

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

Order Instituting Rulemaking to Implement
Public Utilities Code Section 451.2 Regarding
Criteria and Methodology for Wildfire Cost
Recovery Pursuant to Senate Bill 901 (2018).

Rulemaking 19-01-006
(Filed January 10, 2019)

**OPENING COMMENTS OF THE UTILITY REFORM NETWORK
ON THE ENERGY DIVISION STAFF PROPOSAL
FOR A STRESS TEST FRAMEWORK**



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SUMMARY OF RECOMMENDATIONS

Following is a summary of The Utility Reform Network's (TURN's) recommendations regarding the Staff Proposal, organized by the questions posed in the April 12, 2019 Ruling of Administrative Law Judge (ALJ) Haga. In these comments, TURN uses the term "Stress Test Costs" as that term is defined in the Staff Proposal.¹

Maximum Incremental Debt Capacity

- Targeting the midpoint of the financial ratios to determine a utility's maximum incremental debt capacity is unreasonable and would result in avoidable harm to ratepayers. Instead, the Commission should target the low end of the range in order to minimize harm to ratepayers, which would still enable a utility to maintain an investment grade credit rating.

Excess Cash

- When a utility is faced with potentially large catastrophic wildfire costs and expenses, a prudent utility should suspend its dividends in order to conserve cash flow, which would also signal to the Commission and the public that the utility has made a good faith effort to conserve cash and that it is not seeking Stress Test Costs from ratepayers unnecessarily. However, if the utility chooses to continue paying dividends prior to a Stress Test application, any dividends paid within a year prior to the application, at a minimum, must be counted toward Excess Cash (Component B of Customer Harm Threshold).

Regulatory Adjustments

- To prevent gaming of the Stress Test methodology by a utility, the regulatory adjustment should be plus or minus 20% of the disallowed costs in all instances.

¹ Workshop Slides: "Staff's Proposed Stress Test Methodology for Disallowed 2017 Catastrophic Wildfire Costs," April 10, 2019, as amended on April 17, 2019 ("Staff Proposal Slides"), Slide 6.

- A utility with a credit rating below investment grade should not be eligible for the Stress Test framework, unless the Commission accepts TURN's proposal (see Ratepayer Protection Measures below) to require full repayment of the Stress Test Costs to ratepayers. If the Commission applies the framework to a utility with a credit rating below investment grade, the regulatory adjustment should also be up to 20% of disallowed costs.

Application of Stress Test to a Utility Below Investment Grade

- A utility under bankruptcy protection should not be eligible for the Stress Test until it emerges from bankruptcy with an approved Plan of Reorganization.
- A utility with a credit rating below investment grade should not be eligible for the Stress Test framework, unless the Commission accepts TURN's proposal to require full repayment of the Stress Test Costs to ratepayers.

Ratepayer Protection Measures

- The Commission should adopt the following TURN proposal to require full repayment of any Stress Test Costs paid by ratepayers:
 - A utility would apply for Stress Test Costs and be evaluated according to the adopted methodology to determine if ratepayer payment of Stress Test Costs is warranted.
 - Suspension of dividend payment would be a condition of the utility receiving any Stress Test Costs from ratepayers.
 - The Stress Test Costs to be paid by ratepayers would be included in any securitized funding paid by ratepayers pursuant to Section 850 *et seq.* of SB 901. The utility would create a Stress Test Cost Balancing Account (STCBA) to track the portion of the securitized funding paid by ratepayers that reflects the Stress Test Costs approved by the Commission.
 - Upon the utility's determination that its financial status has sufficiently improved, the utility may file an application with the Commission in which it: (a) presents a plan to pay back to ratepayers the full amount of Stress Test Costs with interest

- over the remaining period of the securitized financing and (b) presents a plan to resume payment of dividends while maintaining an investment grade credit rating.
- The plan for repayment of the Stress Test Costs should include tracking in the STCBA the amounts that are repaid to ratepayers, which will ultimately equal the total of the Stress Test Costs paid by ratepayers including interest.
 - The plan shall ensure that, by the end of each year, the utility will not have paid aggregate dividends to common equity shareholders that exceed the aggregate amount of repaid amounts that have been recorded in the STCBA for the benefit of ratepayers, until the net of: (1) the amount collected from ratepayers under the securitization surcharge, and (2) the aggregate bill credit, is zero.²
 - The amounts repaid to ratepayers would be paid in a bill credit, levelized as much as possible to avoid bill fluctuations and structured as much as possible to reduce inter-temporal differences between ratepayers' payment of Stress Test Costs via securitized funding and the bill credits.
 - Upon a Commission decision approving the utility plan, including a finding that the utility has presented a reasonable plan for repaying the full amount of Stress Test Costs, with interest, to ratepayers, the utility may implement the plan to resume payment of dividends to shareholders.

Process

- TURN supports the sequencing in the Staff Proposal to require a determination of the amount, if any, of disallowed costs before Stress Test Costs can be determined.
- Regarding the required process in a future application seeking ratepayer payment of Stress Test Costs:
 - Absent adoption of TURN's proposal to require full repayment of Stress Test Costs paid by ratepayers, a utility would have a strong incentive to exaggerate the

² As TURN will demonstrate in its illustration in Attachment 2, depending on the actual amounts securitized, the bill credits to ratepayers could "catch up" with the aggregate surcharge collected from ratepayer under the securitization. In this case, the utility will simply need to keep providing bill credits equal to the securitization surcharge and could pay dividends higher than the annual securitization amount.

bailout amount, which constitutes free money for shareholders. Because of the high stakes and zero-sum nature of such a proceeding, ratepayers would be entitled to maximum due process protections, equal to or exceeding those provided in a typical general rate case (GRC).

- If TURN's proposal to require full repayment of Stress Test Costs is adopted, the process would likely be much less contentious and therefore capable of a much quicker determination, provided that the utility accepts its obligation to fully repay Stress Test Costs in accordance with TURN's proposal.

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“Where’s the accountability for the poor operations and the contributions to the fires? If you just look at it, it looks like a scenario where their operations could have been better, and now to fix those operations they just increase the rates. Why is the accountability falling on the ratepayers?”

- David Hoffman, Distinguished Professor of Leadership and Organizational Behavior, University of North Carolina, quoted in “PG&E Seeks Higher Rates to Counter Wildfire Risk”, *The New York Times*, April 24, 2019, p. B1.

I. INTRODUCTION AND SUMMARY OF COMMENTS

Pursuant to the April 5, 2019 Assigned Commissioner’s Ruling and the April 12, 2019 Administrative Law Judge’s (ALJ) Ruling (ALJ Ruling) which extended the date for opening comments to April 24, 2019, The Utility Reform Network (TURN) submits these opening comments on the April 5, 2019 Energy Division Staff Proposal for a Stress Test Framework (Staff Proposal).

The Staff Proposal is a thoughtful effort. It advances this proceeding by providing a sound six-element framework for developing the stress test methodology to be adopted by this case.³ Staff states that its proposed framework “prescribes a thorough examination of a utility’s financial ability to pay for the greatest share of disallowed wildfire liability costs while retaining

³ As reflected in the ALJ Ruling, those six elements are: Maximum Incremental Debt Capacity, Excess Cash, Regulatory Adjustments, Application of Stress Test to a Utility Below Investment Grade, Ratepayer Protection Measures, and Process.

a minimum investment grade credit rating,” while also offering “potential options to enable ratepayers to participate in a utility’s financial upside.”⁴

Despite its virtue as a comprehensive framework for eliciting party comment, the Staff Proposal ultimately weighs far too heavily in favor of utility interests and fails to adequately protect ratepayers. Section 451.2(b)⁵ obligates the Commission to achieve two goals in allocating wildfire liability costs resulting from utility imprudence: (1) avoiding a material impact to the utility’s ability to provide adequate and safe service, and (2) avoiding harm to ratepayers. As explained in TURN’s opening comments on the Order Instituting Rulemaking (OIR),⁶ ratepayers are harmed whenever they are required to pay a utility’s malfeasance in causing a wildfire. Thus, to the extent that the Staff Proposal allows a utility to obtain ratepayer funds to pay for its imprudence *without requiring full repayment of those funds as the utility’s financial condition allows*, the Staff Proposal would run afoul of Section 451.2(b) by forcing ratepayers to pay for a bailout of the utility.

In these comments, TURN will demonstrate that harm to ratepayers can be avoided while still achieving the Staff Proposal’s goal of maintaining a utility’s investment grade credit rating. The heart of TURN’s comments, presented in Section III.E below, is an alternative to the two ratepayer protections measures proposed by the Staff. TURN’s proposal rests on a simple fairness principle – a utility that has received bailout funding from ratepayers should not be able to resume paying dividends without simultaneously and fully repaying the bailout that enabled the utility’s financial turnaround. Thus, utility shareholders would effectively receive a loan from ratepayers to enable the utility to continue to provide safe and adequate service – a loan that

⁴ Staff Proposal, pp. 2-3.

⁵ All references are to the Public Utilities Code, unless otherwise indicated.

