
5 which I believe is a conservative approach.”¹⁷ Dr. Woolridge relied exclusively on Beta
6 coefficients from Value Line, inclusive of the Blume Adjustment.

7 The alternative Beta coefficients that Dr. Woolridge provides from Yahoo! Finance
8 in this proceeding are inconsistent with his own past practice, and of little analytic value
9 since he only produces them for the current period. This provides no evidence as to what
10 Beta coefficients were: 1) at the time SDG&E’s 10.20 percent ROE was authorized; 2) in
11 the period prior to the onset of the COVID-19 pandemic; or 3) at any point during the CCM
12 measurement period. As such, we gain little insight as to how the cost of equity changed in
13 the CCM measurement period.

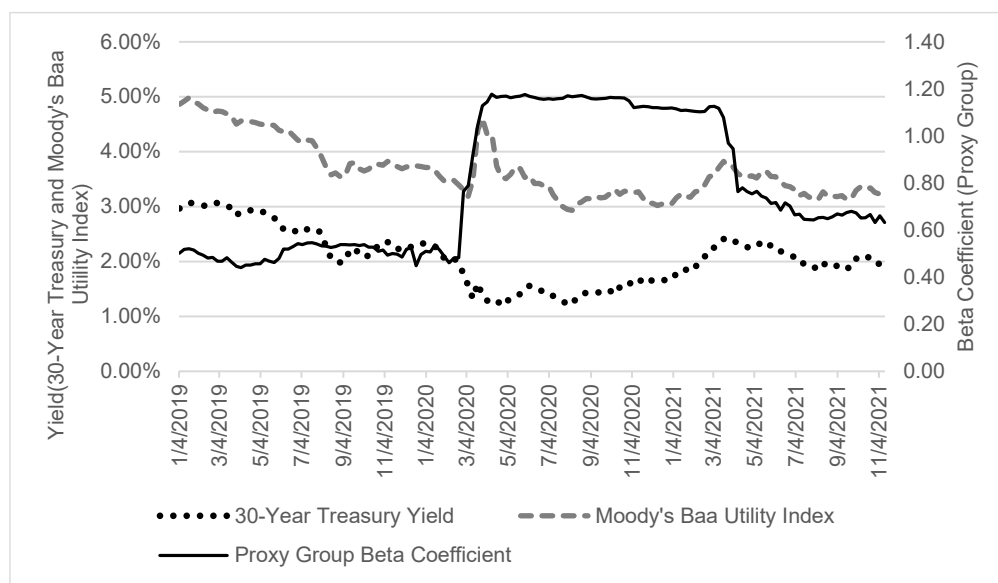
14 **Q. What is your response to the criticism that five-year Beta estimates are overly influenced**
15 **by historical events that do not affect the forward-looking cost of capital?**

16 A. Selecting the appropriate term for Beta calculations requires a balance such that estimates
17 are not overly influenced by transitory events, but representative of the current expectations
18 of the underlying company. In my view, a five-year estimate appropriately balances these
19 objectives. Nonetheless, since we are focused on the effect of an extraordinary event on the
20 cost of equity, the specific timing of the event and its duration of its impact are relevant
21 variables to consider. As such, I have also considered a 12-month estimate of the Beta
22 coefficient for utilities. This analysis demonstrates that after an initial significant increase in

¹⁷ New Hampshire Public Utilities Commission, Docket No. DE 21-030, Direct Testimony of Dr. J. Randall Woolridge, On Behalf of New Hampshire Department of Energy (November 23, 2021) at 59-60.

1 Beta at the onset of the pandemic, there was a decline in estimates of Beta. However, it is
2 important to note that 12-month Beta coefficients remain above pre-pandemic levels. As
3 shown in Figure 2, using short-term, 12-month Beta coefficients, there is evidence that the
4 cost of equity has increased even when the most volatile periods (February to April 2020)
5 are no longer included in the analysis.

6 **Figure 2: Cost of Debt and Utility 12-Month Beta Coefficients,**
7 **January 2019-November 2021¹⁸**



8
9 **Q. Were any other estimates of Beta presented by the intervening witnesses?**

10 **A.** Yes, Mr. Rothschild introduced an unconventional measure of “option-implied” Beta
11 coefficients. Mr. Rothschild cites an article in support of his methodology, Chang,
12 Christoffersen, Jacobs, and Vainberg regard the approach as a “radically different
13 approach,” and note “much remains to be done” in terms of further research.¹⁹ As such, it is
14 appropriate to give caution in applying this approach. However, Mr. Rothschild failed to

¹⁸ Source: Bloomberg Professional.

