Docket	A.20-04-023
Date	October 14, 2020
Exhibit	________________
Witness	Michael P. Gorman

Direct Testimony of

Michael P. Gorman

On behalf of

Energy Producers and Users Coalition

October 14, 2020

BRUBAKER & ASSOCIATES, INC.

Project 10966.1

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Direct Testimony of Michael P. Gorman

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q WHAT IS YOUR OCCUPATION?

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

Q PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A This information is included in Appendix A to my testimony.

Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A I am testifying on behalf of the Energy Producers and Users Coalition (EPUC). EPUC is an *ad hoc* group representing the electric end user and customer generation interests of its members.[1]

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[1] EPUC represents the following companies in this proceeding: Aera Energy LLC; California Resources Corporation; Chevron U.S.A., Inc.; PBF Energy Inc.; and Phillips 66 Company.

I. SUMMARY

Q WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A In my testimony, I will make the following recommendations concerning Pacific Gas and Electric Company's (PG&E) proposal:

1. Its proposal to cap shareholder contributions to the customer credit trust, that will be used to offset Fixed Recovery Charge (FRC) payments for securitization bonds, should be denied. Shareholder contributions to the trust should be made in an adequate amount to ensure that the trust is able to provide full credits to FRC payments during the entire term of securitization bond amortization. This is needed to meet the rate neutrality commitment.

2. PG&E should be ordered to identify and track in annual filings to the Commission its total debt issuances used to satisfy wildfire damage claims or for other purposes than to fund investments in utility plant investments. Issuance of non-traditional debt for wildfire damage claim payments, and other non-rate base investment purposes, should be regarded as non-traditional debt and PG&E should commit to paying this debt off as quickly as possible, and prioritize this nontraditional debt reduction ahead of reinstating dividends payments to its parent company. Paying off and expeditiously extinguishing this non-traditional utility debt is necessary to protect customers under the rate neutral obligations under Assembly Bill (AB) 1054. Moreover, elimination of non-traditional utility debt will significantly improve PG&E's financial strength under the Stress Test methodology. The Commission should establish, and expect compliance with this standard for its adopted Stress Test Methodology applicable to PG&E.

3. PG&E's proposed financial metric targets under its Stress Test Methodology are too high and expose customers to paying costs that would otherwise be disallowed from recovery in rates, because the proposed financial metrics will understate the maximum amount of debt PG&E can maintain while navigating its financial recovery and restoration of its minimum investment grade bond rating.

4. The FRC should be designed in a way that most fairly allocates securitization bond charges across rate customers that align with the most accurate cost-causation factors available. A design of the FRC that reasonably aligns with functional cost of service will not impair PG&E's ability to implement a special purpose entity and reconciliation procedures that minimizes its risk of not fully recovering

securitization bond debt service costs from customers, and support its ability to get the lowest interest rate on these bonds as possible.

I.A. Summary of PG&E Position

Q PLEASE SUMMARIZE THE COMPANY'S PROPOSAL WITH RESPECT TO ISSUANCE OF SECURITIZATION BONDS.

A PG&E seeks authority to issue $7.5 billion of securitization bonds. The proceeds of these bonds will be used to retire approximately $6.0 billion of temporary utility debt that was issued to pay wildfire damage claims associated with 2017 wildfire settlements. PG&E admits these wildfire settlement costs are "disallowed for recovery in rates."[2]

In its filing, PG&E asserts that its Application and supporting testimony demonstrate that securitization is consistent with California Governor Gavin Newsom's proposed use of a financial plan to be approved by the California Public Utilities Commission (CPUC or Commission) for securitization of up to $7.5 billion in wildfire damage claim costs. PG&E states that the issuance of these bonds under a "rate neutral securitization" pursuant to Senate Bill (SB) 901 meets all legal requirements and will strengthen the utility's going-forward business and its ability to provide safe, reliable, affordable and clean energy to its customers. Based on this plan, PG&E believes its proposed Application and securitization filing meets the Governor's statement and is in the public interest.[3]

PG&E represents that a "rate neutral" impact on customers' rates will be accomplished by a bill credit to customers sufficient to offset the FRC proposed

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[2] PG&E Updated Prepared Testimony, Aug. 7, 2020, at 1-1.
[3] *Id*. at-1-1, 1-2.

to be imposed on customers. Thus, the proposed customer FRC credit produces the rate neutrality impact on customer bills as required under AB 1054, and as PG&E asserts, meets the Governor's financial plan. While PG&E has pledged an intention to achieve rate neutrality, it does not guarantee that the customer credit will be adequate to achieve this rate neutrality.