⁶ TURN Opening Comments on the OIR, p. 7.

will be fully repaid as the utility's improving financial condition frees up the cash needed both to pay dividends and repay ratepayers. TURN's proposal avoids the serious moral hazard problem that comes from giving a utility a windfall of free money to relieve its financial responsibility for imprudent operations. And it reduces the incentives under the Staff Proposal for a utility to manipulate its financial metrics to maximize bailout funding from ratepayers, since whatever amount the utility receives from ratepayers will need to be repaid in full. There are many other virtues to TURN's proposal, which are fully explained in Section III.E of these comments. The bottom line is that TURN's proposal is a complete ratepayer protection measure, in comparison to the uncertain and inadequate measures in the Staff Proposal.

TURN expects utilities and other skeptics to attempt to paint TURN's ratepayer protection proposal as infeasible and unrealistic. Such claims would be incorrect. In reviewing the Staff Proposal and preparing its alternative recommendations, TURN has carefully consulted with a utility financial expert with extensive expertise in utility cost of capital cases and related matters. In addition, TURN has taken care to provide a thorough explanation of the mechanics of the proposal and how it would work over time. To that end, TURN has prepared a detailed spreadsheet illustration, presented in Attachment 2 to these comments, that models the flow of funds among the utility and its ratepayers and shareholders, resulting in a full repayment of any stress test costs paid by ratepayers at the same time that dividends are being paid to shareholders. While shareholders would surely prefer higher dividends than TURN's proposal would allow during the repayment period, shareholders need to recognize that reduced dividends are vastly preferable to the complete wiping out of their equity in a utility bankruptcy. Moreover, a fair-minded shareholder would have to concede that it would be unconscionable for shareholders to

reap full dividends that have only been made possible because ratepayers have bailed out the utility they own.

In the comments below, after a background section that frames the legal and policy issues in this case, TURN responds to each of the questions in the ALJ Ruling. Where TURN disagrees with the choices made in the Staff Proposal, TURN offers its alternative recommendations and explains why they are superior.

II. SB 901 REQUIRES BOTH THE FACILITATION OF ONGOING UTILITY OPERATIONS AND THE AVOIDANCE OF RATEPAYER HARM

Section 451.2(b) provides that, when allocating wildfire liability costs resulting from utility imprudence, the Commission is required to determine the maximum amount the utility can pay without either: (a) harming ratepayers, or (b) materially impacting the utility's ability to provide adequate and safe service. The statute makes clear that both objectives must be achieved. Neither one is given priority over the other.

With respect to enabling the utility to provide adequate and safe service, TURN accepts the premise of the Staff Proposal that the Commission should endeavor to maintain an investment-grade credit rating for the utility.⁷ At the same time, the statute also requires that the Commission avoid harming ratepayers. As TURN explained in its opening comments,⁸ ratepayers are indisputably harmed if they are required to pay any amounts that utility

⁷ In accepting this premise, TURN emphasizes that, as the Staff Proposal recognizes, the Commission needs to retain discretion to make its own determination of the amount of liabilities a utility can pay, without effectively delegating that determination to the ratings agencies, which are private, non-governmental interests that are not accountable to California residents and are not charged with carrying out the public interest.

⁸ TURN Opening Comments on the OIR, p. 7.

shareholders are otherwise required to pay because of utility imprudence. Such amounts constitute a bailout, pure and simple.⁹

Reduced to its essence, the fundamental issue in this case is whether – and if so, by how much – ratepayers should bail out a utility for its imprudence in causing catastrophic wildfires in 2017. Under the Staff Proposal, Stress Test Costs¹⁰ paid by ratepayers have the potential to constitute a bailout to the extent that any such costs are not fully repaid to ratepayers. Absent repayment, utility shareholders would receive a windfall of free money at the expense of ratepayers. Giving the utilities free money to pay for the costs of their imprudence and mismanagement is exactly the wrong way to stop catastrophic wildfires. Bailouts create a serious moral hazard problem, by perversely rewarding the behavior that the State desperately needs to halt in order to prevent more catastrophic wildfires. Unless the stress test methodology is fashioned to avoid this ratepayer harm, the utilities will have a strong incentive to maximize the amount of free money they can obtain from their customers.

The Commission should also keep in mind that the customers who would be required to pay any bailout amount include large numbers of direct and indirect wildfire victims. In the case

⁹ Utilities and their supporters often assert that, absent a bailout, utilities will be “forced” to increase their cost of capital, which increases costs to ratepayers. Whether and how much a utility’s cost of capital will increase if it does not receive a desired bailout amount is entirely speculative at this point and should be addressed in the upcoming cost of capital cases. Moreover, this assertion assumes, incorrectly, that it is automatic that a utility’s cost of capital should increase if it is not reliably allowed to impose on ratepayers liability costs resulting from the utility’s imprudence. In fact, cost of capital increases should not be allowed in this instance, under the longstanding principle that it is neither just nor reasonable to make ratepayers pay higher rates resulting from a utility’s imprudence. Thus, TURN emphatically disputes the speculative factual claim that a utility’s cost of capital should or would increase under such circumstances. In any event, as described in these comments, TURN proposes that a utility be allowed to receive Stress Test Costs from ratepayers as needed to retain its investment grade credit rating, provided that those Stress Test Costs are repaid in full in concert with the resumption of dividend payments.

¹⁰ As shown in Staff Proposal Slide 6, “Stress Test Costs” represent the amount to be paid by ratepayers, calculated as the difference between “Disallowed Costs” and the costs below the “Customer Harm Threshold”, i.e., the costs that are allocated to the utility.

of the 2017 wildfire liability, the overlap between ratepayers and persons and businesses harmed by the fires is large and tragic. Dun and Bradstreet estimates that the 2017 wildfires negatively impacted more than 380,000 California businesses statewide in nine counties,¹¹ on top of the impact on individual households. All of these are certainly ratepayers. The 2018 Camp Fire destroyed almost 14,000 utility customer homes and over 500 commercial buildings,¹² and the Woolsey fire destroyed 1,500 customer homes.¹³ Any bailout of utilities, even one limited to 2017 wildfires at this point, would increase the bills for many of these households and businesses who are both wildfire victims and ratepayers, adding insult to injury.

The modifications to the Staff Proposal described in the remainder of these comments, particularly the repayment requirement detailed in Section III.E below, avoid ratepayer harm while preserving the utilities' ability to provide safe and adequate service. Rather than structuring the payment of Stress Test Costs as a bailout, under TURN's proposal, such costs effectively become a loan that is fully repaid as the utility regains its financial strength. In this way, TURN's recommendations fully satisfy both requirements of Section 451.2(b).

III. RESPONSES TO QUESTIONS IN ALJ RULING

A. Question 1: The Maximum Incremental Debt Capacity Should Be Set at a Level that Minimizes Harm to Ratepayers While Maintaining a Minimum Investment Grade Credit Rating for the Utility

Section 451.2(b) states that the Commission shall determine the maximum amount the corporation can pay "without harming ratepayers or materially impacting [the corporation's] ability to provide adequate and safe service."¹⁴ As noted above, TURN agrees with the Staff

¹¹ Impact of California Wildfires, Dun & Bradstreet, <https://www.dnb.com/utility-pages/businesses-impacted-from-california-wildfires-2017.html>

¹² http://cdfdata.fire.ca.gov/incidents/incidents_details_info?incident_id=2277

¹³ https://cdfdata.fire.ca.gov/incidents/incidents_details_info?incident_id=2282

¹⁴ Public Utilities Code Section 451.2(b).

Proposal that, in order to enable the utility to provide adequate and safe service, the Commission should be committed to maintaining an investment grade credit rating for the utility. At the same time, the statute also requires that the Commission avoid harming ratepayers. Thus, if the Commission is able to help the utility maintain an investment grade credit rating but also avoid harm to ratepayers, the Commission is required to do so. When determining the maximum incremental debt capacity for the utility (also referred to as Component A of the Customer Harm Threshold), the Staff Proposal recommends that the Commission target the midpoint of the desired financial ratios. For the reasons explained below, targeting the midpoint of the financial ratios is unreasonable and would result in avoidable harm to ratepayers, which is prohibited by Section 451.2(b). Instead, the Commission should target the low end of the range in order to minimize harm to ratepayers because doing so would still enable the utility to maintain an investment grade credit rating, as demonstrated below.

First, the financial ratio ranges in Table 4 of the Staff Proposal do not overlap (except the endpoints); therefore, targeting the midpoint is unreasonable since the utility would not be rated in a lower financial risk category if the financial ratio is near the endpoint. For example, a 13.1% FFO/Debt ratio, even though at the bottom of the “Significant” range, would not be classified as “Aggressive” using S&P’s Financial Risk Metrics.¹⁵ The Staff Proposal contends that targeting the midpoint is reasonable because the rating agencies have discretion.¹⁶ However, while the credit agencies have discretion over the non-financial factors, the financial ratio ranges use financial metrics that are objective measures and therefore not subject to similar discretion. If the utility can maintain an investment grade rating near the endpoint, then targeting

¹⁵ Staff Proposal, p. 8.

¹⁶ Staff Proposal, p. 7.

the midpoint unnecessarily increases harm to ratepayers by allocating a greater amount of disallowed costs to ratepayers than required. Using the example in the Staff Proposal, the utility could move to a FFO/Debt ratio of 13.1% instead of 18% and still stay within the same Significant rating for Financial Risk Profile and maintain an investment grade rating, which would mean an implied incremental debt capacity of an *additional* \$6 billion.¹⁷ That \$6 billion would increase Component A of the Customer Harm Threshold by \$6 billion and accordingly decrease the bailout amount by \$6 billion. Thus, under this scenario, by targeting the midpoint of the range, the Staff Proposal would require ratepayers to pay \$6 billion more than necessary to keep the utility at an investment grade rating.