¹⁹ Bo-Young Chang & Peter Christoffersen & Kris Jacobs & Gregory Vainberg, (2011) Option-Implied Measures of Equity Risk, Review of Finance 16: 385-428.

1 address some of the fundamental concerns cited in the research surrounding option-implied
2 Betas. In another article referenced by Mr. Rothschild as support for the methodology, titled
3 “Forward-Looking Betas”, Christoffersen, Jacobs, and Vainberg suggest that six months
4 may not be the appropriate time-period to use when estimating the cost of capital.

5 Specifically, Christoffersen, Jacobs, and Vainberg note that:

6 [T]he main focus in this paper has been on forecasting 180-day ex-post betas,
7 which are relevant for certain applications such as abnormal returns. **For**
8 **other applications, such as cost of capital calculations, longer-horizon**
9 **betas may be needed.** We plan to investigate the performance of option
10 implied betas in this context by using LEAPS as well as option contracts with
11 longer maturities traded on non-U.S. markets. Indeed, our option-implied
12 beta approach allows for the computation of a complete term structure of beta
13 for each company so long as the options data is available.²⁰

14 Mr. Rothschild’s option-implied Beta calculations are based on options data for the
15 next six months. Given that Mr. Rothschild did not address one of the fundamental concerns
16 cited by the authors that developed option-implied Betas, this “radically different approach”
17 should be disregarded.

18 **Q. How do you address Ms. Dowdell’s argument that other segments of the economy were**
19 **also affected by the pandemic?**

20 A. Ms. Dowdell first mischaracterizes the positions of the Utilities, suggesting that “[t]he Utilities
21 instead cite anomalous 2020 beta coefficients greater than 1.0 for utilities including those in
22 California as evidence that their cost of equity capital has increased permanently.”²¹ The
23 Utilities have not argued that the cost of equity has changed permanently; only that that CCM
24 mechanism has failed to track the cost of equity as measured by changes in bond yields that

²⁰ Peter Christoffersen, Kris Jacobs, and Gregory Vainberg, “Forward-Looking Betas”, April 25, 2008, at 24. (Emphasis added.)

²¹ TURN (Dowdell) at 17.

1 were deliberately lowered by Federal Reserve and Government policy. There is no reason to
2 believe these actions or their effects are permanent.

3 Second, Ms. Dowdell argues that other sectors of the economy were also affected by
4 the pandemic as demonstrated by changes in their betas. She draws the conclusion that
5 “[i]nstead, the anomalous betas across multiple reflect temporary turmoil in the overall market
6 as investors attempt to re-evaluate risks and respond to changing economic realities.”²² In
7 response, it comes as no surprise that other sectors of the economy were also impacted by the
8 pandemic, and I agree with Ms. Dodwell that there was turmoil in the overall market. Yet
9 Ms. Dowdell acknowledges that the utility sector was negatively affected compared to the
10 broader market. Moreover, even assuming as true that certain other sectors were also
11 negatively impacted, the applicable comparison under the Commission’s standard is the utility
12 sector to the market as a whole.²³ And that comparison demonstrates that utilities were
13 negatively affected compared to the market, as evidenced by the rise in beta and stock
14 underperformance.

15 **Q. Were there any other concerns raised by the intervening witnesses?**

16 A. Dr. Woolridge claims that “not one of the witnesses has provided cost of capital studies to
17 document that utility cost rates did not decline in 2021.”²⁴ As a preliminary matter, this is
18 not accurate. I provided a cost of equity study as part of my Direct Testimony that supports
19 an ROE that is higher than SDG&E’s currently authorized ROE. This demonstrates that, if

²² *Id.* at 18, Figure 2.

²³ See Assigned Commission's Scoping Memorandum and Ruling (December 24, 2021) (“Scoping Memo”) at 5 (“Do the financial impacts on the Utilities described in the applications, where they are largely attributed to the COVID-19 pandemic, constitute an extraordinary or catastrophic event that materially impacts their respective cost of capital and/or capital structure and impacts them differently than the overall financial markets?” (citation omitted)).

