Company: San Diego Gas & Electric Company (U 902 M)
Proceeding: 2026 Cost of Capital
Application: A.25-03-XXX
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PREPARED DIRECT TESTIMONY OF

VALERIE A. BILLE

POLICY OVERVIEW

ON BEHALF OF SAN DIEGO GAS & ELECTRIC COMPANY

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

March 20, 2025

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I. INTRODUCTION AND SUMMARY OF PROPOSALS

My testimony provides an overview of San Diego Gas & Electric Company's ("SDG&E" or "Company") test year ("TY") 2026 application for a newly authorized cost of capital ("COC") for SDG&E's California Public Utilities Commission ("Commission" or "CPUC") operations, including detailing how SDG&E's above-average risk compared to utilities outside California informs SDG&E's cost of capital proposals.

I am an officer for SDG&E. This Application applies to SDG&E's electric distribution, gas distribution, and gas transmission businesses, together with the electric generation and the electric and natural gas procurement functions.[1] SDG&E proposes a Return on Equity ("ROE") of 11.25%, a capital structure ratio of 54% common equity and 46% long term debt, and an overall Rate of Return ("ROR") of 8.21%. These proposals are consistent with financial modeling and capital market data demonstrating that the cost of equity for utilities, and SDG&E in particular, has increased with the rise in interest rates. And they are reflective of SDG&E's above-average risks and SDG&E's longstanding actual capital structure to prudently manage those risks. In fact, Moody's in March 2025 stated that SDG&E is only "weakly positioned" at SDG&E's current credit rating, due to concerns about wildfire risk—including the wildfire fund's durability—increased regulatory lag, and cost recovery concerns.[2] SDG&E's proposals here will help buttress SDG&E's credit ratings, supporting lower borrowing costs for customers.

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[1] The return on electric transmission is not included since its governing regulatory agency is the Federal Energy Regulatory Commission ("FERC").

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

II. SDG&E'S PROPOSED COST OF CAPITAL

For 2026, SDG&E proposes the following cost of capital.

Table 1 – Proposed 2026 Authorized Cost Of Capital

Component	Capital Ratio	Cost	Weighted Cost
Long-Term Debt	46.00%	4.62%	2.13%
Preferred Stock	0.00%	6.22%	0.00%
Common Equity	54.00%	11.25%	6.08%
ROR	100%	N/A	8.21%

The Company's currently authorized cost of capital, as set in Commission Decision ("D.") 22-12-031 ("2023 CoC Phase 1 Decision") and last modified in D.24-10-008 (the "2023 CoC Phase 2 Decision"), is shown below.

Table 2 – Currently Authorized Cost of Capital

Component	Capital Ratio	Cost	Weighted Cost
Long-Term Debt	45.25%	4.34%	1.96%
Preferred Stock	2.75%	6.22%	0.17%
Common Equity	52.00%	10.23%	5.32%
ROR	100%	N/A	7.45%

If adopted, SDG&E's proposals will increase the Company's currently authorized rate of return by 0.76%, which will result in an estimated $96.45 million revenue requirement increase.[3]

[3] SDG&E's revenue requirement impact is illustrative and will be updated as a result of the final outcome of this proceeding. The revenue requirement impact calculated using an imputed 2026 rate base from the 2024 General Rate Case (GRC) since the adopted post-test year (PTY) mechanism did not authorize a specific rate base for the 2025-2027 PTY period. In addition to the cost of capital components, the revenue requirement calculation reflects the adjustment associated with the equity rate base exclusion for wildfire mitigation capital expenditures required by Assembly Bill ("AB") 1054, as adopted by the Commission in Resolution E-5071.

As noted, SDG&E's requests are informed by the Company's actual capital structure, sound financial modeling, capital market data, and other qualitative and quantitative analyses from SDG&E and independent sources such as equity analysts, credit rating agencies, and state utility commissions' cost of capital authorizations. The Company's testimony supports its cost of capital proposals. While my testimony highlights the findings of the Company's witnesses, each witness sponsors the recommendations in their areas of responsibility. My testimony also, in conjunction with the testimony of Joshua Nowak, details SDG&E's above-average risk compared to utilities outside of California and why it supports the Company's requests.

III. SDG&E'S ROE SHOULD BE SET AT 11.25 PERCENT TO APPROPRIATELY REFLECT THE COST OF EQUITY AND SDG&E'S ABOVE-AVERAGE RISKS

Mr. Nowak provides SDG&E's ROE proposal of 11.25 percent. Mr. Nowak's recommendation is eminently supportable—given Mr. Nowak's quantitative analysis showing an ROE range of 10.50-11.50 percent, the current high-interest rate environment, the increase in authorized ROEs nationwide, and the above-average risks that SDG&E faces relative to the proxy group as detailed both here and Mr. Nowak's testimony. In particular, as noted, SDG&E faces extreme wildfire liability risk that has only further increased following the Eaton Fire, along with increased regulatory and financial uncertainty as identified by Moody's.

To invest in the wires, poles, pipelines and substations needed to deliver clean, safe, and reliable electricity and/or natural gas to customers, SDG&E raises funds by either issuing debt or selling equity. Both methods have costs. The company pays interest to debt creditors on borrowed funds. Or it pays a portion of its profits or dividends to equity investors, *i.e.*, shareholders. These costs are known as the cost of capital.