Second, the non-financial factors can be expected to improve after a utility files a Stress Test application and is granted ratepayer funding for some of the disallowed costs. Prior to the application, the electric corporation is potentially liable for all of the disallowed costs without ratepayer assistance, which increases uncertainty in the utility's business and regulatory environments. In contrast, after the Commission resolves the Stress Test application, not only will ratepayers be required to assist as necessary to maintain an investment grade rating, the uncertainty around business and regulatory environment will also likely be reduced or eliminated. Hence, the non-financial factors are likely to improve, which would likely lift the utility to a higher investment grade level even if the low point of the financial ratio is targeted. Using the same example above from the Staff Proposal, if the business environment improves from Strong to Excellent, a FFO/Debt ratio of 13.1% would actually place it at a credit rating of A, four notches above the target minimum investment grade rating of BBB-.¹⁸

¹⁷ Staff Proposal, p. 8.

¹⁸ Staff Proposal, pp. 6, 8.

Third, as the utility's non-financial ratings become stronger, it can take on more debt and still maintain an investment grade credit rating, which the Staff Proposal Slides noted.¹⁹ Therefore, the incremental debt capacity can be expected to increase as the utility continues to regain a sounder financial footing. Targeting the midpoint of the financial ratio is unreasonable because as the utility's incremental debt capacity increases, the FFO/Debt and Debt/EBITDA ratios would also increase. Once again using the Staff's example, if the Commission targeted a midpoint of 18%, the FFO/Debt ratio could increase by 6% and end up at 24%, pushing the utility to a Financial Risk Profile of Intermediate, which results in a credit rating of A-/BBB+, two to three notches above the target minimum investment grade rating. Whereas if the Commission targeted a low end of 13.1%, the FFO/Debt ratio could increase by 6% and end up at 19.1%, which would be slightly above the midpoint of a Financial Risk Profile of Significant, giving the utility a credit rating of BBB, one notch above the target minimum investment grade credit rating. Thus, the utility would retain its investment grade rating, while imposing a significantly smaller amount of Stress Test Costs on ratepayers.

In conclusion, for the above reasons, it would be unjust and unreasonable for the Commission to target the midpoint of the financial ratios because doing so would result in undue harm to ratepayers while exceeding the minimum investment grade credit rating. Instead, the Commission should target the low end of the range in order to minimize harm to ratepayers, which would still enable the utility to maintain an investment grade credit rating.

¹⁹ Staff Proposal Slides, Slide 16.

B. Question 2: Any Dividends that the Utility Pays Out Within a Year Prior to the Stress Test Application Must Be Counted Toward the Excess Cash Component

The Staff Proposal recommends that cash or cash equivalents the utility can redirect to satisfy wildfire liabilities be added to the Customer Harm Threshold (as Component B), and that the utility's Stress Test application should address what levels of minimum cash are reasonably necessary to operate the business, including identifying cash proceeds from pending asset sales.²⁰ While TURN generally supports this approach, the Staff Proposal does not explicitly consider the crucial element of dividends. The utility should not be allowed to effectively reward its shareholders with dividends while asking ratepayers for a bailout. To discourage such patently unfair utility behavior, the Commission's adopted methodology should include a requirement that, at a minimum, any dividends paid within a year prior to a utility's Stress Test application will be counted toward Excess Cash (Component B).

Every dollar that a utility pays out as dividends reduces its cash or cash equivalents available to satisfy wildfire liabilities, which also means that every dollar that a utility pays out as dividends effectively lowers the Customer Harm Threshold and therefore increases the amount of disallowed costs that the ratepayers would pay. At the same time, Component A of the Customer Harm Threshold considers the utility's Funds from Operations (FFO) to Debt ratio and a Debt to Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) ratio, both of which are not affected by a dividend payout per the definition of these ratios.²¹ Thus, by issuing a dividend, a utility would be able to lower Component B of the Customer Harm

²⁰ Staff Proposal, pp. 8-9.

²¹ Staff Proposal, p. 7.

Threshold without increasing Component A, which effectively allows a utility to game the system and increase the amount ratepayers would pay while rewarding its shareholders.

Even though component C of the Customer Harm Threshold allows for regulatory adjustments, the effect of the regulatory adjustment is not large enough to deter a utility from issuing dividends prior to the Stress Test application, since the adjustment is only limited to 20% of the sum of Components A and B. For example, if Component A is \$3 billion and Component B is \$1 billion, the utility would be motivated to issue a dividend prior to the application because it could lower B by the full \$1 billion, while limiting its maximum regulatory adjustment exposure to \$0.6 billion (20% of \$3 billion). Indeed, there are many situations where the utility would be motivated to reduce Component B of the Customer Harm Threshold by issuing a dividend – which would lead to the unconscionable result that a utility’s shareholders would be able to increase the amount that ratepayers have to pay for the utility’s imprudence by paying themselves a dividend.

To mitigate this potential for gaming, the Commission should determine that when a utility files for a Stress Test determination, any dividends paid within a year prior to the application, at a minimum, will be counted toward Excess Cash (Component B). When a utility is faced with potentially large catastrophic wildfire costs and expenses, a prudent utility should suspend its dividends in order to conserve cash flow. If the utility chooses to suspend its dividend at least a year before a Stress Test application, it would signal to the Commission and the public that the utility has made a good faith effort to conserve cash and that it is not seeking Stress Test Costs from ratepayers unnecessarily. However, if the utility chose to continue paying dividends prior to a Stress Test application, any dividends paid should count toward Excess Cash for the aforementioned reasons.

C. Question 3: To Prevent Gaming of the Stress Test Methodology by the Utility, the Regulatory Adjustment Should Be Plus or Minus 20% of the Disallowed Costs in All Instances

For a utility with an above investment grade rating that submits a Stress Test application, the Staff Proposal recommends a regulatory adjustment up to 20% of the subtotal of Components A and B.²² While TURN supports the construct of a regulatory adjustment up to 20%, TURN urges the Commission to modify the proposal to allow the regulatory adjustment to be up to 20% of the disallowed costs, not 20% of the subtotal of Components A and B. Limiting the regulatory adjustment to 20% of the subtotal of Components A and B would severely limit the Commission's ability to exercise sufficient discretion and judgment when the Customer Harm Threshold amount is low, and it would also allow potential gaming of the framework by the utility to increase the amount that ratepayers would pay for the utility's imprudence.

If the regulatory adjustment is up to 20% of the subtotal of Components A and B, then by definition the smaller components A and B are, the smaller the potential regulatory adjustment, resulting in a limited Commission opportunity to exercise discretion and judgment. The Staff Proposal seems to recognize this limitation and states that if a utility is already at the minimum investment credit rating (or if already below investment grade), sum of components A and B could yield a Customer Harm Threshold that is very low or even zero.²³ In an attempt to remedy this problem, the Staff Proposal then proposes a 5% regulatory adjustment of the disallowed costs for these situations.²⁴

The Staff Proposal's remedy is insufficient. The bifurcated approach in the Staff Proposal should be rejected because it introduces a perverse incentive for the utility to

²² Staff Proposal, p. 9.

²³ Staff Proposal, p. 10.

²⁴ *Id.*

strategically time its Stress Test application in order to minimize its regulatory adjustment exposure and maximize the potential share of the disallowed costs that ratepayers may pay. Under this bifurcated approach, the utility would be incentivized to apply for the Stress Test when its incremental capacity for debt and cash/cash equivalents (Components A and B, respectively) are at or near zero, since the regulatory adjustment would only be up to 5% of the disallowed amount. Hence, by strategically timing the filing of its application, the utility can nearly ensure that shareholders will pay little, if any, more than 5% of the disallowed costs. This is illustrated by an example provided as part of the Staff Proposal Slides, where ratepayers end up paying 90% to 100% of the disallowed costs because the sum of Components A and B was only 5% of the disallowed costs.²⁵ Furthermore, a regulatory adjustment of 5% is not sufficient to account for all of the alternative cash-enhancing measures that the Staff Proposal states a utility should consider to satisfy disallowed wildfire costs (including but not limited to asset sales, financial policy enhancements, adjustments to dividend policies, assessment of equity flows to or from the parent corporation, and reducing or deferring discretionary spending).²⁶ With only 5% of the disallowed costs at stake, it is doubtful that the utility will marshal all available funds and exhaust all reasonable options to pay for claims resulting from utility imprudence before seeking ratepayer bailout as a last resort.

Instead, TURN's recommended approach of setting the regulatory adjustment at 20% of the disallowed costs in all instances would discourage potential gaming of the framework by the utility to minimize its regulatory adjustment exposure. If the utility knows that the Commission has discretion to adjust the Customer Harm Threshold by 20% of the disallowed costs at any

²⁵ Staff Proposal Slides, Appendix p. 3.