PG&E's proposal is to create a customer credit trust funded by shareholder assets which will be used to pay for the customer credits that offset increases in bills caused by the FRCs. Shareholder assets generally reflect net operating losses or tax savings created by the payment of wildfire damage claims. PG&E's projections show it will gradually fund the customer credit trust over the period 2021-2035, and the trust funding is projected to be adequate to pay customer credits over the 30 years that the FRC will recover securitization bond debt service costs from customers. The customer trust fund must be adequate to fully fund credits during the period securitization FRC charges are imposed on customers, or rate neutrality will not be achieved.

PG&E also represents that the issuance of the securitization bonds will be authorized under SB 901 in applying the CPUC Stress Test Methodology that was defined in Decision (D.) 19-06-027. PG&E states that it can issue these securitization bonds under the Stress Test authority in this decision. Under the Stress Test authority, which differs from the rate neutrality commitment of AB 1054, PG&E notes that costs that would otherwise be disallowed for ratemaking purposes, can be recovered from customers under the Stress Test Methodology, to the extent the disallowed costs exceed a "maximum amount of debt" the utility can maintain while preserving its financial integrity and credit rating. Importantly, this Stress Test Methodology creates a contradiction with the rate neutrality obligation under AB 1054, and provides PG&E an ability to pass wildfire damage settlement costs on to its customers, to the extent the securitization bonds result in PG&E taking on more than a maximum amount of debt allowed under the Stress Test methodology.

Because of the risk to customers that the Stress Test Methodology will allow for recovery of costs that would otherwise be disallowed for ratemaking purposes, PG&E should be obligated to deleverage as quickly as possible with a clear and verifiable commitment to pay off non-traditional utility debt. Non-traditional debt would be debt taken on by PG&E that will be used to fund obligations other than those related to making investments in utility infrastructure needed to provide service. Non-traditional debt used to fund obligations includes wildfire damage claims that will not produce cash flows. Non-traditional debt will erode PG&E's maximum debt under the Stress Test Methodology adopted by the Commission and put customers at risk of paying costs that are normally not allowed in rates. In order to track PG&E's commitment to reduce non-traditional debt, PG&E should make annual filings to the Commission demonstrating that it is prioritizing the payoff of non-traditional debt, ahead of paying dividends to its parent company, and showing a sincere and exerted effort by shareholders to improve the utility's financial recovery and improvement of its credit rating to investment grade.

I also recommend adjustments to the financial thresholds proposed by PG&E in measuring its maximum amount of debt under the Stress Test Methodology. PG&E's credit metric thresholds are unreasonably high, and do not align with the Company's objective to restore its unsubordinated credit rating to minimum investment grade. The Company's proposed thresholds align more with the bond rating that existed prior to PG&E filing for bankruptcy protection. Use of unreasonable elevated credit metric thresholds lowers PG&E's maximum debt threshold and exposes customers of being obligated to pay for wildfire damage costs, or other costs that should be disallowed for ratemaking purposes.

I will also comment on the rate design of an FRC to accomplish the lowest possible interest rate available for the issuance of securitization bonds. For the reasons outlined below, the Company's claim that the FRC should be designed as a uniform charge per kilowatt hour for all customers, is not reasonable and inconsistent with fair and accurate price-setting of such charges, as discussed more fully by EPUC witness Robert R. Stephens. The distinction for minimizing the risk of the securitization bonds lies in producing a verifiable and predictable reconciliation of annual FRC revenues to the annual securitization bond annual debt service costs and is not tied to a specific rate design of the FRC.

II. RESPONSE TO PG&E'S FILINGS

Q PLEASE SUMMARIZE YOUR RECOMMENDATIONS AND CONCLUSIONS CONCERNING PG&E'S PROPOSED $7.5 BILLION OF SECURITIZATION BONDS ISSUE.

A My findings and recommendations are summarized as follows:

1. The CPUC should emphasize a commitment for rate neutrality under the issuance of the securitization bonds. These securitization bonds will be used to pay for 2017 wildfire damage claim settlements costs paid by PG&E, which it has admitted should be "disallowed for recovery in rates."[4] The CPUC should find that these costs are not prudent and will not be recovered from retail ratepayers in regulated rates in this proceeding.

2. PG&E needs to have more commitments and verification that the proposed funding of the customer credit trust will be made in full. PG&E proposes that shareholder contributions to the trust be capped. PG&E offers its expectation that with its capped funded amounts anticipated to be made over the period 2021-2035, and earnings produced on the trust fund assets, the trust will be able to fund sufficient customer credits to offset FRC charges over the amortization period of the securitization bonds.