Capital markets are competitive. Investors will only choose to invest with SDG&E to fund critical projects for wildfire mitigation, grid modernization for electrification, and other critical safety and reliability programs for gas and electric operations if SDG&E presents a reasonable return on those investments relative to the Company's risks. As the Commission recently reiterated, the "legal standard for setting the fair rate of return has been established by the United States Supreme Court in the *Bluefield* and *Hope* cases."[4] The Commission continued that return must thus be set at a level that is comparable to the return for other businesses with corresponding risks.[5] As the Commission added, the "issue of affordability as it relates to the cost of capital is subsumed under the *Hope* and *Bluefield* standards. Consideration of affordability beyond the *Hope* and *Bluefield* standards risk undermining them."[6]

That is, if ROE is set too low it harms both ratepayers and shareholders, as investors will invest in other companies that have the same return with lower risk profiles[7]—preventing adequate investments in needed areas like wildfire mitigation, grid modernization, and pipeline safety. And it can lead to increased financial leverage and/or credit rating downgrades, raising costs for customers.[8] As the Commission has recognized, a strong investment grade credit rating—which is based on the soundness of the Company as an investment—benefits both the utility and ratepayers.[9] The riskier that SDG&E is considered as an investment, the more expensive it is for the Company

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4 D.24-10-008 at 30 (citing *Federal Power Com. v. Hope Natural Gas Co.,* 320 U.S. 591, 601 (1944); *Bluefield Co. v. Pub. Serv. Comm'n*, 262 U.S. 679, 692 (1923)).

5 D.24-10-008 at 30.

6 *Id.*

7 Prepared Direct Testimony of Joshua C. Nowak - Return on Equity on Behalf of SDG&E (March 2025) ("Ex. SDG&E-03 (Nowak)") at JCN-16 – JCN-20; *see* D.22-12-031 at 15 (the Commission "attempt[s] to set the ROE at a level of return commensurate with market returns on investments having corresponding risks and adequate to enable a utility to attract investors," ensuring a return that is "reasonably sufficient to ensure confidence in the financial soundness of the utility, and adequate, under efficient management, to maintain and support its credit and to enable it to raise the money necessary for the proper discharge of its public duties.").

8 *See* D.22-12-031 at 15 (finding that ROR must be set at a level to "maintain and support" a utility's credit rating).

9 D.12-12-034 at 7-8.

to raise capital—because it has to compensate bond and stock holders for that increased risk—through higher interest rates, a higher return on equity or, most likely, both.[10]

Ratepayers ultimately bear these costs. For example, the fact that SDG&E's credit ratings remain at least two notches below the A rating that SDG&E possessed through 2018 -through no fault of its own but instead stemming from the perceived increased risk environment in California-results in higher costs for both SDG&E and its customers. If SDG&E's credit rating is downgraded further—as Moody's March 2025 report suggests—that would only increase those costs more.

To determine a reasonable return on equity for SDG&E, Mr. Nowak applied the results of three ROE-models (DCF, CAPM, and Risk Premium) to a proxy group of 26 investment-grade, dividend-paying electric and/or combined electric and gas utilities to establish a just and reasonable ROE range.[11] He found a reasonable range for the proxy group to be 10.50-11.50 percent. As Mr. Nowak noted, interest rates have dramatically increased and remain high over the past several years in response to the Federal Reserve's focus on record high inflation following the COVID-19 pandemic.

Although the Federal Reserve has reduced the federal funds rate from a high of 5.25 percent to 5.50 percent in August 2024 (the highest level in the last 20 years) to its current target of 4.25 percent to 4.50 percent, the Federal Reserve maintained that rate level at its January 2025 and March 2025 meetings and remains concerned about "elevated inflation."[12] As a result, as S&P's Regulatory Research Associates (RRA) has found, the average authorized ROE by state regulatory

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[10] *See* D.03-12-035 at 42 ("the cost of investment grade debt is considerably less . . . the lower cost of a utility's debt translates into lower rates, all else being equal." (citation omitted)).

[11] Ex. SDG&E-03 (Nowak) at JCN-3 – JCN-4.

[12] *Id.* at JCN-14 – JCN-16.

commissions has continued to increase in response to elevated interest rates.[13] Specifically, the average authorized ROE for electric utilities was 9.74 percent in 2024 compared to 9.60 percent in 2023 (and 9.54 percent in 2022 and 9.39 percent in 2021); an increase in over 30 basis points since 2021.[14]

Mr. Nowak then considered SDG&E's risk profile—as described both by Mr. Nowak and in my testimony here—to develop an ROE recommendation within that range. Mr. Nowak concluded that SDG&E's above-average risk compared to other regulated utilities outside of California—principally with regards to wildfire and wildfire liability risk—supports an ROE in the top half of Mr. Nowak's range. Mr. Nowak thus recommended an ROE of 11.25 percent, at the midpoint of the upper half of the zone of reasonableness.

IV. SDG&E'S ABOVE AVERAGE RISKS COMPARED TO UTILITIES OUTSIDE OF CALIFORNIA SUPPORT ITS COST OF CAPITAL PROPOSALS

As noted, I detail SDG&E's above-average risks which, in conjunction with Mr. Nowak's testimony, support SDG&E's proposal for an 11.25% ROE and 54% common equity ratio.

A. SDG&E Faces Unique Wildfire Risks

1. SDG&E's Above Average Wildfire and Wildfire Liability Risk

Despite SDG&E being considered a "leader in wildfire prevention,"[15] California electric utilities face unique risks related to catastrophic wildfires in California from a combination of the higher risk of wildfires in California and the threat of massive uninsured and unrecoverable losses

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13 RRA, Major energy rate case decisions in the US January-December 2024 at 4 ("In 2024, the average authorized returns for electric and gas utilities rose moderately compared to 2024, driven by a higher interest-rate environment.").