²⁶ Staff Proposal, p. 9.

time, it would not be incentivized to time its Stress Test application when its incremental debt capacity and cash/cash equivalents are zero or near zero in order to minimize its regulatory adjustment exposure. Furthermore, when the regulatory adjustment is up to 20% of the disallowed cost, the utility would be motivated to make a strong showing regarding alternative options that it has considered to satisfy disallowed wildfire costs before turning to the Stress Test application as a last resort.

As stated below in Section III.D, responding to Question 4, TURN strongly believes that utilities with credit ratings below investment grade should not be eligible for the Stress Test framework unless the Commission accepts TURN's proposal to require full repayment of the Stress Test Costs to ratepayers. If the Commission applies the framework to utilities with credit ratings below investment grade, the regulatory adjustment should be up to 20% of disallowed costs for the same reasons TURN explained above. Otherwise, the utility may have a perverse incentive to wait until it is at the minimum investment grade rating or even below investment grade before filing a Stress Test application.

D. Question 4: A Utility That Has Fallen Below Investment Grade Rating Should Not Be Eligible for the Stress Test Methodology

TURN will respond to Question 4 in the ALJ Ruling by addressing two separate cases: (1) a utility that has opted for bankruptcy protection; (2) a utility with a below-grade investment rating that has not chosen bankruptcy protection. In neither case should a utility be able to take advantage of the stress test methodology, for different reasons.

1. A Utility under Bankruptcy Protection Should Not be Eligible for the Stress Test

SB 901, which directed this rulemaking be opened to establish a Stress Test Methodology, was enacted to prevent utilities from going into bankruptcy as a result of wildfire liabilities in excess of their ability to pay.²⁷ A utility that voluntarily pursues bankruptcy subsequent to the passage of SB 901, for which utilities vigorously lobbied and advocated in all available venues, has broken faith with its customers, regulators, legislators and other industry participants by suggesting through its actions that its regulatory environment is untenable.

Application of the Stress Test methodology should not be made available to a utility whose credit ratings are below investment grade due to voluntary bankruptcy unless and until it has an approved Bankruptcy Plan of Reorganization (Bankruptcy Plan). Through the bankruptcy reorganization process, a Chapter 11 debtor may have more access to capital and resources than a utility that has simply been downgraded to junk status. It may be able to abrogate uneconomic contracts and obligations which it would be forced to honor and fund under other circumstances. Through bankruptcy, there is a clear procedural path under federal jurisdiction to resolve debts. Unlike a junk grade utility, the bankruptcy debtor's assets and liabilities are not known until there is an approved Bankruptcy Plan. Thus, as a practical matter, the determination of the Customer Harm Threshold cannot be reliably made without an approved Bankruptcy Plan which would incorporate all protections and special arrangements available from the Chapter 11 reorganization process, reflecting the most likely financial outlook for the utility going forward.

²⁷ California regulator lays groundwork for PG&E bailout, J.D. Morris, San Francisco Chronicle, 11/15/2018. <https://www.sfchronicle.com/california-wildfires/article/California-regulator-lays-groundwork-for-PG-E-13397247.php>

2. A Utility that Allows Its Credit Rating to Fall Below Investment Grade Should Not Be Eligible for the Stress Test, Unless the Commission Adopts TURN’s Ratepayer Protection Proposal

The Assigned Commissioner’s Scoping Memo in this proceeding states, “the goal of the Rulemaking [R.19-01-006] is to adopt criteria and a methodology for the Commission to use in future applications for cost recovery of wildfire costs.”²⁸ When a utility is facing significant wildfire liabilities and financial distress, a credit rating downgrade to below investment grade is neither an immediate nor foregone conclusion. As highlighted in the staff workshop presentation,²⁹ non-financial factors, in particular the regulatory and business environment facing a utility represent more than 50% of the weight in determining its public credit rating.

A key purpose of this proceeding, and other efforts by the State, is to demonstrate a regulatory commitment to providing a regulatory environment that enables a utility to maintain its investment grade credit rating. This means that the adoption through this proceeding of a credible mechanism to prevent credit default due to wildfire risks should prevent rating agencies from downgrading utilities exposed to wildfires based on subjective regulatory environment factors. All credit agencies maintain a formal “Watch List” indicating in real time their positive or negative disposition toward the creditworthiness of a company, and the ability of utilities as credit rating clients to request formal credit reviews to make their case for the highest possible ratings, should provide ample notice and opportunity for a utility to act before it is downgraded. Cash generating options available to the utility include:

- Taking tax benefits *at the utility level* rather than at the holding company. This will keep cash flow from favorable accounting treatments for net operating losses in the utility, and will increase internally generated cash to aid financial recovery.

²⁸ R.19-01-006, Assigned Commissioner’s Scoping Memo and Ruling, dated 3/29/2019, pg. 3.

²⁹ Staff Proposal Slide 8.

- Suspending bonuses for executive-level employees and senior management;
- Reducing or eliminated discretionary spending (both capital and expense) that is not necessary or cost-effective to meet immediate safety needs or otherwise essential-whether new or on-going programs.
- Suspending dividends throughout the claims payment period.
- Issuing new shares to raise equity capital where possible.
- Selling assets not needed in the core utility business as reviewed and approved by the Commission under Sections 851 and 854, such as real estate or fiber optic right of ways.
- Reviewing the efficiency of the current corporate structure including potential savings from collapsing holding company operations into the utility.

In light of these opportunities and the beneficial effects of the Commission’s commitment to adopting a Stress Test methodology that maintains investment grade credit ratings, a utility that nevertheless allows its credit rating to sink below investment grade should not be entitled to benefit from Stress Test Costs.

However, if the Commission accepts TURN’s proposal to require full repayment of the Stress Test Costs to ratepayers, TURN would not oppose extending the methodology to a utility even if its credit rating falls below investment grade.

E. Question 5: The Staff’s Well-Intended Ratepayer Protections Need Enhancement In Order to Prevent Unnecessary Ratepayer Harm

TURN is gratified that the Staff and Assigned Commissioner Picker have taken obvious care and consideration to develop concepts for measures that attempt to inject some ratepayer fairness into a patently unfair situation. As the Staff Proposal states, the Staff’s two concepts are designed “to mitigate the concern that equity holders are passing risk they have historically borne

to ratepayers.”³⁰ This is another way of stating that shareholders have always been responsible for paying costs resulting from imprudence and this case, per SB 901, is contemplating the unfair shifting of that risk to ratepayers. The Staff Proposal also recognizes that the utility benefitting from a bailout in order to maintain its investment grade credit rating will return to financial health and should not obtain a “windfall of all future upside.”³¹

However, the Staff’s two ratepayer protection concepts do not go far enough to address the identified inequities. The concepts are designed to provide *some* offsetting benefits to ratepayers using scales and decrements that can only be described as arbitrary. However, absent full repayment of Stress Test Costs, these concepts still allow the utility to obtain a significant amount of free money from ratepayers. A methodology that provides an incentive for utilities to maximize the amount of the windfall they receive from ratepayers exacerbates the moral hazard problem created by a bailout.

Accordingly, in the sections below, TURN outlines its alternative proposal for a ratepayer protection measure, one that satisfies the Commission’s goal of retaining an investment grade credit rating, while requiring the utility to repay the full amount of Stress Test Costs over time as the utility’s restoration to financial health allows. With this requirement, the utilities will know that, in the long run, they will not gain a windfall at ratepayer expense, which will have two highly salutary results: (1) utilities will not be financially rewarded for mismanagement and imprudence; and (2) utilities will not have an incentive to inflate the amount of Stress Test Costs they seek from ratepayers.

³⁰ Staff Proposal, p. 11.

³¹ Staff Proposal, p. 11.

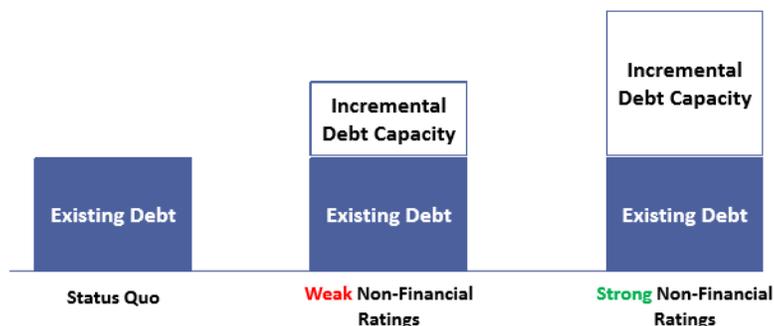
1. TURN's Alternative Ratepayer Protection Proposal to Require Repayment of Stress Test Costs Maintains an Investment Grade Credit Rating While Preventing Ratepayer Harm

TURN's ratepayer protection proposal begins with the unassailable principle that utility shareholders should not benefit from dividends if they are receiving a bailout from ratepayers. Simply put, if a utility can afford to pay a dividend, then it should not be eligible to obtain a customer-funded windfall of free money. Thus, TURN's proposal would not allow any utility to obtain any Stress Test Costs from ratepayers unless and until it has suspended the payment of dividends to shareholders. This will protect ratepayers by ensuring that all available cash stays in the business and offsets amounts that ratepayers would otherwise have to fund by freeing up shareholder cash for necessary capital and expense projects. And it will benefit the recovery of the utility by using internally generated cash to supporting the business where it is most needed, rather than flowing it out to investors.