   The Commission should reject PG&E's proposal that shareholder contributions to the customer trust should be "capped." Instead, PG&E's shareholders should be obligated to adequately fund the customer trust to ensure that it has a sufficient amount of funds to ensure that FRC charges are offset by credits and result in neutral impacts on customers' bills. That is, the trust can fund customer credits to offset increases in customer bills created by the imposition of FRC charges over the full securitization bond amortization period.

3. PG&E should commit to prioritizing deleveraging its non-traditional utility debt, and provide clear and transparent annual evidence that issuance of securitization bonds and other non-traditional utility debt will not result in PG&E exceeding a "maximum amount of debt" that would trigger the Stress Test exception and allow PG&E to seek recovery of costs from retail customers that should be "disallowed for recovery in rates."

   Because the Stress Test is based on PG&E deleveraging itself to stay within the "maximum amount of debt" guidelines, to avoid customers being exposed to costs that should not be passed on to customers, PG&E's financial recovery should include a deleveraging obligation or formal PG&E commitment to the CPUC as a condition of the use of securitization bonds.

4. PG&E's Stress Test financial benchmarks are not tied to its goal to achieve a minimum investment grade bond rating on its path to financial recovery. Its proposed financial metrics reflect much stronger bond ratings than that of a minimum investment grade.

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[4] *Id*. at 1-1.

Using financial metrics for a much stronger bond rating than PG&E currently has, reduces the maximum debt threshold under the Stress Test, and exposes customers to paying costs that would otherwise be disallowed for ratemaking purposes. This is clearly at odds with the rate neutrality provisions contemplated in AB 1054, which requires customers to pay adequate rates to maintain liquidity at PG&E that provides it an opportunity to regain its financial standing and minimum investment grade bond rating.

Credit metrics under the Stress Test should reflect this first step in its goal to financial recovery and should be tied to the minimum investment grade bond rating, and not an investment grade bond rating considerably higher than this minimum level. As outlined below, I recommend credit metrics from Standard & Poor's (S&P) and Moody's that tie to cash flow coverages of total outstanding utility debt, including both traditional utility debt used to fund investments in rate base, and non-traditional utility debt that is taken on to pay wildfire damage claims and other uses as opposed to funding infrastructure investments. This non-traditional debt, as noted above, should be paid off on an accelerated basis, and should be prioritized above PG&E's reinstating dividend payments up to its parent company.

5. The FRC design should follow a reasonable cost basis in allocating FRC costs across customer classes. This rate design is discussed in EPUC witness Robert R. Stephens's testimony. As outlined below, the design of FRC rates is not critical in minimizing the risk of PG&E fully recovering the debt service costs on securitization bonds. Rather, proper FRC rate design relates to fairness to customers, along with a securitization bond reconciliation methodology that produces a high likelihood the FRC revenues will fully pay annual debt service costs on the securitization bonds.

III. POTENTIAL COSTS AND CREDITS OF $7.5 SECURITIZATION BOND ISSUE

Q WHAT WILL BE THE ANNUAL COST TO RETAIL CUSTOMERS UNDER THE COMPANY'S PROPOSAL TO ISSUE $7.5 BILLION OF SECURITIZATION BONDS?

A The estimate of the actual number will not be known until the actual interest rates on the securitization bonds and principal amortization schedule are determined, but the Company has made projections of the annual costs of the securitization bonds to be $389.1 million (2024-2050).[5] The debt service in 2021-2023 will be lower.

The Company projects that it will fund credits against these annual securitization charge collections from customers by crediting other customers' bills.[6]

III.A. Customer Credit Trust

Q HOW IS THE COMPANY PLANNING TO FUND A CUSTOMER TRUST THAT ENSURES THAT IT WILL HAVE ADEQUATE FINANCIAL SUPPORT TO FUND CUSTOMER CREDITS OVER THE DURATION OF THE SECURITIZATION BOND AMORTIZATION?