²⁴ CalPA (Woolridge) at 6.

1 anything, the cost of equity increased in 2021. However, this analysis was not addressed in
2 my Opening Testimony, as the Scoping Memo was clear that “the parties should not include
3 technical analysis on modifications to the ROE.”²⁵ As such, the scope of my Opening
4 Testimony was focused on analyses that answered the fundamental question—are there
5 extraordinary circumstances that warrant a departure from the CCM for 2022? While this
6 did not include a cost of capital study, my evidence and findings in my Opening Testimony
7 are consistent with the results of my cost of capital study that was provided in my Direct
8 Testimony.

9 **V. TRENDS IN AUTHORIZED ROES FOR UTILITIES**

10 **Q. Please describe recent trends in authorized ROEs since the Commission’s Decision in**
11 **SDG&E’s last cost of capital proceeding.**

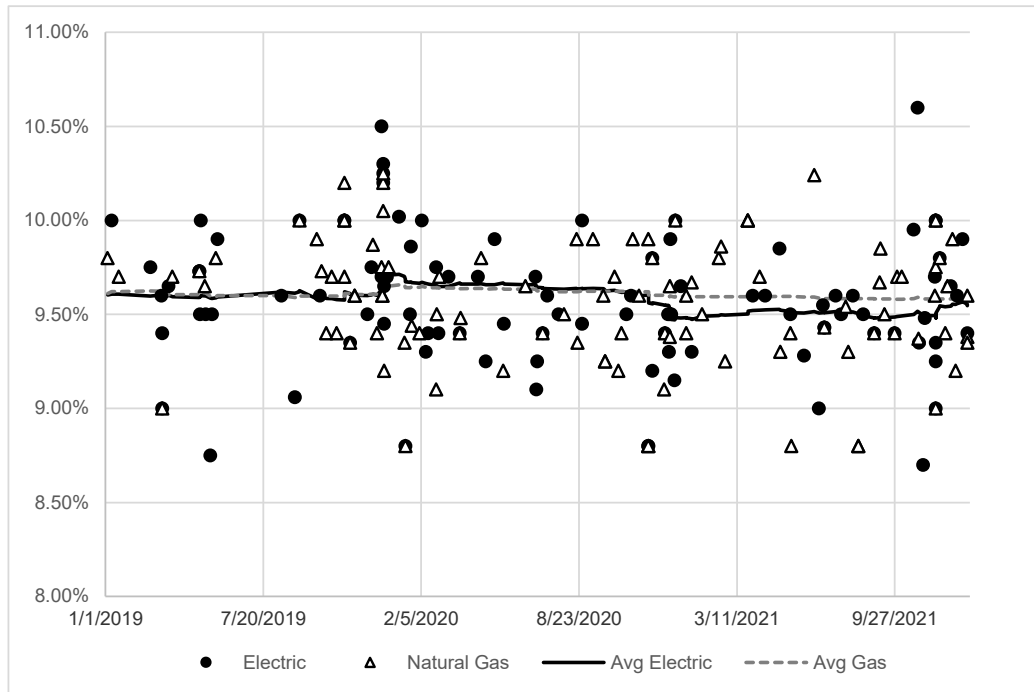
12 A. Since the Commission authorized SDG&E’s ROE of 10.20 percent in December 2019,
13 authorized ROEs have remained generally consistent. As shown in Figure 3, below, the
14 trailing 12-month average authorized ROE has remained in a narrow band of 9.47 percent to
15 9.71 percent for electric utilities and of 9.57 percent to 9.66 percent for gas utilities since
16 2019.²⁶

²⁵ Scoping Memo at 7.

²⁶ Source: Capital IQ Pro, Regulatory Research Associates.

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Figure 3: Authorized ROEs 2019-2021, including 12-Month Trailing Average²⁷



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While certain intervening witnesses point to a decline in authorized ROEs,²⁸ these are modest reductions that cannot be directly attributed to a trend in the cost of equity as the irregular schedule of rate case filings will cause differences in any given year based on the composition of companies and jurisdictions in which cases were adjudicated. Dr. Woolridge points to a 6 basis point decline from 2020 to 2021.²⁹ Mr. Gorman’s data refutes Dr. Woolridge’s analysis showing a modest increase of 1 to 2 basis points from 2020 to 2021.³⁰ Mr. Ellis points to a decline of 26 basis points based on a linear trendline from six months prior to the pandemic (August 2019) through the end of 2021.³¹ However, the quarterly data

²⁷ Source: Capital IQ Pro, Regulatory Research Associates.