Once Stress Test Costs have been authorized using the methodology approved in this case, the utility's financial condition will improve. As the graphic shown below from Slide 16 in the Staff Proposal recognizes, over time, the utility will be able to take on more debt and still maintain an investment grade credit rating. A utility receiving Stress Test funds can be expected to move from its initial position of financial distress to better financial metrics, and ultimately to full financial recovery with credit ratings in a more desirable range for investor-owned utilities.³²

³² Based on S&P Capital IQ as of January 22, 2019, for 157 U.S. Utility Operating Companies the credit rating breakdown is roughly 52% with a rating of A- rating or higher, and 38% in the BBB+ or BBB range. However considering just investor-owned electric utilities, Edison Electric Institute's (EEI) 2018 4Q Credit Rating Snapshot, indicates 26 out of 47 (55%) of electric utility credit ratings by S&P were BBB+ or BBB; 34% were rated A- or higher.
<http://www.eei.org/resourcesandmedia/industrydataanalysis/industryfinancialanalysis/QtrlyFinancialUpdates/Pages/default.aspx>.

Slide 16



Over time, the utility's capacity to finance its liabilities using its own balance sheet will increase, it will begin to generate free cash flow sufficient to support dividends, and its stock price will likely increase as noted in the Staff's equity warrant proposal.

In addition to the benefit of being freed from wildfire liability that would depress its financial metrics and constrain its debt capacity for capital investment and other on-going business needs, the utility will have access to tax benefits in the form of net operating loss carry forwards (NOLs). The net loss offsets taxable income that must be paid in the current year the liability is incurred, but potentially for multiple years in the future because the wildfire liability will likely be significantly larger than the current year's taxable earnings. When wildfire costs paid by the utility are then allocated to ratepayers as securitized Stress Test Costs, the amount of losses on the income statement may still be deducted by the utility in the year the liability is incurred. For example, a \$6 billion liability ultimately funded by ratepayers would still create a dollar-for-dollar deductible NOL offset of \$6 billion cash which the utility would use to reduce the amount of income taxes it will pay for many years into the future years. Left within the utility, that cash would typically be used in the place of debt or equity to fund capital

investments. These tax benefits, and related cash flow, will be an important means by which the utility will be able to regain its financial health.

TURN recognizes that dividends are important to certain classes of utility investors and that restoring dividends is a priority for utilities. However, a utility that has received Stress Test Costs and that is regaining its financial health should not be allowed to provide dividends to shareholders unless it has a plan to make ratepayers whole for the Stress Test Costs they have paid. TURN believes such a plan is both fair and feasible. TURN's proposal would work as follows:

- A utility would apply for Stress Test Costs and be evaluated according to the adopted methodology to determine if ratepayer payment of Stress Test Costs is warranted.
- Suspension of dividend payment would be a condition of the utility receiving any Stress Test Costs from ratepayers.
- The Stress Test Costs to be paid by ratepayers would be included in any securitized funding paid by ratepayers pursuant to Section 850 *et seq.* of SB 901. The utility would create a Stress Test Cost Balancing Account (STCBA) to track the portion of the securitized funding paid by ratepayers that reflects the Stress Test Costs approved by the Commission.
- Upon the utility's determination that its financial status has sufficiently improved, the utility may file an application with the Commission in which it: (a) presents a plan to pay back to ratepayers the full amount of Stress Test Costs with interest over the remaining period of the securitized financing and (b) presents a plan to resume payment of dividends while maintaining an investment grade credit rating.
- The plan for repayment of the Stress Test Costs should include tracking in the STCBA the amounts that are repaid to ratepayers, which will ultimately equal the total of the Stress Test Costs paid by ratepayers including interest.
- The plan shall ensure that, by the end of each year, the utility will not have paid aggregate dividends to common equity shareholders that exceed the aggregate amount of repaid amounts that have been recorded in the STCBA for the benefit of

ratepayers, until the net of: (1) the amount collected from ratepayers under the securitization surcharge, and (2) the aggregate bill credit, is zero.³³

- The amounts repaid to ratepayers would be paid in a bill credit, levelized as much as possible to avoid bill fluctuations and structured as much as possible to reduce inter-temporal differences between ratepayers' payment of Stress Test Costs via securitized funding and the bill credits.
- Upon a Commission decision approving the utility plan, including a finding that the utility has presented a reasonable plan for repaying the full amount of Stress Test Costs, with interest, to ratepayers, the utility may implement the plan to resume payment of dividends to shareholders.

TURN believes its alternative proposal enables the utility to maintain an investment grade credit rating while providing a mechanism whereby ratepayers can be fully repaid over time as the utility recovers financially. In this respect, TURN's proposal prevents the payment of Stress Test Costs from constituting a ratepayer funded bailout and therefore avoids the moral hazard problem with the Staff Proposal. TURN's proposal prevents utility shareholders from enjoying dividend payments until the utility can demonstrate a path to move the off-balance sheet stress test costs provided by ratepayers onto its own increasingly healthy balance sheet as essentially a regulatory obligation. Creation of this regulatory obligation would not damage the utility's key cash and credit ratios because the payment of cash dividends indicates the utility has excess cash that is not needed for redeployment in the business. Furthermore, an obligation to repay the Stress Test Costs, in contrast to the Staff's equity upside concept, would provide

³³ As TURN will demonstrate in its illustration in Attachment 2, depending on the actual amounts securitized, the bill credits to ratepayers could "catch up" with the aggregate surcharge collected from ratepayer under the securitization. In this case, the utility will simply need to keep providing bill credits equal to the securitization surcharge and could pay dividends higher than the annual securitization amount.

transparency and predictability around how ratepayers can expect to recover the Stress Test Costs they have paid. Use of a regulatory balancing account and bill credits employs a tried and true regulatory framework that is familiar to all stakeholders.

2. TURN Strongly Favors Its Proposal Over the Staff's Two Ratepayer Protection Concepts

While the intentions of the staff's two ratepayer protection concepts are laudable, both concepts at best provide only partially offsetting benefits to ratepayers. A Commission policy of anything other than making ratepayers whole creates an unfair windfall for utilities, rewarding imprudence and setting up an environment of on-going moral hazard that all but guarantees more bailouts in the future.

Apart from this overarching problem, each of the two proposed mechanisms raise concerns. In the case of ROE de-escalation, the benefits to ratepayers under the staff proposal are unclear. As the staff notes,³⁴ the application of ROE de-escalation while the utility is struggling to return to financial health is potentially damaging to ratepayer interests by increasing financing costs in an environment of rising utility capital investment requirements.

In the case of equity warrants, the ratepayer upside is speculative and the implementation complex. Ratepayers' upside payout is dependent on the stock price rising precipitously, based on the assumption that utility management will make prudent decisions going forward so as not to depress the stock — an outcome not borne out in recent history made even less credible by the moral hazard set up by the bailout. The logistical issues associated with implementation include the following:

³⁴ Staff Proposal Slide 21

- Equity prices fluctuate, going both up and down; so the value to ratepayers of the warrants may change significantly over a short period of time, even after the utility has recovered financially. This means that warrants may or may not generate a significant return for ratepayers; in contrast, TURN's repayment amount is a known quantity that will fully offset the stress test costs paid by ratepayers.
- If actual rights are issued, there would need to be a sale to monetize their benefits, the timing of which, if public, would expose the trust to market speculation; in addition, unless carefully managed, the transaction size could depress the stock price on sale.
- Assuming the equity rights were non-voting shares, this would create a large passive exposure for ratepayers with little or no control over management actions, which may feel more like doubling down on utility risk exposure than a protection from utility risk.
- Assuming the equity rights are actual voting shares, this could trigger large shareholder reporting requirements and increased proxy wars depending on the size of the ownership stake ratepayers ultimately hold.
- The equity trust must be administered by a third-party trustee who must be fully and transparently vetted so as to be clear of conflicts of interest both with regard to the management of the trust but also with respect to the utility.
- The use of an equity trust lacks precedent and may require substantial time, effort, and cost to structure, implement, administer and report on over time.

In comparison to these two mechanisms, TURN's ratepayer repayment proposal best protects the interests of ratepayers because it restores the economic position they would have enjoyed absent having to pay Stress Test Costs for the utility in the first place. And given the justifiable ratepayer outrage at subsidizing utility imprudence, it is important that the mechanism by which ratepayers are protected be transparent and easily explained, which is a clear virtue of TURN's proposal.

3. TURN's Alternative Proposal Is Fully Consistent with Maintaining an Investment Grade Credit Rating and Otherwise Feasible

TURN's alternative proposal protects ratepayers by aligning utility interests with the goal of repaying ratepayers. TURN's plan targets cash flow that would otherwise be paid to shareholders in dividends. This cash will fund an offsetting bill credit to ratepayers to repay the securitization with interest over a term up to the initial term of the securitization. TURN's plan fully supports both the SB 901 securitization and the public policy goal of investment grade utilities. Under TURN's proposal, ratepayers will still pay the securitization surcharge as provided for in SB 901 fully and timely over the life of the bonds. When the utility is healthy enough to begin repaying the stress test amounts, ratepayers will receive an offsetting credit on their bills. The bill credit and the SB901 surcharge will remain independent and separate cash streams.