A PG&E's proposed customer credit mechanism would involve the development of a grantor trust that would be managed by a majority independent committee. This trust would be funded by shareholder assets that would be adequate to make payments to PG&E for providing credits to customers' bills for customers that pay the FRCs. The customer credit should be equal in amount to the FRC.[7]

PG&E proposes initial funding of this customer credit by $1.85 million in 2021. In later years, PG&E commits to make additional contributions to fund the customer credit trust up to a shareable cap funding of $7.59 billion. PG&E will use tax losses on wildfire damage claim payments to produce shareholder assets to make contributions to this trust. PG&E proposes to make these contributions over time, as the net operating losses related to these wildfire

[5] *Id*. at 3-Exh3.2-1.
[6] *See id*. at 3-Exh3.1-38 – 1-39.
[7] *Id*. at 6-1.

damage claim payments can be used to offset taxable income and produce cash flow available to PG&E.[8]

As demonstrated in Chapter 6, page 6-15, Table 6-3, PG&E's projections show an initial contribution of $1.8 billion in year 2021, and smaller contributions on an annual basis starting in year 2027 through 2035, at the point where all shareholder contributions will have been fully made. Hence, PG&E's projections indicate that it will take an approximate 15-year period to fully fund the customer trust.

These shareholder tax benefits arise from payments by PG&E shareholders related to wildfire claim settlements and contributions to the Go-Forward Wildfire Fund. PG&E proposes that beyond its proposed shareholder cap and the projected trust earnings, the trust should be able to fund credits, and shareholder obligations will end.[9]

PG&E also states that the trust structure will not function as a business trust and will not be eligible for bankruptcy protection.[10]

Q IS PG&E'S PROPOSAL TO CAP SHAREHOLDER ASSET CONTRIBUTIONS TO THE CUSTOMER TRUST REASONABLE?

A No. As outlined at Chapter 6, page 6-1, PG&E proposes to <u>cap</u> its shareholder contributions to the trust at $7.59 billion. Based on PG&E's projections in Table 6-3 at page 6-15 of its filing, this level of shareholder contributions is anticipated to fully pay FRC credits in an amount that will neutralize the impact on customer

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8 *Id*.
9 *Id*. at 6-2.
10 *Id*. at 6-3.

bills. However, there are certain assumptions in these projections which do not <u>guarantee</u> rate neutrality or bill credits will be made to offset FRC charges.

Those include the assumption on the interest rate on the securitization bonds, and the assumption on the customer trust fund investment returns that will produce additional cash flows within the trust that are projected to be needed to fully fund customer credits and achieve rate neutrality. Because there are economic conditions which can distort the actual trust fund cash flows' ability to completely credit FRC charges to customer bills, the Commission should reject the notion that shareholder contributions to the trust should be capped.

Q IF SHAREHOLDER CONTRIBUTIONS TO THE CUSTOMER TRUST ARE CAPPED, AND THE CUSTOMER TRUST IS NOT ABLE TO FUND CREDITS TO FRCs OVER THE AMORTIZATION PERIOD OF THE SECURITIZATION BONDS, WILL RATE NEUTRALITY ON CUSTOMER BILLS BE REALIZED?

A No. To the extent the funding in the customer trust is not adequate to pay FRC credits to customers' bills over the planned 30-year amortization of the securitization bonds, then customers could be exposed to paying FRC charges without a customer credit. This will result in increased bills to customers and a failure to meet the rate neutrality commitment under AB 1054.

The Company's proposal to cap shareholder contributions to the trust should be rejected. Instead, PG&E should be obligated to make necessary contributions to the customer trust, to ensure the trust has adequate funding to pay customer credits over the amortization period of securitization bonds over the period FRC charges are imposed on customer bills.

IV. STRESS TESTS

IV.A. Total Debt

Q HAS PG&E MADE PROJECTIONS OF ITS TOTAL DEBT, AND DEMONSTRATED THAT ITS PROPOSAL IN THIS CASE WILL NOT RESULT IN THE UTILITY'S DEBT BEING ABOVE A MAXIMUM AMOUNT OF DEBT THAT WOULD TRIGGER ITS ABILITY TO PASS COSTS ON TO RETAIL CUSTOMERS?

A In outlining its proposed Stress Test Methodology, PG&E has made estimates of its Maximum Incremental Debt Capacity (MIDC), and its Maximum Overall Debt Capacity (MODC). However, PG&E has not separated its total debt to reflect traditional utility debt, or debt used to fund investments in utility rate base, from the amount of non-traditional utility debt, or debt used to fund wildfire damage claims, as well as other bankruptcy-related non-utility operating costs. PG&E's total debt reflects both of these traditional debt and non-traditional debt obligations.