14 *Id.*; RRA, Major energy rate case decisions in the US January-December 2023 at 1; *cf.* D.22-12-031 at 32-33 (citing nationwide state commission authorized ROE averages for 2021 and 2022 and "recogniz[ing] that since the 2020 Test Year Decision, there has been a continued downward trend for the authorization of ROE for peer utilities in the United States, representing a downward trend of 20-30 basis points.").

15 S&P Global Ratings, San Diego Gas & Elec. Co. (June 26, 2024) ("S&P June 2024") at 2.

for California investor-owned utilities due to California's application of "inverse condemnation" to utility-caused wildfires. This legal doctrine makes a California utility strictly liable for any wildfire resulting from the utility's equipment, regardless of fault.

Regarding the former, as S&P states, "California wildfires have been increasing in intensity and frequency, occurring in all seasons, and spreading into more densely populated areas, resulting in more structural and infrastructure damage then in the past."[16] As S&P recently added, "[e]nvironmental factors are a negative consideration in our credit rating analysis of SDG&E, reflecting ***above-average*** physical risk compared with peers because of wildfires in California, which may also experience drought-like conditions."[17] And S&P has likewise noted that SDG&E faces a "high threat of wildfires in its service territory relative to utility peers across North America."[18]

Wildfire risk is now a nearly year-round threat in California. "Wildfires are increasing in size and intensity in the Western United States, and wildfire seasons are growing longer."[19] Climate change has both lengthened wildfire seasons and increased fire potential with the amount of available dry fuels.

According to Cal Fire, seventeen of the State's twenty most destructive wildfires in recorded history have been subsequent to 2007—including the Eaton and Palisades fires in January 2025

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[16] S&P Global Ratings, Credit Risks Associated with Wildfires Are Increasing for California Public Finance Entities (Feb. 20, 2025) ("S&P Feb. 20, 2025") at 1, available at https://www.spglobal.com/ratings/en/research/articles/250220-credit-risks-associated-with-wildfires-are-increasing-for-california-public-finance-entities-13421042.

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

[18] S&P, Sempra Outlook Revised to Negative, Ratings Affirmed; Southern California Gas Downgraded, Outlook Stable (Jan. 9, 2025) ("S&P Jan. 9, 2025") at 2.

[19] *See* The New York Times, Hotter Summer Days Mean More Sierra Nevada Wildfires, Study Finds (November 17, 2020), available at https://www.nytimes.com/2021/11/17/climate/climate-change-wildfire-risk.html.

already being the second and third most destructive fires in California history.[20] As credit rating agencies note, this increased duration of wildfire season and the higher frequency of wildfire-prone conditions has increased the opportunities for a utility's equipment to be involved in an ignition, expanding the risks both for the utility bearing costs and/or not obtaining cost recovery.[21] The ten most destructive wildfires in the history of the U.S. based on insured losses have all occurred in California.[22] Due to California's higher population density, higher property values, and many new housing developments being constructed near or in the what the CPUC has determined to be "High Fire Threat Districts," damages caused by wildfires in California are more costly than in other states.

This concern is particularly acute in San Diego. The Federal Energy Management Agency last fall ranked San Diego County as the most at-risk California county for wildfires.[23] The CPUC has classified 57% of SDG&E's service territory as being in a High Fire Threat District.[24]

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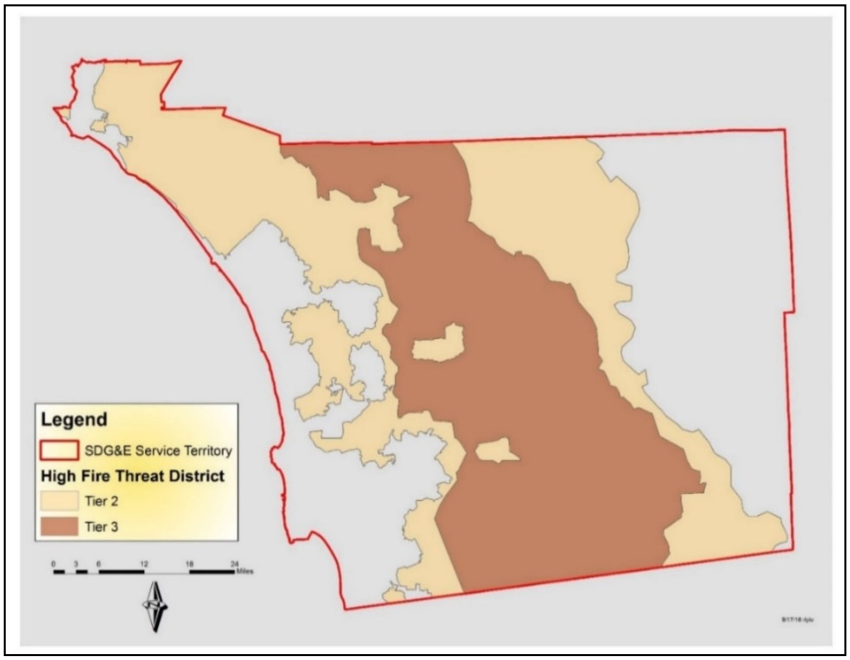
[20] *See* Cal Fire, Statistics, available at https://www.fire.ca.gov/our-impact/statistics.

[21] Moody's Investor Services, San Diego Gas & Elec. Co., (Dec. 4, 2023) ("Moody's Dec. 2023") at 1, 7.

[22] *See* Insurance Information Institute, Facts + Statistics: Wildfires, available at https://www.iii.org/fact-statistic/facts-statistics-wildfires.