Under the TURN proposal, utility credit quality will be maintained. The suspension of dividends along with the extra internal cash generated by the NOL tax benefits will improve financial metrics and credit ratings. While utility credit ratings may be lower than in the absence of ratepayer repayment, they will always be above investment grade when the utility elects to pay dividends. By definition, the payment of shareholder cash dividends indicates there is internally generated cash in excess of what is needed by the utility to support operations, investment, and necessary access to capital markets. The utility's desire to pay dividends to its shareholders will provide an incentive for management to make prudent decisions that limit risk going forward, so that it will have the near-term cash to increase dividends while repaying ratepayers. This is well-aligned with ratepayers' interest in safety, repayment, and financially healthy utilities who are able to finance their own liabilities on their own balance sheet going forward.

Beyond the foregoing, TURN's plan offers many important additional benefits, including but not limited to:

- TURN's repayment proposal is tied to the utility's ability to resume dividends to shareholders, which is an objective and reliable measure of financial health.
- TURN's plan lets the utility's management undertake ratepayer repayment through an application to the Commission when *the utility* believes it is healthy enough to pay dividends.
- TURN's proposal does not arbitrarily force a regulatory obligation on an ailing utility's balance sheet. Rather, TURN's proposal recognizes that the ability to pay cash dividends is a clear signal a utility has recovered and there is sufficient excess cash to maintain investment grade ratings.
- Unlike the ROE de-escalation concept, TURN's proposal does not put additional potential stress on credit measures by reducing earnings on rate base investments and associated internally generated cash at a time of financial distress.
- TURN's plan for ratepayer protection does not rely on a single large "balloon payment" which would put stress on the utility's financial measures and counter-productively jeopardize its investment grade credit ratings. Instead, TURN proposes to make ratepayers whole incrementally, over time.
- Unlike an equity trust to hold and sell publicly traded securities, all parties and stakeholders are familiar with the operation and administration of balancing accounts for repaying money to ratepayers.
- By constraining the level of annual shareholder dividends so that it cannot exceed the ratepayer repayment amounts until ratepayers are made whole, TURN's proposal creates a mechanism that is highly likely to result in ratepayers being fully repaid.
- There is Commission precedent for constraints on a utility's payments to shareholders pending repayment of debt. In the Commission plan to help SCE avoid bankruptcy related to the 2001 Energy Crisis, a condition of its approved

recovery was to pay energy creditors by suspending its common stock dividend and using these funds to pay liabilities.³⁵

Utility shareholders may object that TURN's proposal would require them to accept lower dividends than if they benefitted from a bailout from ratepayers. However, equity investors should recognize that another potential outcome, as illustrated by the PG&E bankruptcy, is the complete eradication of any shareholder value. Long-term value investors rationally ought to prefer a reduction in dividend to the complete loss of the value of their equity. Moreover, a fair-minded shareholder would have to concede that it would be unconscionable for shareholders to reap full dividends that have only been made possible because ratepayers have bailed out the utility they own. By these lights, a sharing of cash available for dividends between shareholder and ratepayer is a reasonable compromise that meets the twin goals of Section 451.2(b).

Overall TURN believes its proposal goes a long way toward transparently protecting ratepayers under extraordinary circumstances while recognizing the importance of utility financial health and credit worthiness. In preparing this proposal, TURN availed itself of substantial expertise including that of TURN's financial expert Michael P. Gorman, a member of the consulting firm, Brubaker & Associates, Inc., whose qualifications are attached as Attachment 1.

³⁵ Southern California Edison Dodges Bankruptcy Bullet, *Electric Light & Power*, dated 11/1/2001, by Kathleen Davis, Associate Editor: <https://www.elp.com/articles/print/volume-79/issue-11/features/industry-news/southern-california-edison-dodges-bankruptcy-bullet.html>

4. To Assist the Commission, TURN Has Modeled an Illustration of Its Full Stress Test Cost Repayment Proposal

To help the CPUC better understand the mechanics of TURN's proposal and its feasibility, TURN has prepared an illustrative example (attached as Attachment 2) modeling how ratepayers would be repaid while dividend payments resume. The example uses illustrative values for utility rate base, ROE and potential disallowed costs. Rather than attempting a detailed forecast of utility cash, TURN's illustrative model uses earnings on rate base as a proxy for distributable cash and assumed tax benefits arising from NOLs at the level of disallowed costs. TURN has applied conservative assumptions consistent with the ranges of rate base, authorized ROEs, targeted dividend payout ratios, and level of dividends recently observed in the public financial statements of California's two largest investor owned utilities. Those assumptions include:

- Rate base compound annual growth of approximately 6% for 12 years with flat rate base thereafter for the remaining years of the 20-year securitization period³⁶.
- Utility ability to resume paying dividends five years or less after receiving Stress Tests Costs.³⁷
- Distributable earnings cash payout ratio of 45%³⁸ allocated between ratepayers and shareholders until the Stress Test Cost Balancing Account (STCBA) reaches a zero net balance.

TURN applies these assumptions to a scenario of:

³⁶ TURN believe this is a conservative assumption as the CPUC website shows that CPUC jurisdictional weighted average rate base has increased approximately 6.8% over the 10 years ended 2016. Source: <http://www.cpuc.ca.gov/General.aspx?id=12092>. In public statements to the investment community, PG&E and SCE have forecast capital investment CAGRs ranging from 7%-9%.

³⁷ In their respective recoveries from the California Energy Crisis of 2001, PG&E resumed dividends roughly 5 years after suspension and SCE resumed dividends after 3 years.

³⁸ TURN believes a payout of 45% to be conservative relative to the typical payout ratios within the utility industry and recent public statement by PG&E and SCE to the investment community regarding their dividend targets.

- Total disallowed costs of \$6 billion.
- Stress Test Costs, including securitization fees, of \$4.9 billion.
- Securitization of \$ 4.9 billion at 5% interest for 20 years.

TURN's illustration shows that once a utility is in a position to resume dividends to shareholders, stress test amounts can be fully repaid over time under TURN's proposal. While the period for ratepayer repayment will necessarily depend on the amount of stress test costs approved by the Commission, protecting ratepayers from an unjust bailout of utility imprudence is an achievable public policy goal. This is a goal the Commission must pursue under Section 451.2(b) because maintaining healthy utilities and repaying ratepayers to avoid ratepayer harm are not mutually exclusive objectives.

5. Question 6: Process³⁹

6. TURN Supports the Sequencing in the Staff Proposal to Require a Determination of the Amount, If Any, of Disallowed Costs Before Stress Test Costs Can Be Determined

The Staff Proposal wisely would require a determination of the amount of disallowed wildfire costs before a utility could request Stress Test Costs.⁴⁰ As the Staff correctly points out, if no wildfire liability costs are disallowed, no Stress Test determination is needed, conserving the resources of the Commission and the parties.⁴¹ In addition, because the Commission should have up-to-date financial information when it decides the amount of Stress Test Costs and

³⁹ With respect to the process for *this* proceeding, TURN continues to believe that evidentiary hearings are necessary in order to address disputed and material issues of fact regarding the feasibility and financial impacts of the proposed methodologies, as TURN explained previously in its Opening Comments on the OIR (p. 14) and at the Prehearing Conference (Reporter's Transcript, pp. 23-24). Accordingly, TURN hereby renews its request for evidentiary hearings in this proceeding.

⁴⁰ Staff Proposal, p. 13.

⁴¹ *Id.*

because that decision cannot be made until the amount of disallowed costs has been determined, it does not make sense for a utility to be allowed to request a Stress Test determination until that threshold step has been completed.

7. The Process Would Need to Be Highly Rigorous and Protective of the Due Process Interests of Ratepayers If the Adopted Methodology Allows a Bailout That Is Not Fully Repaid; In Contrast, Requiring Full Repayment of Stress Test Costs Would Allow a Much More Streamlined Process

For various reasons discussed above, most notably the failure to require full repayment of any Stress Test Costs paid by ratepayers, the Staff Proposal would give utilities a huge incentive to manipulate both the timing of their requests and the financial showing made in support, in order to maximize the amount of free money they can obtain from ratepayers. As a result, and because billions of dollars of ratepayer bailout funding could be at stake, ratepayer representatives would demand the opportunity for the highest level of scrutiny of the utility requests and would be entitled to maximum due process protections, equal to or exceeding those provided in a typical general rate case (GRC). As in a GRC, a utility's bailout request would need to be supported by complete testimony and workpapers that meet the utility's threshold burden of proof. Non-utility parties would then be entitled to a full opportunity to conduct the necessary discovery and analysis in order to prepare quality responsive testimony, which given the high stakes, would likely require six months or longer, depending on the sufficiency of the utility's initial showing. Assuming the utility seeks rebuttal testimony, which can often be extensive in rate cases, non-utility parties should then have the opportunity for adequate discovery on the rebuttal in order to prepare for evidentiary hearings. Those hearings, and the ensuing opening and reply briefs should be expected to be highly contentious and litigious because of the high stakes and the zero-sum nature of the bailout that would be at issue. In sum,

if the Staff Proposal were adopted, the “rapid determination” anticipated in the Proposal would be entirely unrealistic.⁴² Instead, the Commission should expect the Stress Test determination to require a full year or longer between submission of the request and the Commission decision, in order to comply with due process requirements in what could be one of the biggest dollar rate cases in CPUC history. And regardless of the outcome, as in the SDG&E wildfire prudence review case (A.15-09-010), the Commission should expect applications for rehearing and court appeals, further extending the process and the consumption of Commission and party resources.