In outlining appropriate Stress Test Methodologies, the Commission should distinguish its ongoing traditional utility debt obligations and the need for investment grade bond ratings and access to capital in order to maintain service reliability and safety. On the other hand, as part of its emergence from bankruptcy and settling claims made against it related to wildfire damage claims, PG&E will also take on a significant amount of non-traditional utility debt to fund these litigation costs, only part of which will be satisfied under the proposed rate neutral securitization bond issue in this proceeding. For these reasons, I believe the Stress Test Methodology should recognize that PG&E does or should have a firm obligation to the Commission to pay off non-traditional debt as quickly as possible, as a major component of its financial restructuring and effort to reclaim its unsubordinated investment grade bond rating. With a firm commitment to pay off this non-traditional debt, the Stress Test Methodology should be designed recognizing that total amounts of debt at the beginning of the Stress Test measurement phase will be vastly different from the debt at the end of the Stress Test phase, because non-traditional debt should be largely eliminated over a relatively short period of time. After this time period, Stress Test credit measures should be considerably stronger because PG&E's total debt should be reduced down to only traditional utility debt, that will be used to support investments in utility rate base, and will produce both revenue, profit, and operating cash flow that will provide strong coverages of PG&E's debt.

The non-traditional debt in this proceeding is not included in rate base and does not produce cash flows. As such, the existence of the non-traditional utility debt will weaken PG&E's credit metrics, and increase the likelihood that its actual existing debt will exceed a maximum debt threshold as identified in the Stress Test, and provide PG&E an ability to pass certain costs on to customers, where those costs would otherwise not be appropriate for inclusion in rates.

Q IS PG&E'S DEBT FUNDING OF WILDFIRE DAMAGE CLAIMS, AND THE POTENTIAL MAXIMUM DEBT TO FUND WILDFIRE DAMAGE CLAIMS LIMITED TO THE DEBT DESCRIBED IN THIS PROCEEDING?

A No. PG&E proposes to issue $7.5 billion of securitization bonds to retire approximately $6 billion of temporary utility debt and pay other wildfire damage costs related to the 2017 wildfire damage. However, PG&E has exposure of issuing significantly more debt to fund additional wildfire damage claims, both more related to 2017 wildfire events and those after 2018. The non-traditional debt will significantly impact PG&E's total debt carried on its balance sheet, which could trigger a Stress Test that permits PG&E to pass on costs to customers that otherwise would not be allowed to be recovered in rates. For these reasons, the Commission should require PG&E to outline the additional debt it takes on to pay all wildfire damage claims and debt for any other non-utility infrastructure investment purposes, to clearly show how its total debt is composed of traditional versus non-traditional debt. Finally, its plan should transparently track its success to retire debt as a priority before paying dividends to its parent company, its non-traditional debt and to restore its financial condition.

For, example in Chapter 4, PG&E witness Fischel states that the North Bay wildfire damage claims could be as much as $12.8 billion.[11] This is more than $5 billion in excess of the amount of funding for securitization bonds proposed in this case. To the extent PG&E funds these additional wildfire damage claims with non-traditional utility debt, it could easily result in PG&E exceeding the maximum debt threshold under the Stress Test, and result in customers paying for costs that should be disallowed from setting rates.

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[11] *Id*. at 4-3.

IV.B. Stress Test Credit Metrics

Q DID PG&E OUTLINE HOW THE CPUC STRESS TEST METHODOLOGY WILL BE USED WITHIN ITS PLAN OF FINANCIAL RECOVERY?

A Yes. In its filing in Chapter 5, PG&E describes the Stress Test Methodology and its ability to recover costs and expenses arising from the catastrophic wildfire with an ignition date in 2017 with specific prohibitions on recovering costs that are not appropriate to recover in rates. In the Stress Test, PG&E recognized the Commission's consideration of PG&E's financial status, and maintaining its ability to determine a maximum amount of the debt the corporation can pay without harming ratepayers or materially impacting its ability to provide adequate and safe service.

PG&E estimates that under the maximum debt application of the Stress Test Methodology, PG&E needs to reduce its total debt by around $7.5 billion, which is the amount PG&E proposes to securitize.[12] PG&E reaches this conclusion based on its assessment of an MODC that is consistent with an investment grade issuer credit rating.[13]

In reaching these decisions, PG&E references certain cash flow coverages of debt—Funds From Operations (FFO) and Cash Flow from Operations (CFO), related to taxes and rate base revenue requirement (earnings before interest, taxes, depreciation, and amortization (EBITDA)). The relationship to total debt is outlined in PG&E's Figure 5-12. It is also important to note that in calculating these credit metrics, PG&E uses its on-balance sheet

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[12] *Id*. at 5-34.
[13] *Id*. at 5-35.

total debt (long-term and short-term), but also reflects financial contractual obligations as debt equivalents—both S&P and Moody's consider these contractual obligations to be off-balance sheet debt equivalents. For these reasons, it is important to recognize the full debt will be considered in establishing the MODC for PG&E in establishing its stress test maximum debt threshold.