[23] *See* FEMA, National Risk Index, available at https://hazards.fema.gov/nri/report/viewer?dataLOD=Counties&dataIDs=C06073,C06065,C06025,C06071,C06079,C06029,C06111,C06083,C06037,C06059,C06107,C06031,C06053,C06019,C06027,C06039,C06085,C06001,C06013,C06087#SectionRiskIndex; *see also* ABC 10 News San Diego, FEMA ranking shows San Diego County tops list of most at risk for Wildfires in Southern California, available at https://www.10news.com/news/local-news/fema-ranking-shows-san-diego-county-tops-list-of-most-at-risk-for-wildfires-in-southern-california#:~:text=FEMAranks%20San%20Diego%20County,to%20date%20with%20possible%20evacuations.

[24] *See also* Moody's March 2025 at 8 ("According to SDG&E's 2023-2025 base wildfire plan, about 64% of its service territory is within High Fire Threat Districts subject to conditions with an increased potential for wildfires.").



This enhanced wildfire threat is exacerbated by inverse condemnation, which, as noted, makes California electric utilities strictly liable for liability damages if their facilities were a contributing cause to the wildfire, even if the utility was not negligent.[25] These liabilities may include homeowner insurance claims, uninsured property damage claims, business interruptions, agricultural damages, emotional harm, personal injuries, and other losses. Strict liability can also result in far more potential damages for the same event than under a contributory negligence scheme.

In 2007, the Witch, Guejito, and Rice fires were associated with SDG&E's equipment. SDG&E settled approximately $2.4 billion of the $4 billion in total damage claims. But SDG&E was only able to offset that liability with an insurance reimbursement of $1.1 billion, cost recovery

[25] S&P Feb. 11, 2025 at 1; *accord* Moody's Dec. 2023 at 7 (Under inverse condemnation, "utilities are strictly liable for damages from fires ignited by their equipment, regardless of fault or how reasonably they acted.").

of almost $80 million, and settlements with third parties of $827 million, due to the Commission denying cost recovery for the same wildfires where FERC found that SDG&E acted prudently.[26]

SDG&E has not experienced a catastrophic wildfire in its service territory since 2007. Nevertheless, the combination of high wildfire risk and the significant costs associated with that risk have resulted in SDG&E's credit ratings in 2018-2019 being reduced two notches below the A- credit rating that SDG&E had in 2018 from all three credit rating agencies following significant wildfires in the state in 2018-2019 and Pacific Gas and Electric Company ("PG&E") on January 29, 2019 filing for Chapter 11 bankruptcy protection based, at least in part, on risk and potential liability from wildfires.[27]

That is, S&P found that SDG&E "has developed a 17-year track record of not causing a significant wildfire (in part due to its robust wildfire mitigation practices)."[28] As S&P added, SDG&E has "develop[ed] and implement[ed] sophisticated analytics and an advanced wildfire warning system that includes weather stations and fire cameras, which aids the fire mitigation efforts."[29] Moody's similarly recently noted "SDG&E's track record of effective wildfire risk

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[26] *See SDG&E*, 146 FERC ¶ 63,017, P 60 (FERC's finding that SDG&E was prudent on the same conduct and granted recovery, determining that even if SDG&E's presumption of prudence was not dispositive, the recovery of SDG&E's wildfire costs was valid because SDG&E would likely be held responsible for such costs under inverse condemnation regardless of fault); *see also* Moody's March 2025 at 9 ("in the case of SDG&E's 2007 wildfires, while the CPUC denied recovery, the FERC rule that SDG&E acted prudently and allowed the recovery of the wildfire costs.").

[27] *See* PG&E Corporation, PG&E Files for Reorganization Under Chapter 11 (January 29, 2019), available at http://www.pgecorp.com/news/press_releases/Release_Archive2019/190129press_release.shtml.

[28] S&P Feb. 11, 2025 at 1; *accord* S&P Jan. 9, 2025 at 2 ("In addition, we expect SDG&E to remain a global leader in wildfire prevention and mitigation given the high threat of wildfires in its service territory relative to utility peers across North America.").

[29] S&P Feb. 11, 2025 at 1; *accord* Moody's December 2023 at 8 (SDG&E's "practices include aggressive vegetation management, replacing wood poles with steel poles, increasing situational awareness with an extensive network of high-tech alter cameras . . . and weather stations, year round access to several firefighting helicopters as well as the utility's contribution to develop the Santa Ana Wildfire Threat Index.").

mitigation."[30] Nevertheless, SDG&E's credit ratings were repeatedly downgraded in 2018 and early 2019 due to the unique risk from wildfires and wildfire liability related to inverse condemnation in California compared to utilities outside the state.

Table 3 - SDG&E's Credit Ratings 2018-2024

Agency	Date	Rating
S&P	Jul 9, 2018	A
	Sep 5, 2018	A-
	Jan 21, 2019	BBB+
Moody's	Apr 11, 2018	A1
	Sep 6, 2018	A2
	Mar 5, 2019	Baa1
	Mar 30, 2021	A3
Fitch	Apr 20, 2018	A
	Sep 13, 2018	A-
	Jan 22, 2019	A-
	Mar 11, 2019	BBB+

In sum, as S&P recently stated, despite viewing SDG&E as a "global leader in wildfire prevention," S&P assesses SDG&E's business risk profile at the "lower end of our range for the excellent category" because "the threat of wildfires in its service territory [i]s high relative to that of its utility peers across North America."[31]

2. AB 1054 Helps Mitigate—But Does not Eliminate—SDG&E's Above Average Wildfire Risk, particularly with Heightened Concerns about the Wildfire Fund's Depletion

AB 1054 was signed into law on July 12, 2019. As Moody's states, there are three primary sources of wildfire liability risk reduction from that legislation: (1) it creates liquidity through the creation of a $21 billion wildfire fund that a utility can immediately use to pay claims and then reimburse the fund later if there are any disallowances should the utility be deemed imprudent; (2) it

[30] Moody's, Moody's Ratings announces competition of a periodic review of ratings of Southern California Gas Company and San Diego Gas & Electric Company (Nov. 28, 2024) ("Moody's Nov. 28, 2024") at 1.