²⁸ CalPA (Woolridge) at 11; EPUC/IS (Gorman) as 26-27; and PCF (Ellis) at 45-48.

²⁹ CalPA (Woolridge) at 11.

³⁰ EPUC/IS (Gorman) at 27, Table 8.

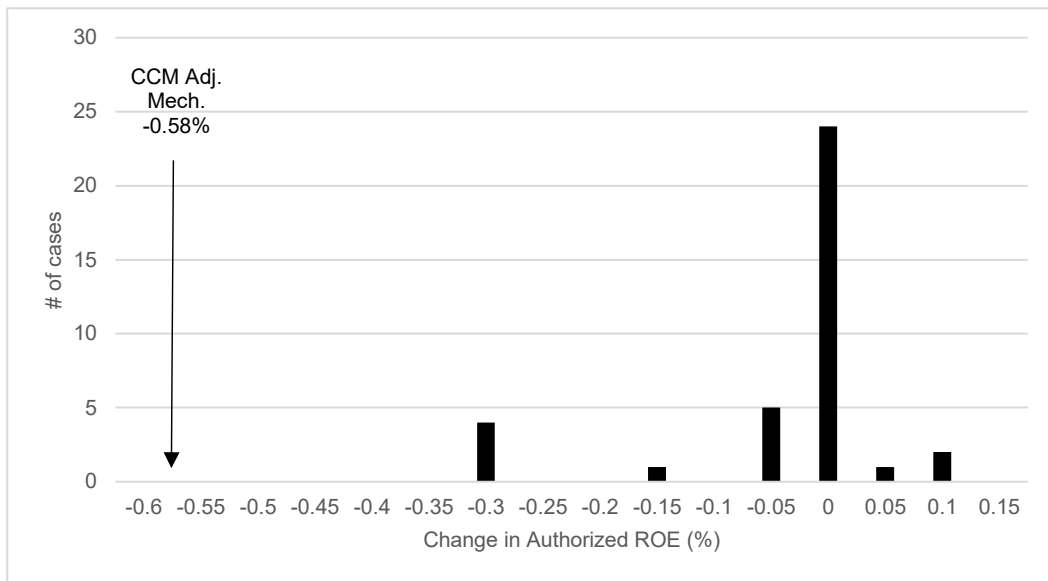
³¹ PCF (Ellis) at 46.

1 on which he relies demonstrates quarter-by-quarter fluctuations in the data of a greater
2 magnitude which points to the irregular timetable of specific utility rate cases.

3 More importantly, none of the intervening witnesses point to a decrease in authorized
4 ROEs to the degree that the CCM adjustment mechanism would reset the ROE for SDG&E.
5 The CCM adjustment mechanism would reduce the ROE by 58 basis points. By focusing on
6 individual companies that have received multiple ROE authorizations from 2019 through
7 2021, we can remove the underlying variables in quarterly and annually authorized ROE
8 summary data. As shown in Figure 4, in the United States, there were 37 instances of a
9 single utility filing multiple rate cases between 2019 and 2021. In 70 percent of these cases
10 authorized ROE was either unchanged (23 cases) or increased (3 cases). There were 11 cases
11 where the ROE was reduced, but even in these cases the maximum reduction was 32 basis
12 points and the average was 17 basis points.³² ROEs authorized across the United States
13 from 2019 to 2021 demonstrate that a 58-basis point decrease in SDG&E's authorized ROE
14 would be inconsistent with the underlying trends observed in the data. And that is without
15 considering SDG&E's greater risk than the average U.S. utility.

³² Source: Capital IQ Pro, Regulatory Research Associates.