I have replicated Figure 5-12 below, highlighting PG&E's proposed ranges and targets (Columns 1 and 2), and outlining adjustments that I think are more appropriate (Columns 3 and 4), and protect customers' right to rate neutrality while supporting the Company's goal of restoring its financial recovery and its investment grade unsecured bond rating.

TABLE 1

Target Financial Metrics

	PG&E Proposed		Gorman Adj.	
Description	**Range (1)**	**Target (2)**	**Range (3)**	**Target (4)**
S&P				
FFO / Debt	13% - 23%	23.00%	14.0% - 17.5%	15.75%
Moody's				
CFO Pre-WC / Debt	13% - 22%	19.75%	14% - 18%	16.00%

Source:
Pacific Gas and Electric Company, Updated Chapter 5, Figure 5-12.

Q WHY DO YOU BELIEVE PG&E'S PROPOSED TARGETED FINANCIAL METRICS UNNECESSARILY REDUCE ITS MAXIMUM DEBT MEASUREMENT UNDER THE STRESS TEST?

A PG&E'S targeted cash flow coverage of total debt (FFO and CFO) from S&P and Moody's are outlined in Columns 1 and 2 in Table 1 above. Its target from S&P of 23.00% is based on its comparison data at page 5-40, Figure 5-10, in comparison to other utilities. A 23% FFO to Debt ratio exceeds the downgrade threshold significantly for all utilities with a minimum investment grade bond rating between BBB- and BBB+. A 23% FFO/Debt aligns with S&P's "Upgrade" threshold for a utility with an A- to BBB+ rating. Specifically, reference column titled "Upgrade Threshold," 23% identified for NorthWestern Corporation with a BBB+ bond rating, and for Oklahoma Gas & Electric Company with an A- bond rating. An upgrade threshold would indicate these are appropriate credit targets for achieving an A to an A- bond rating, essentially an upgrade to the referenced bond ratings for these two utilities.

Q IN ESTABLISHING ITS PROPOSED FINANCIAL TARGETS, DOES PG&E CONSIDER THE BUSINESS AND FINANCIAL RISK ASSESSMENTS FROM S&P AND MOODY'S?

A Yes. In looking at the business and financial risk assessments of the utilities, PG&E's Figure 5-9 outlines the credit rating assessments of the utility parent companies.

PG&E's Figure 5-9 outlines a "Strong" business position ranking for Edison International and Sempra Energy.

Importantly, California utilities' business risk assessment from S&P prior to PG&E's filing for bankruptcy (2017 reports), and the heightened risk associated with Inverse Condemnation, were all "Excellent." I do not dispute that current reports list a "Strong" business profile as PG&E asserts.[14]

Q HAVE CALIFORNIA AB 1054 AND THE CPUC STRESS TEST BEEN RECOGNIZED AS SUPPORTIVE OF CALIFORNIA UTILITIES' ABILITY TO OPERATE AND RECOVER THEIR COST OF SERVICE?

A Yes, and this is a clear sign that the business profile score of these companies could be increased as the investment community gains confidence that California utilities can mitigate their potential loss associated with Inverse Condemnation and mitigate claims of imprudence related to wildfire damages. Indeed, this is clearly indicated in S&P's most recent report for PG&E.

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[14] SCE:

- *S&P Global Ratings*, *RatingsDirect®, Research Update*: "Edison International And Subsidiary Outlooks Revised To Negative On Adverse Wildfire Conditions; 'BBB' Ratings Affirmed," September 16, 2020.
- *S&P Global Ratings, RatingsDirect®*: "Southern California Edison Co.," December 26, 2019.
- *S&P Global Ratings, RatingsDirect®, Summary*: "Southern California Edison Co.," August 24, 2017.

SDG&E:

- *S&P Global Ratings*, *RatingsDirect®, Research Update*: "San Diego Gas & Electric Co. Outlook Revised To Negative On Adverse Wildfire Conditions; 'BBB+' Rating Affirmed," September 16, 2020.
- *S&P Global Ratings, RatingsDirect®*: "San Diego Gas & Electric Co.," June 30, 2020.
- *S&P Global Ratings, RatingsDirect®, Summary*: "San Diego Gas & Electric Co.," December 20, 2017.

SoCalGas:

- *S&P Global Ratings*, *RatingsDirect®, Research Update*: "Southern California Gas Co. Ratings Affirmed; Stand-Alone Credit Profile Revised; Outlook Remains Negative," February 18, 2020.
- *S&P Global Ratings, RatingsDirect®, Summary*: "Southern California Gas Co.," December 20, 2017.