[31] S&P June 2024 at 4-5.

caps the amount that the utility would have to reimburse the fund at 20% of the equity portion of the utility's rate base; and (3) it revises the prudency standard that applies at the Commission if the utility has a valid state safety certification.[32]

Although AB 1054's establishment of a wildfire fund with a cap on expenses meaningfully reduces risks, it does not eliminate them. This is reflected in the fact that, while Moody's raised SDG&E's credit rating one notch in 2021, SDG&E's credit ratings remain at least two notches lower from all three credit rating agencies even after AB 1054's passage. As Moody's states, exposure to wildfire risk continues to "temper[] SDG&E's credit quality," even after AB 1054's passage, resulting from the "combination of (i) severe wind events; (ii) growing housing developments in fire-prone areas; and (iii) the California courts' application of the inverse condemnation doctrine, which heightens the utilities' risk exposure to property damage."[33] As the table below likewise shows, investor analysts currently discount SDG&E and other California utilities' equity valuation relative to the average regulated utility; meaning that SDG&E and other California electric utilities carry a risk premium for their above-average risks.

Table 4 - Investor Analysts Valuation Discount

Date	Bank / Equity Analyst	Valuation Discount	Commentary
September 10, 2024	Barclays	10%	We apply a -10% discount to the FY25 Electric group multiple for SDG&E . . . [w]e see [the] discounts as reasonable given the state's [inverse condemnation] framework (electric)[34]
August 6, 2024	Wells Fargo	11%	Discounted multiple reflects lingering risks related to CA's inverse condemnation policy and highly politicized regulatory environment.[35]

32 Moody's March 2025 at 8; *accord* Moody's Dec. 2023 at 7-8.

33 Moody's March 2025 at 8.

34 Barclays, CA Utilities: ALJ Reduces ROEs: Unexpected Negative (September 10, 2024) at 10.

35 Wells Fargo, Sempra Energy (SRE) SRE: ECA Delay Rains on TX Parade (Aug. 6, 2024) at 3.

Date	Bank / Equity Analyst	Valuation Discount	Commentary
August 6, 2024	Evercore	10%	We continue to value SDG&E . . . by applying a 10% discount . . . due to wildfire liability issues associated with inverse condemnation.[36]
January 19, 2022	Bank of America Securities	2.0x (equivalent to 11%)	We continue to apply a -2x discount to reflect above-average wildfire risk (albeit below that for Northern California peers) and uncertainty on the gas LDC's longer-term prospects as the state takes actions to reduce consumption.[37]
June 30, 2021	Morgan Stanley	10%	We value the CA utilities at a 10% discount to peers as the above-average rate base growth outlook is counterbalanced by a challenging regulatory and political backdrop along with heightened fire risk.[38]
June 29, 2021	Vertical Research Partners	7.5%	We continue to apply a 7.5% California utility discount…to our 17.5x 2023E regulated target multiple.[39]

In addition, as discussed further in the testimony of Mr. Nowak, the wildfire fund has no replenishment mechanism.[40] If the "fund's claim paying capability is exhausted, the majority of the credit supportive elements, including the liability cap, will terminate."[41] In other words, not only does SDG&E lose the availability of the wildfire fund, but also the cap on liability. Fitch thus states that "SDG&E's risk profile is upwardly constrained because the availability of the insurance fund is subject to mitigation efforts and claims by other utilities."[42]

36 Evercore ISI, Sempra Energy (Aug. 6, 2024) at 2.

37 BofA Global Research, Sempra Energy, Setting the Stage for CAGR Launch: Depends Where You Start (January 19, 2022) at 9.

38 Morgan Stanley, Sempra Energy North America, Analyst Day Takeaways (June 30, 2021) at 2.

39 Vertical Research Partners, Sempra Energy (SRE) Infrastructure is the new Energy (June 29, 2021), at 1.

40 *See* S&P Feb. 11 2025 at 1 ("In addition, the fund does not have an automatic replenishment mechanism.").

41 Moody's March 2025 at 8-9 ("AB 1054 also caps the utility's liability (that is, the amount to be reimbursed to the fund) at 20% of the equity portion of its electric T&D rate base of a trailing three calendar year period.").

42 Fitch Ratings, Fitch Rates San Diego Gas and Electric Company's First Mortgage Bonds 'A', (Mar. 18, 2024) at 2.

This concern regarding the wildfire fund's durability—and the resulting increase in risk as viewed by credit rating agencies and equity investors—has become increasingly acute following the January 2025 wildfires. Moody's stated that the "fires illustrate California's increasing exposure to physical climate risks and will exacerbate strains on the state's property insurance market."[43] The rating's agency continued that "because of the size and scale of the Eaton fire, this event could test the effectiveness of [the AB 1054] enhancements, and potentially test California's regulatory support for utilities."[44]

As a result, on February 3, 2025, S&P placed SCE on negative watch, stating that, it "reflect[s] the potential that the California wildfire fund could materially deplete given the significant number and value of structures that have been damaged or destroyed (over 10,000) due to the Eaton fire, and the possibility that SCE's equipment may be linked to the fire."[45] S&P continued that the "negative outlooks also reflect the potential for a more-challenging operating environment going forward for Edison and SCE due to wildfire risk, which could weaken credit quality."[46]

The concern about the fund's material depletion is again putting pressure on SDG&E's equity and credit ratings despite there not being a significant wildfire in SDG&E's service territory.[47] On February 11, 2025, S&P stated that, because the Wildfire Fund was at risk of

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43 Moody's, LA wildfires pose biggest challenges for utilities, local governments and insurers (Jan. 17, 2025) at 1.