1 **Figure 4: Histogram of Individual Company Changes in Authorized ROEs³³**



2
3 **Q. Given lower interest rates, are relatively stable ROEs consistent with past regulatory**
4 **practice and financial theory?**

5 A. Yes, they are. Mr. Gorman points to an increase in the equity risk premium given the
6 decline in interest rates, even when the assumed authorized ROE is set at the CCM
7 adjustment mechanism level of 9.62 percent. There is a long-standing and widely
8 recognized inverse relationship between interest rates and the equity risk premium.³⁴ While
9 Mr. Gorman points to the risk premium increasing even if SDG&E's authorized ROE were
10 reset at 9.62 percent, the authorized ROE data demonstrate that this would be an inadequate
11 equity risk premium compared to similarly situated utilities in the current interest rate
12 environment.³⁵

³³ Source: Capital IQ Pro, Regulatory Research Associates.

³⁴ I demonstrate this inverse relationship in my Direct Testimony (August 23, 2021) Figures 12 and 13 at JMC-47 – JMC-48, using 40 years of data for electric and gas utility allowed ROEs in relation to bond yields, and the relationship is -0.55 for electric utilities and -0.58 for gas utilities.

³⁵ See S&P Oct. 2021 at 5 (noting that state utility commissions have recently approved ROEs that contain a higher premium over Treasury bond yields than have historically prevailed because state commissions

1 **Q. How would the CCM adjustment mechanism ROE compare to recently authorized**
2 **return?**

3 A. An authorized ROE of 9.62 percent would be within 7 basis points of the 12-month trailing
4 average authorized ROE for electric utilities and gas utilities as of December 31, 2021.
5 However, in the Commission’s Decision in SDG&E’s last case, it concluded “that the
6 adopted ROE should be set at the upper end of the just and reasonable range.”³⁶ By
7 allowing the CCM adjustment mechanism to reset SDG&E’s authorized return, this would
8 contradict the Commission’s decision that an ROE at the upper end of the just and
9 reasonable range is appropriate. As discussed in my Opening Testimony, there are several
10 factors that have a direct bearing on SDG&E’s risk profile in relation to other utilities that
11 include: (1) the Company’s exposure to Wildfire Risks; (2) the Company’s substantial
12 capital expenditure program; (3) California’s clean energy mandates; and (4) regulatory risk
13 relative to other jurisdictions. As such, there is no basis to conclude that an ROE at the
14 upper end of the just and reasonable range is no longer appropriate for SDG&E. Mr.
15 O’Donnell recognizes that SDG&E’s risks have not decreased since the Commission’s 2019
16 Decision.³⁷ The CCM, under these circumstances, would negate the Commission’s finding,
17 be inconsistent with authorized ROE returns nationwide, and not provide an accurate
18 measurement of the cost of capital.

recognize that Treasury yields have been artificially suppressed by the Federal Reserve’s unprecedented intervention to respond to the pandemic).

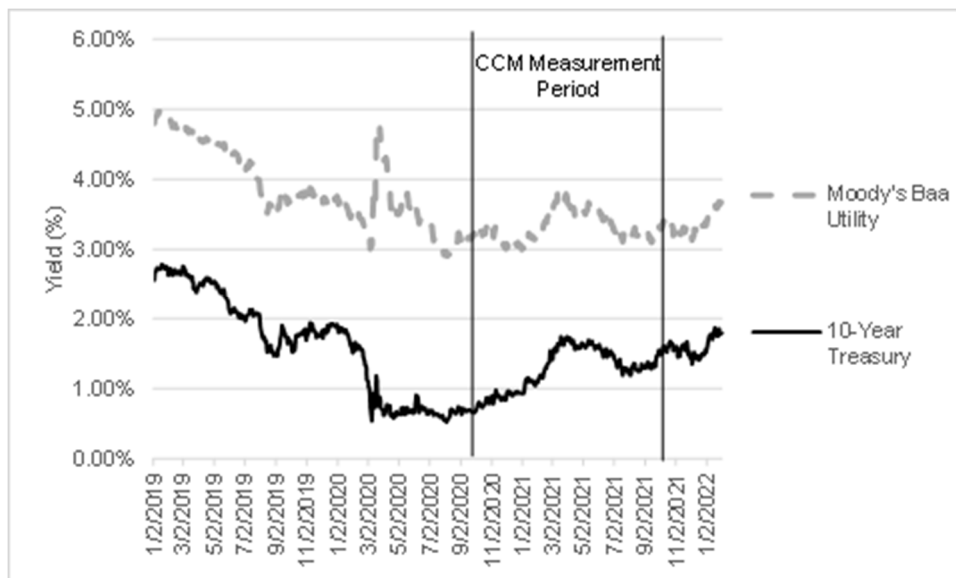
³⁶ D.19-12-056 at 42.