In S&P's credit report for PG&E, published on July 10, 2020, and included in Chapter 5, 5-Ex5.6-13, makes this clear. S&P notes key credit rating strengths for PG&E to be:

A. "Generally predictable regulatory construct that includes multiyear rate case filings with subsequent attrition rate increases."

B. "Significant wildfire mitigation investments in technology and system hardening and operational reforms that should reduce the likelihood of the company causing a catastrophic wildfire."

Similarly, higher credit risk aspects of PG&E include the following:

A. "Our view of a weak management and governance assessment that incorporates the company filing for bankruptcy twice over the past two decades. The company has a history of legal infractions and, at times, a contentious relationship with regulatory authorities."

PG&E Corp.'s credit rating is largely based on the current and expected improvement of the financial strength of its regulated utility company, as outlined in statements of S&P on PG&E Corp. on 5-Ex5.6-1. More specifically, current BBB- ratings for both PG&E Corp. and PG&E are noted as follows:

> The stable outlook reflects our expectation that the investments that California investor-owned electric utilities, including Pac Gas, have made in system hardening, incorporating technology, wildfire mitigation efforts, operational enhancements, and improvements to the legal framework, will reduce the possibility of them being found to be the cause of a future catastrophic wildfire. Our base case assumes that over the next two years PG&E's funds from operations (FFO) to debt will be in the 13%-15% range.

California's implementation of AB 1054 and pursuit of the Stress Test financial integrity protection are supporting the market's perception that California utilities' operating risks are reduced and are moving back to a low operating risk level for California utility companies. The Commission should be aware of these investor perceived positive aspects of AB 1054 and the Stress

Test in determining and implementing a Stress Test metric that supports the financial strength and recovery of California utilities but does not impose unnecessary and/or inflated cost burdens on California utility customers, particularly for costs that should otherwise be disallowed for ratemaking purposes.

Q WHAT DO YOU BELIEVE TO BE AN APPROPRIATE CREDIT RATING TARGET IN ESTABLISHING PG&E'S MAXIMUM DEBT OR MODC FOR PURPOSES OF ESTABLISHING ITS STRESS TEST LIMITS?

A I believe it is appropriate to reflect a target level of debt that reflects an "Excellent" business position ranking, which is the consistent finding by S&P for California utility companies. PG&E states that its regulatory legislative support to allow it to emerge from bankruptcy and restore its financial integrity and investment grade credit standing, would be viewed positively by credit rating agencies. California regulatory mechanisms consistently have supported an "Excellent" business position ranking.

Further, I also believe it is appropriate to recognize that in addressing PG&E's maximum debt, it is also important to recognize that non-traditional debt will be paid off as quickly as possible. This distinguishes the maximum operating debt as a permanent ongoing financial operation of PG&E rather than a non-recurring obligation that is a bankruptcy-related cost and the non-traditional debt is expected to be paid off as quickly as possible as PG&E works toward restoring its financial integrity and bond rating.

With this understanding, a lower credit metric is appropriate during a period where PG&E is taking on significant non-traditional debt to satisfy wildfire damage claims, with the commitment to the CPUC to pay off the debt as quickly as possible. This is particularly relevant given the state and regulatory support to PG&E to accomplish these financial restructuring objectives.

Q PLEASE OUTLINE THE APPROPRIATE TARGET CREDIT METRICS USED TO ESTABLISH PG&E'S MAXIMUM DEBT UNDER THE STRESS TEST METHODOLOGY.

A The minimum downgrade threshold for BBB range utility companies is 14% up to around 20% for a BBB+ company. Reference several companies with BBB rated bond ratings as the low-end of the range, and 15% to 20% range for Allete and Sempra Energy. The range for the upper level of the minimum investment grade bond rating (BBB-, BBB, and BBB+) is 15% to 18%, with a midpoint of 17.5%.

PG&E's current unsecured bond rating is below investment grade. PG&E is targeting to adjust this unsecured bond rating up to a minimum investment grade while it pays off significant amounts of debt related to funding wildfire damage claims payment. In order to prevent customers from paying part of those wildfire damage claims, the threshold for its MODC amount of debt under the Stress Test should be tied to its goal of the minimum investment grade bond rating category, and not the much stronger A to A+ bond ratings that reflect PG&E's target FFO/debt of 23%.