44 Moody's, Edison International and Southern California Edison Company (Jan. 16, 2025) at 1.

45 S&P, Edison International and Subsidiary SoCalEdison Outlooks Revised to Negative from Stable on Potential Risk for Wildfire Fund Depletion, at 1-2 (Feb. 3, 2025).

46 *Id.*

47 Fitch, Fitch Affirms Edison International and Southern California Edison's IDRs at 'BBB'; Outlook Stable, at 1-2 (Jan. 17, 2025) ("As a result, protection provided by the fund to SCE and other utilities could be meaningfully reduced, increasing EIX and SCE's credit risk profile.").

experiencing a material draw down without a replenishment mechanism, S&P would continue monitoring several developments that would affect their view of SDG&E's credit quality going forward, including:

- the ongoing investigations on whether SCE's equipment is found to have contributed or caused the Eaton fire;
- the potential level of third-party claims that may arise due to the Eaton fire, and;
- whether SDG&E can continue to sustain its track record of not causing a significant wildfire, given the potential for a more-challenging operating environment for California investor-owned utilities due to wildfire risk.[48]

Moody's likewise recently added that negative momentum on SDG&E's credit rating "is also possible if SDG&E's wildfire risk exposure unexpectedly increases or the state's wildfire fund is materially depleted."[49]

As Mr. Nowak details, the concern about the wildfire fund's durability (and with it, the cap on liability) has led to a swift stock market response. EIX, PCG, and Sempra experienced stock price declines of 35, 20, and five percent respectively between December 9, 2024 through February 10, 2025 (one month prior and subsequent to the start of the Eaton Fire) despite an overall increase in the S&P Utilities 500 index over that same period. Although, as Mr. Nowak discusses, concerns about Edison's possible role in the Eaton fire could reflect some of the decline in EIX's stock, PG&E and SDG&E do not face any liability concerns and yet have likewise experienced significant dips, reflecting overall wildfire liability concerns in California. And as Mr. Nowak details, given that less than half of Sempra's assets are associated with SDG&E, the EIX and PG&E decline better represent the increased worry that investors have regarding the ongoing risks to California utilities such as SDG&E. This is reflected in recent comments by equity analysts as well.

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48 S&P Feb. 11, 2025 at 1-2.

49 Moody's March 2025 at 3.

Table 5 - Equity Analyst Comments post Eaton Fire

Date	Bank / Equity Analyst	Commentary
February 18, 2025	Guggenheim	Investors have focused on the wildfire construct of AB1054 and potential draw-down of funds by the Eaton fire . . . there is no visibility to a legislative fix to regain investor confidence, which in our view could be a long road ahead . . . [t]he recent S.CA wildfires brought to light the shortcomings of AB1054.[50]
February 6, 2025	Wolfe Research	We think the state will need to take actions to shore up investor confidence to address risk of future fires.[51]
January 31, 2025	Goldman Sachs	We expect uncertainty to weigh on shares of California utilities until at least the cause of the Eaton fire is determined . . . Since the start of the fires on 1/7, EIX, PCG, and SRE have traded down 29%/30%/3%, respectively, and debate surrounding the long term outlook of the wildfire fund has been top of mind for investors . . . We are not aware of any current plan to replenish the fund if it is depleted, and thus if such high damages were to occur it would likely be an overhang for California utility stocks given uncertainty around the fund's future.[52]

50 Guggenheim, PCG: Goodbye Hotel California, Downgrading to Neutral as We Hold out for External Factors; Despite Strong Fundamentals, Policy Uncertainty Creates a Vacuum of Investors (Feb. 18, 2025) ("Guggenheim, Feb. 18, 2025") at 1 (emphasis omitted).

51 The Fleishman Daily 2/6/25 (Feb. 6, 2025) at 3.

52 Goldman Sachs, Estimating the potential costs for the Eaton fire and impact to the state wildfire fund (Jan. 31, 2025) at 1, 4.

In sum, credit ratings and equity investors both recognize that the wildfire risk is higher now for SDG&E then it has been since AB 1054's passage, owing to a combination of an increasing risk of wildfires and the acute threat to the wildfire fund's durability.

B. Credit Rating Agencies Have Recognized Additional Above-Average Risks to SDG&E

Wildfire risk, however, is not the only elevated threat that SDG&E faces compared to utilities outside the state. Instead, as noted, Moody's stated in March 2025 that SDG&E is only "weakly positioned at the A3 rating level."[53] Moody's opined that SDG&E's final 2024 general rate case ("GRC") decision has "introduced some regulatory uncertainty" that "will affect the utility's cash flow visibility and tempers [SDG&E's] A3 credit rating."[54] The ratings agency specified that "there is considerable uncertainty regarding the utility's 2025-2027 cash flow arising from":

> (i) CPUC's pending decisions in connection with intervenor requests for re-hearing of the 2024 GRC and SDG&E's Track 2 and Track 3 to address the deferred recovery of the wildfire costs and investments in excess of the amounts authorized in the 2019 GRC; (ii) the CPUC's decision on the treatment of balancing accounts that could affect the timeliness of true-ups for recovering under-collected amounts and heighten the utility's exposure to regulatory lag; (iii) management's ability to offset some of the regulatory headwinds with the cost saving initiatives announced at the end of February 2025. This uncertainty positions the utility weakly at the A3 rating level.[55]

Moody's continued that it views SDG&E as facing a credit challenge compared to utilities outside California from the "[e]levated political risk and public scrutiny in California amid demanding public policy goals."[56] Moody's previously added that that SDG&E's credit is

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[53] Moody's March 2025 at 2.