In contrast, if TURN’s proposal to require full repayment of Stress Test Costs is adopted, the process would likely be much less contentious and therefore capable of a much quicker determination. Provided that the utility accepts its obligation to fully repay those costs in accordance with TURN’s proposal, the utility would have a reduced incentive (as compared to the Staff Proposal) to manipulate the timing and the showing in its application in order to increase the Stress Test Costs paid by ratepayers. Instead, the utility would know that it would ultimately not obtain any financial benefit from attempting to inflate its need for ratepayer funding. Under these circumstances, less scrutiny of the utility request would be needed than would be the case under the Staff Proposal. Although discovery, testimony and evidentiary hearings might still be needed to resolve any disputed issues of material fact, such disputes should be minimal or non-existent in a proceeding in which ratepayers can expect to be made whole by the end of the securitization period. Thus, adoption of TURN’s proposal would likely facilitate a much more rapid determination and initiation of payment of Stress Test Costs than under the Staff Proposal.

⁴² Staff Proposal, p. 13.

IV. CONCLUSION

For the reasons set forth above, TURN urges the Commission to adopt the recommendations described in these comments and summarized in the Summary of Recommendations.

Dated: April 24, 2019

Respectfully submitted,

By: _____/s/_____
Thomas J. Long

Thomas J. Long, Legal Director
David Cheng, Staff Attorney
Jennifer Dowdell, Energy Analyst
THE UTILITY REFORM NETWORK

ATTACHMENT 1

Qualifications of Michael P. Gorman

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140,
3 Chesterfield, MO 63017.

4 **Q PLEASE STATE YOUR OCCUPATION.**

5 A I am a consultant in the field of public utility regulation and a Managing Principal with
6 the firm of Brubaker & Associates, Inc. ("BAI"), energy, economic and regulatory
7 consultants.

8 **Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK
9 EXPERIENCE.**

10 A In 1983 I received a Bachelor of Science Degree in Electrical Engineering from
11 Southern Illinois University, and in 1986, I received a Master's Degree in Business
12 Administration with a concentration in Finance from the University of Illinois at
13 Springfield. I have also completed several graduate level economics courses.

14 In August of 1983, I accepted an analyst position with the Illinois Commerce
15 Commission ("ICC"). In this position, I performed a variety of analyses for both formal
16 and informal investigations before the ICC, including: marginal cost of energy, central
17 dispatch, avoided cost of energy, annual system production costs, and working
18 capital. In October of 1986, I was promoted to the position of Senior Analyst. In this
19 position, I assumed the additional responsibilities of technical leader on projects, and

1 my areas of responsibility were expanded to include utility financial modeling and
2 financial analyses.

3 In 1987, I was promoted to Director of the Financial Analysis Department. In
4 this position, I was responsible for all financial analyses conducted by the Staff.
5 Among other things, I conducted analyses and sponsored testimony before the ICC
6 on rate of return, financial integrity, financial modeling and related issues. I also
7 supervised the development of all Staff analyses and testimony on these same
8 issues. In addition, I supervised the Staff's review and recommendations to the
9 Commission concerning utility plans to issue debt and equity securities.

10 In August of 1989, I accepted a position with Merrill-Lynch as a financial
11 consultant. After receiving all required securities licenses, I worked with individual
12 investors and small businesses in evaluating and selecting investments suitable to
13 their requirements.

14 In September of 1990, I accepted a position with Drazen-Brubaker &
15 Associates, Inc. ("DBA"). In April 1995, the firm of Brubaker & Associates, Inc. was
16 formed. It includes most of the former DBA principals and Staff. Since 1990, I have
17 performed various analyses and sponsored testimony on cost of capital, cost/benefits
18 of utility mergers and acquisitions, utility reorganizations, level of operating expenses
19 and rate base, cost of service studies, and analyses relating to industrial jobs and
20 economic development. I also participated in a study used to revise the financial
21 policy for the municipal utility in Kansas City, Kansas.

22 At BAI, I also have extensive experience working with large energy users to
23 distribute and critically evaluate responses to requests for proposals ("RFPs") for
24 electric, steam, and gas energy supply from competitive energy suppliers. These
25 analyses include the evaluation of gas supply and delivery charges, cogeneration

1 and/or combined cycle unit feasibility studies, and the evaluation of third-party
2 asset/supply management agreements. I have participated in rate cases on rate
3 design and class cost of service for electric, natural gas, water and wastewater
4 utilities. I have also analyzed commodity pricing indices and forward pricing methods
5 for third party supply agreements, and have also conducted regional electric market
6 price forecasts.

7 In addition to our main office in St. Louis, the firm also has branch offices in
8 Phoenix, Arizona and Corpus Christi, Texas.

9 **Q HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?**

10 A Yes. I have sponsored testimony on cost of capital, revenue requirements, cost of
11 service and other issues before the Federal Energy Regulatory Commission and
12 numerous state regulatory commissions including: Arkansas, Arizona, California,
13 Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas,
14 Louisiana, Michigan, Mississippi, Missouri, Montana, New Jersey, New Mexico, New
15 York, North Carolina, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Texas,
16 Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming, and before
17 the provincial regulatory boards in Alberta and Nova Scotia, Canada. I have also
18 sponsored testimony before the Board of Public Utilities in Kansas City, Kansas;
19 presented rate setting position reports to the regulatory board of the municipal utility
20 in Austin, Texas, and Salt River Project, Arizona, on behalf of industrial customers;
21 and negotiated rate disputes for industrial customers of the Municipal Electric
22 Authority of Georgia in the LaGrange, Georgia district.

1 Q PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR
2 ORGANIZATIONS TO WHICH YOU BELONG.

3 A I earned the designation of Chartered Financial Analyst (“CFA”) from the CFA
4 Institute. The CFA charter was awarded after successfully completing three
5 examinations which covered the subject areas of financial accounting, economics,
6 fixed income and equity valuation and professional and ethical conduct. I am a
7 member of the CFA Institute’s Financial Analyst Society.

ATTACHMENT 2

Illustrative Example of TURN's Proposal to Require Full Repayment of Stress Test Costs to Coincide with Resumption of Dividends to Shareholders

As a demonstration of the mechanics and feasibility of its proposal, TURN has developed an illustrative example described in the spreadsheet appearing at the end of this Attachment. The following discussion will walk through this example line-by-line.

Beginning with the assumptions in the TURN RATEPAYER PROTECTION ILLUSTRATIVE ASSUMPTIONS box on the top left side of the spreadsheet:

- The first item is Disallowed Costs (shown on line 1). For the illustrative purposes of TURN's example, these are assumed to be \$6 billion.
- Applying a purely illustrative assumed Customer Harm Threshold of \$1,100 on line 2, results in the amount to be securitized shown on line 3.
- Lines 4 through Line 8 give assumptions for:
 - Securitization interest rate (line 4) and debt term (line 5)
 - The dividend suspension period (line 6). This is the elapsed time during which the utility would be retaining cash with the company in order to recover its financial health and credit metrics.
 - The average long-term payout ratio (line 7) is the percentage of Earnings Cash that the utility targets to distribute to shareholders rather than using to directly support operations.
 - Line 8 is the blended California state and federal tax rate at which the utility pays current cash income taxes. It is used to determine the cash value of the NOLs.
- Line 9 shows the years starting at the first year of the securitization. TURN's proposal assumes that ratepayers will be repaid within the securitization period. This means that if the securitization period is 20 years and dividends are deferred for 5 years (as in this example), ratepayers would need to be made whole over 15 years or by the time the securitization bonds were paid off by the surcharge on bills.

- As explained in the comments, TURN did not attempt to forecast utility cash in detail. Rather it used earnings on equity rate base as a proxy for cash earnings.
 - Illustrative levels of weighted average CPUC jurisdictional rate base is shown on line 10.
 - An Illustrative ROE of 10%, intended to represent the low end of CPUC authorized utility returns in California, is shown on line 11.
 - Authorized equity ratio shown on line 12 is assumed to be 50%
 - For each year Base Earnings on Rate Base (line 13) is calculated by taking Rate Base times ROE times Equity Ratio.
- In addition to base earnings on equity rate base, TURN also considered cash from wildfire-related net operating losses (NOL) and the reduction in cash income tax payments as these are applied to future years. Estimates of these amounts are shown on line 14.
 - The NOL cash on line 14 is estimated as the “gross-up” on the Base Earnings on Rate Base. This is the difference between line 13 divided by (1 minus the blended tax rate) and line 13 itself.
 - In TURN’s illustration, NOLs are applied to create tax benefits until the total of line 14 equals the amount of the disallowance. Since the disallowance is equal to all of the wildfire tax losses when this total is exhausted, TURN has assumed the utility would have no more NOLs to apply.
- Line 15 shows the accumulated cash benefit of suspending dividends and tax savings. This is a subset of the cash shown in line 16 which is the cash from which the utility could elect to pay dividends. Typically, in times of financial distress, utilities suspend their dividends to conserve cash. As discussed in the comments, this cash is retained in the company and serves to accelerate financial recovery by internally financing some capital that would ordinarily be supported by debt. This improves debt coverage ratios and helps to increase credit ratings over time.
- Line 16 totals line 13 and line 14. This shows the cash from which the utility may elect to pay dividends and repay ratepayers.