³⁷ FEA (O’Donnell) at 12.

1 **Q Would a return to “normal” markets in 2022 validate the use of the CCM for 2022?**

2 A. No, and that is one of the challenges with the CCM under these circumstances. The CCM is
3 based on a trailing measurement period from October 1, 2020 to September 30, 2021. As I
4 have discussed, this period was impacted by extraordinary events which have only partially
5 abated in 2022. The figure below illustrates this point, comparing 10-year Treasury and
6 Moody’s Baa Utility bond yields over the periods prior, during, and following the CCM
7 Measurement Period. The yields for both treasuries and utilities were driven down in response
8 to policies aimed at lowering interest rates to support the economic fallout from the pandemic.
9 As the economy has recovered, so have interest rates in response to increasing inflation and
10 federal Reserve announcements to ratcheting rate hikes. The CCM Measurement Period was
11 clearly impacted by these circumstances, which are reversing in 2022.

12 **Figure 5: 10-Year U.S. Government Treasury and Baa Utility Bond Yields**



13 Some intervenor witnesses focus on how economic conditions have normalized in 2022.³⁸

14 But these arguments underscore my point—that the conditions that led to the CCM triggering

15
³⁸ See, e.g. EPUC/IS (Gorman) at 10 (conditions largely abated over 2021); EPUC/IS (Gorman) at 33 (“[m]ore recent beta estimates suggest that as economy has recovered and has observable risk premiums

1 are abating. Focusing on the S&P Utility 500’s performance through the second half of 2021
2 and early 2022 (ignoring much of the CCM’s measurement period and incorporating data from
3 after that period),³⁹ or arguing that, “as of January 20, 2022, the gap between the S&P 500
4 Index and S&P Utilities Index has substantially closed,”⁴⁰ only underscores that utilities
5 underperformed the broader stock market through the pandemic and CCM measurement
6 period. Moreover, as intervenors acknowledge, the Federal Reserve is drawing back its
7 intervention and interest rates are increasing in response. The trailing Measurement Period
8 thus does not reflect investors’ expectations for 2022.

9 VI. CONCLUSIONS

10 Q. What conclusions do you reach from your examination of the intervenor evidence?

11 A. The intervenors have presented an interpretation of market data and accompanying
12 arguments that would minimize or ignore the extent of the extraordinary circumstances that
13 prevailed during the CCM measurement period. While the definition of extraordinary may
14 be subjective, an objective assessment of the market and economic data indicates a period of
15 unprecedented shifts in the economy, an unprecedented policy response, and unprecedented
16 movements in financial markets. The CCM was clearly not designed to navigate these
17 events and cannot be expected to produce a reasonable result. The evidence points to a cost
18 of equity that increased over the measurement period (as measured through Beta), or at a
19 minimum remained the same (as measured by allowed returns for other utilities)—in

between Treasury and utility bonds as a return to more normal levels, and also measures of beta have returned to more normal levels.”); EPUC/IS Gorman at 17 (Federal Reserve tightening monetary policy); EDF (McCann) at 9 (economy back to pre-pandemic levels); and PCF (Ellis) at 53 (gap between S&P and S&P utilities index closing by Jan 22, 2022).

³⁹ See, e.g., Gorman at 15, figure 1 (providing data from June 30, 2021 through January 16, 2022); WTF (Rothschild) at 30 and chart 8 (focusing on his proxy group’s performance from July 1, 2021 through December 30, 2021).

⁴⁰ PCF (Ellis) at 53.

1 contrast to interest rates that were driven to very low levels by the Federal Reserve's
2 unprecedented interventions. SDG&E was materially impacted and affected differently, as
3 evidenced by the increase in Beta and underperformance of utility stocks (and California
4 utility stocks in particular) relative to the market. The decrease in ROE and adherence to the
5 CCM would not produce a reasonable result under these circumstances, as the decline in
6 interest rates does not reflect a decline in ROE, undermining the basis for the CCM.
7 Moreover, the conditions that led to the CCM triggering based on events during the
8 measurement period are abating for 2022. As the CCM cannot function as intended for
9 2022, it should not be applied.

10 **Q. Does this conclude your Rebuttal Testimony?**

11 A. Yes, it does.