[54] *Id.* at 1.

[55] *Id.*

[56] *Id.* at 2; *accord* Moody's Dec. 2023 at 2; *cf.* Moody's March 2025 at 5, 7 (nothing that Moody's historic view that SDG&E's regulatory environment was credit supportive was buttressed by SDG&E receiving "above-average returns," and noting that SDG&E's current ROE "still compares favorably to the authorized returns in other jurisdictions.").

"constrained by our view that political risk, in terms of media attention and the demand on utilities to implement the state's clean energy policy goals, is higher in California compared to most other jurisdictions in the US."[57] And Moody's expects a "gradual increase in business risk given California's ongoing energy transition away from natural gas technologies."[58] Guggenheim likewise recently stated that:

> We have been nervous around the CA construct, in general. As we have highlighted in our '25 outlook, the recent decisions, cost of capital changes, and the governor's executive order on rates led to the optics of CPUC goal-seeking for outcomes. In other words, rather than support prospective spending and accelerated risk mitigation (including faster undergrounding program), the state appeared to have a specific customer rate inflation in mind and the spending approvals needed to fit within that box. We have seen delays on undergrounding plan implementation, reduction of wildfire mitigation recovery, reductions to PCG GRC capex, changing escalation factors, changing the cost of capital mechanism, etc.[59]

SDG&E thus faces numerous public policy goal challenges, including decarbonization goals that are as aggressive, if not more aggressive, than any in the country. Moody's likewise found that SDG&E has "[w]eakened credit metrics due to regulatory lag," namely from an increase in "net unrecovered regulatory assets."[60] As discussed in the testimony of Maritza Mekitarian, SDG&E is having to finance costs subject to cost recovery—including those in balancing and memorandum accounts—for longer terms, with more expensive long-term financing. As of the end of December 2024, SDG&E's undercollected balances are $924 million; compared to a historical average closer to $300 million.

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[57] Moody's Dec. 2023 at 1; *accord* Moody's Nov. 28, 2024 at 1 (noting that SDG&E faces "elevated political scrutiny in California compared to most other jurisdictions.").

[58] S&P Jan. 9, 2025 at 3.

[59] Guggenheim, Feb. 18, 2025 at 1.

[60] Moody's December 2023 at 2, 6.

And this risk of carrying large balances for long periods may continue to grow. In fact, Moody's found that SDG&E's 2024 GRC "decision on balancing accounts"—that is, "den[ying] two-way balancing account treatment for several regulatory accounts and convert[ing] some existing two-way accounts to one-way accounts"—could "negatively affect the timeliness of true-ups for recovering under-collected amounts.[61] Moody's has stated that its "stable outlook" for SDG&E's credit rating is predicated on our assumption that SDG&E's ratio of CFO pre-W/C to debt will continue to exceed "20% on a sustained basis."[62] But the rating agency cautioned that it could downgrade SDG&E's credit rating "if the company generates weaker credit metrics in the aftermath of the implementation of the 2024 GRC."[63]

SDG&E also faces challenges from extremely high solar rooftop adoption in its service territory. This heavy rooftop solar adoption presents risks—given the Company's current system design and primarily volumetric-based rate structure—and puts SDG&E in a distinct position on two fronts. First, high levels of customer distributed energy resources ("DER") adoption under today's current volumetric rate structure impedes SDG&E's ability to collect the cost of utility infrastructure investments equitably from all customers, impacting the ability to make needed investments for safety and reliability.[64] As Moody's stated, the "challenges arise from the potential for significantly higher rates that would be necessary for SDG&E to be able to recover its costs and investments" from "non-solar roof customers."[65] This rate shift can create political and regulatory

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[61] Moody's Mar. 10 2025 at 6.

[62] *Id.* at 1, 2.

[63] Moody's March 2025 at 3.

[64] CPUC, Utility Costs and Affordability of the Grid of the Future: An Evaluation of Electric Costs, Rates, and Equity Issues Pursuant to P.U. Code Section 913.1 (May 2021) ("White Paper") at 6 (noting that California's net energy metering framework for rooftop solar customers shifts costs from rooftop solar owners to often lower-income and otherwise vulnerable customers).

[65] Moody's Dec. 2023 at 9.

pressures that amplify affordability concerns, potentially having deleterious downstream consequences on SDG&E's ability to make the necessary investments in wildfire mitigation and to meet state policy goals. Second, it introduces reliability risk, as SDG&E must be prepared to provide service to all customers.

In sum, SDG&E has never regained its credit ratings from prior to 2018-2019. Instead, those credit ratings remain at least two notches lower. And the increasing wildfire lability risk following the Eaton Fire regarding the durability of the wildfire fund and increased regulatory and financial uncertainty are putting further pressure on the Company's credit ratings, buttressing the fact that SDG&E faces above-average risks and supporting the Company's proposals here.