- Line 17 shows the payment amount of the securitization expressed as an annuity with a term of 20 years (line 5) and an interest rate of 5% (line 4). It is shown as a negative amount to be paid by ratepayers per SB 901 in each of the 20 years.
- Line 18 shows the minimum payment amount to pay off the securitization over the remaining term following the period of dividend suspension.
- Line 19 indicates the payout ratio assumed in line 7.
- Line 20 is the amount of cash available for dividends and repayment of ratepayers (Line 16) multiplied by the percentage the company targets as dividend payout ratio (line 19)
- Ratepayer allocations (line 21) and shareholder allocation (line 22) show how under TURN’s proposal the cash in line 20 might be split between these two stakeholder classes to pay back ratepayers.
- Annual shareholder dividends are shown in line 23 by year. The aggregate amounts received are shown in line 24.
- Similarly, ratepayer annual bill credits are shown in line 25. The aggregate amounts ratepayers have received is shown in line 26.
- Line 27 aggregates the total amounts paid by ratepayer via the securitization surcharge. This is the running total of line 17. TURN compares this amount to line 26, the aggregate bill credit received to determine the aggregate net remaining amount ratepayers are owed in each year (line 28).
 - Depending on the amount of the securitization, the math may work out so that ratepayer’s bill credits have canceled out their securitization surcharges before the securitization is paid off. This is true when line 28 equals zero but there is still remaining surcharge.

In addition to the year by year analysis just discussed, TURN’s illustration also includes some key measures shown in the “TURN RATEPAYER PROTECTION EXAMPLE SUMMARY RESULTS” box at the top right. These boxed numbers highlight the short-term nature of the liquidity constraints resulting from the wildfire liabilities:

- Over time that there is significant cash (nearly \$50 billion in TURN’s illustrative example) generated by the utility over time—plenty to repay ratepayers.

- Tax benefits from NOLs are an important source of cash for financial recovery and ratepayer repayment and should not be allowed to create a windfall for shareholders.
- TURN's proposal leaves plenty of cash to be paid to shareholders in dividends (more than \$9 billion in this example).

TURN PROPOSAL ATTACHMENT 2

TURN RATEPAYER PROTECTION ILLUSTRATIVE ASSUMPTIONS		
1	Total Disallowed Costs (in \$MM)	\$6,000
2	less Customer Harm Threshold Assumption (in \$MM)	\$1,100
3	Total Securitization (in \$MM)	\$4,900
4	Average interest rate on Securitization (1)	5%
5	Term of Securitization (2)	20
6	Dividend Suspension Period (3)	5
7	Average Long-term Targeted Payout Ratio (4)	45%
8	Blended State and Federal Tax Rate (5)	28%

TURN RATEPAYER PROTECTION EXAMPLE SUMMARY RESULTS			
	Totals Year 1-20		Totals Year 1-20
Base ROE Earnings Cash Flow (in \$MM)	\$42,900	Total Cost of Securitization to Ratepayers	(\$7,800)
Wildfire-Related Tax Benefits (in \$MM)	\$6,000	Total Ratepayer Credits	\$7,800
Total Earnings Cash Flows Available for Ratepayers and Shareholders (in \$ MM)	\$48,900	Net Due to Ratepayers by End of Securitization Term	\$0
Total Dividends Paid to Shareholders by End of Securitization Term (in \$MM)	\$9,424	Accumulated Cash from Dividend Suspension to increase credit metric and return utility to health prior to starting ratepayer repayment (in \$MM)	\$6,418
Average Ratepayer Share of Total Earnings Cash Flows	45.1%		
Average Shareholder Share of Total Earnings Cash Flows	54.9%		

TURN RATEPAYER PROTECTION NUMERICAL ILLUSTRATION																						
	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	YEAR 11	YEAR 12	YEAR 13	YEAR 14	YEAR 15	YEAR 16	YEAR 17	YEAR 18	YEAR 19	YEAR 20		
10	Total Weighted Average CPUC Jurisdictional Ratebase in \$MM	\$25,000	\$28,000	\$30,000	\$34,000	\$36,000	\$40,000	\$43,000	\$44,000	\$45,000	\$46,000	\$47,000	\$48,000	\$49,000	\$49,000	\$49,000	\$49,000	\$49,000	\$49,000	\$49,000	\$49,000	
11	Average Authorized ROE (6)	10.00%																				
12	% Equity	50%																				
13	Base Earnings at ROE in \$MM	\$1,250	\$1,400	\$1,500	\$1,700	\$1,800	\$2,000	\$2,150	\$2,200	\$2,250	\$2,300	\$2,350	\$2,400	\$2,450	\$2,450	\$2,450	\$2,450	\$2,450	\$2,450	\$2,450	\$2,450	
14	Estimated Tax Benefits from NOL	\$6,000	\$486	\$544	\$583	\$661	\$700	\$778	\$836	\$856	\$556	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	
15	Accumulated Cash From Dividend Suspension and Tax Savings (7)	\$6,418	1,049	1,174	1,258	1,426	1,510	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
16	Earnings Cash Flow Available for Ratepayers and Shareholders	1,736	1,944	2,083	2,361	2,500	2,778	2,986	3,056	2,806	2,300	2,350	2,400	2,450	2,450	2,450	2,450	2,450	2,450	2,450	2,450	
17	Annual Annuitized Cost of Securitization (P&I) in \$ MM	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	(\$390)	
18	Minimum Annuitized Amount to Repay Ratepayers within the Securitization Term (8)	\$480																				
19	Target Payout Ratio	0%	0%	0%	0%	0%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	45%	
20	Distributable Cash Available for Ratepayers and Shareholders	\$0	\$0	\$0	\$0	\$0	\$1,250	\$1,344	\$1,375	\$1,263	\$1,035	\$1,058	\$1,080	\$1,103	\$1,103	\$1,103	\$1,103	\$1,103	\$1,103	\$1,103	\$1,103	
21	Ratepayer % of Distributable Cash (9)	0%	0%	0%	0%	0%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%	35%	35%	35%	35%	35%	
22	Shareholder % of Distributable Cash	0%	0%	0%	0%	0%	50%	50%	50%	50%	50%	50%	50%	50%	51%	65%	65%	65%	65%	65%	65%	
23	Annual Shareholder Dividend	0	0	0	0	0	625	672	688	631	518	529	540	551	551	557	713	712	713	713	712	
24	Aggregate Shareholder Dividends	0	0	0	0	0	625	1,297	1,984	2,616	3,133	3,662	4,202	4,753	5,304	5,861	6,574	7,286	7,999	8,712	9,424	
25	Annual Bill Credit Paid to Ratepayers	\$0	\$0	\$0	\$0	\$0	\$625	\$672	\$688	\$631	\$518	\$529	\$540	\$551	\$551	\$546	\$390	\$390	\$390	\$390	\$391	
26	Aggregate Bill Credits Returned to Ratepayers	\$0	\$0	\$0	\$0	\$0	\$625	\$1,297	\$1,984	\$2,616	\$3,133	\$3,662	\$4,202	\$4,753	\$5,304	\$5,850	\$6,240	\$6,630	\$7,020	\$7,410	\$7,800	
27	Aggregate Securitization Payments	(\$390)	(\$780)	(\$1,170)	(\$1,560)	(\$1,950)	(\$2,340)	(\$2,730)	(\$3,120)	(\$3,510)	(\$3,900)	(\$4,290)	(\$4,680)	(\$5,070)	(\$5,460)	(\$5,850)	(\$6,240)	(\$6,630)	(\$7,020)	(\$7,410)	(\$7,800)	
28	Aggregate Net Due to Ratepayers	(\$390)	(\$780)	(\$1,170)	(\$1,560)	(\$1,950)	(\$1,715)	(\$1,433)	(\$1,136)	(\$894)	(\$767)	(\$628)	(\$478)	(\$317)	(\$156)	\$0	\$0	\$0	\$0	\$0	\$0	

EXPLANATORY NOTES ON ASSUMPTIONS AND ANALYSIS:

(1) Assumes high end of financing range from 3-5%

(2) Per Staff Proposal Exhibits

(3) Based on historical dividend suspension periods of 3-5 years, assuming high end of observed range from California Energy Crisis of 2001

(4) Based on stated target payout ratios from investor presentations by SCE and PG&E (3/19)

(5) Assumes Federal corp tax rate of 21%; California state tax rate of 9%. The blended state and federal rate is 21% + ((1-.21) X 8.84%)=28.0%

(6) Low end of current CPUC authorized ROE range

(7) For the period of dividend suspension before the utility begins repaying ratepayers, the utility will help to repair its credit rating ratios through higher levels of internally generated cash. This cash will come from retained cash that would otherwise be divvied out to shareholders and tax benefits from NOLs that will reduce cash income tax payments. This cash may be used to reduce borrowing needs leading to lower debt levels and higher credit ratings all else being equal.

(8) Minimum annuity payment to repay securitization amount plus interest based on the remaining term of the bonds when dividend payment are resumed.

(9) Assumes that ratepayer credit must be at least the annuity amount to repay the securitization in the remaining term of the bonds and shareholder dividends cannot exceed annual ratepayer bill credit