V. SDG&E'S CAPITAL STRUCTURE PROPOSAL IS TO HAVE ITS AUTHORIZED CAPITAL STRUCTURE REFLECT THE COMPANY'S LONGSTANDING ACTUAL CAPITAL STRUCTURE

Maritza Mekitarian's direct testimony supports SDG&E's proposed capital structure of 54 percent common equity, 46 percent long-term debt, and zero percent preferred stock.[66] SDG&E's proposal better aligns SDG&E's authorized capital structure with its five-year average actual capital structure of 54.90 percent common equity, 45.10 percent long-term debt, and zero percent preferred equity.[67] By having an actual capital structure with a higher common equity ratio than its authorized one, SDG&E's investors are buttressing the Company's credit ratings—providing a benefit to ratepayers through lower borrowing costs—without receiving a return on their investment. If

[66] Prepared Direct Testimony of Maritz Mekitarian – Authorized Capital Structure on Behalf of SDG&E (April 20, 2022) ("Ex. SDG&E-02 (Mekitarian)") at MM-5; Ex. SDG&E-03 (Nowak) at JCN-58 – JCN-59.

[67] *See* D.12-12-034 at 11 (setting SDG&E's capital structure to reflect its actual capital structure).

SDG&E reduced its actual common equity ratio to its currently authorized one it could harm the Company's credit ratings, potentially resulting in higher borrowing costs for ratepayers.[68]

SDG&E's proposed capital structure also reasonably removes the fictious preferred equity layer from the Company's authorized capital structure that lacks any relationship to SDG&E's actual management of the Company. Preferred stock is no longer an advantageous method for a utility operating company to raise capital. SDG&E has not issued preferred stock since 1993, redeemed all outstanding shares of preferred stock in 2013, and does not plan to issue this type of financing.[69]

SDG&E's proposal thus better rewards the Company for the judicious management of its capital structure by moving SDG&E's authorized capital structure closer to its actual one—instead of continuing with a fictious authorized capital structure that includes preferred equity that the Company does not have. The proposal would validate SDG&E's prudent business decision to maintain a higher actual equity ratio to manage the Company's above average risks from operating in California; helping counterbalance the fact that SDG&E's credit ratings remain at least two notches below the A rating that SDG&E held prior to 2019 from all three credit rating agencies due to the Company's unique, above average risks. Indeed, the stability provided by SDG&E's proposed capital structure is more important now than ever—in the face of the equity market sell-off and credit rating agency concerns resulting from this winter's wildfires without any involvement from SDG&E—and increased regulatory and financial uncertainty.[70] And it would be consistent

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[68] *See* Ex. SDG&E-02 (Mekitarian) at MM-9 – MM-10 (credit rating agencies assess SDG&E financial risks based upon the Company's actual capital structure).

[69] *Id.*

[70] Ex. SDG&E-03 (Nowak) at JCN-58 – JCN-59.

with prior Commission precedent that based SDG&E's authorized capital structure on its actual one.[71]

The proposal also provides a prudent counter to help SDG&E manage increased financial risks. As noted, Moody's recently stated that a "downgrade of SDG&E's ratings is possible if the company generates weaker credit metrics in the aftermath of the implementation of the 2024 GRC such that its ratio of CFO pre-WC to debt falls below 20%."[72] Again, SDG&E is having to finance costs subject to cost recovery—including those in balancing and memorandum accounts—for longer terms, with more expensive long-term financing.[73] And, as Moody's recently noted, that risk is now increased by the shift to one-way balancing accounts in SDG&E's 2024 GRC.[74]

SDG&E's proposed capital structure would help counterbalance those risks and support further upgrades to SDG&E's credit ratings. In fact, as S&P recently added, despite ongoing wildfire risks, the ratings agency could raise SDG&E's rating if SDG&E's "FFO to debt remained consistently at 21% or above and the company did not cause a significant wildfire."[75]

VI. CONCLUSION

SDG&E's proposed capital structure, ROE, and overall ROR is consistent with financial modeling, relevant capital market data, SDG&E's increased risks, and a heightened interest rate environment. It will help counter SDG&E's risks from, among other things, wildfire liability concerns, heightened regulatory risks, and increased financial uncertainty—enabling the Company

[71] *See, e.g.*, D.12-12-034 at 11.

[72] Moody's March 2025 at 3.

[73] Moody's Dec. 2023 at 6-7 (finding that the "material deterioration in [SDG&E's] financial metrics during 2023 is largely attributable to the drag on its cash flow from the net unrecovered regulatory assets and growing debt to finance its funding requirements").

[74] Moody's March 2025 at 6.

[75] S&P Jan. 9, 2025 at 4. SDG&E also supports the continuation of the CCM, combined with SDG&E's right to file an application when applicable, as it was established in D.08-05-035.

to raise the significant amount of investment required to help meet the State's ambitious climate change and other environmental goals, mitigate wildfire risks, maintain safe, reliable, and affordable service, and help reduce borrowing costs to customers.

VII. WITNESS QUALIFICATIONS

My name is Valerie Bille. I am Senior Vice President, Chief Financial Officer, Chief Accounting Officer, Controller, and Treasurer for SDG&E. My business address is 8330 Century Park Court, San Diego, California 92123.

In my current position, I am responsible for overseeing the financial planning and budgeting, financial reporting, treasury management, and accounting for SDG&E. I assumed my current position in March 2025. Prior to this, I have served in roles of increasing responsibility at Sempra Energy and SDG&E since November 2014.

I received a Bachelor of Science in Business Administration from California State University, San Marcos in 2000. I am a Certified Public Accountant. I began my career with Deloitte & Touche.

I have previously testified before the Commission.