For S&P, the target downgrade range for a BBB utility, the midpoint of the minimum investment grade bond rating, and the upgrade, is around 14% to 17.5%. Hence, this would support a target FFO to Debt range of around 15.75%. Adjusting the target FFO to Debt range from PG&E's proposed 23%

down to 15.75% would increase its MODC to $42 billion from $28.8 billion. See Table 2 below:

TABLE 2

S&P Financial Metrics
($ Millions)

Description	2020	2021	2022
FFO / Debt (Low) - 13%			
Interest-Adjusted OpCo FFO	$ 6,063	$ 6,606	$ 7,016
FFO / Debt	13.00%	13.00%	13.00%
S&P Maximum Overall Debt Capacity	$46,638	$50,815	$53,969
FFO / Debt (Midpoint) - 18%			
Interest-Adjusted OpCo FFO	$ 6,406	$ 6,979	$ 7,412
FFO / Debt	18.00%	18.00%	18.00%
S&P Maximum Overall Debt Capacity	$35,589	$38,772	$41,178
Financial Target FFO / Debt - 23%			
Interest-Adjusted OpCo FFO	$ 6,617	$ 7,209	$ 7,657
FFO / Debt	23.00%	23.00%	23.00%
S&P Maximum Overall Debt Capacity	$28,770	$31,343	$33,291
FFO / Debt - 15.75%			
Interest-Adjusted OpCo FFO	$ 6,617	$ 7,209	$ 7,657
FFO / Debt	15.75%	15.75%	15.75%
S&P Maximum Overall Debt Capacity	$42,013	$45,771	$48,616

Source:
Updated Chapter 5, 5-Exh5.1-2.

Similarly, with respect to Moody's cash flow from operations pre-working capital (CFO pre-WC/Debt), PG&E's proposed 19.75% CFO pre-WC/Debt threshold is too high. As shown at page 5-41, Figure 5.11 outlines downgrade thresholds and upgrade thresholds for utilities with various bond ratings. The minimum investment grade bond rating using Moody's metrics is in the range of

Baa3 up to Baa1. A Baa2 bond rating is the midpoint of this first investment grade range (Baa1 to Baa3). Using the midpoint of the Baa2 range, the downgrade threshold to upgrade threshold is in the range of around 14% to 18%, with a midpoint of 16%. As shown in Table 3 below, using a 16% CFO pre-WC/Debt indicates a 2020 MODC of $36.25 billion, which is $6.9 billion greater than the $29.37 billion MODC produced by PG&E at a 19.75% target CFO pre-WC/Debt.[15]

TABLE 3

Moody's Financial Metrics
($ Millions)

Description	2020	2021	2022
CFO Pre-W/C / Debt (Low) - 13%			
Interest-Adjusted OpCo CFO Pre-W/C	$ 5,418	$ 6,097	$ 6,551
CFO Pre-W/C	13.00%	13.00%	13.00%
Moody's Maximum Overall Debt Capacity	$41,677	$46,900	$50,392
CFO Pre-W/C / Debt (Midpoint) - 17.5%			
Interest-Adjusted OpCo CFO Pre-W/C	$ 5,700	$ 6,414	$ 6,892
CFO Pre-W/C	17.50%	17.50%	17.50%
Moody's Maximum Overall Debt Capacity	$32,571	$36,651	$39,383
Financial Target CFO Pre-W/C / Debt - 19.75%			
Interest-Adjusted OpCo CFO Pre-W/C	$ 5,800	$ 6,526	$ 7,012
CFO Pre-W/C	19.75%	19.75%	19.75%
Moody's Maximum Overall Debt Capacity	$29,367	$33,043	$35,504
CFO Pre-W/C / Debt - 16%			
Interest-Adjusted OpCo CFO Pre-W/C	$ 5,800	$ 6,526	$ 7,012
CFO Pre-W/C	16.00%	16.00%	16.00%
Moody's Maximum Overall Debt Capacity	$36,250	$40,788	$43,825

Source:
Updated Chapter 5, 5-Exh5.1-4.

[15] 5-Exh5.1-4.

Q HAS PG&E MADE PROJECTIONS ON ITS INTENTION TO PAY OFF NON-TRADITIONAL DEBT TO REDUCE THE UTILITY'S TOTAL DEBT TO ACCOMMODATE THE NOTION OF A MAXIMUM AMOUNT OF DEBT ANTICIPATED IN THE STRESS TEST METHODOLOGY?

A No, but this is a critical factor that will drive Stress Test maximum debt amounts and PG&E should separately identify this non-traditional debt and disclose its target and achievement to pay off this debt throughout its financing recovery period.

Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A Yes, it does.

Qualifications of Michael P. Gorman

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q PLEASE STATE YOUR OCCUPATION.

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

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

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

In August of 1983, I accepted an analyst position with the Illinois Commerce Commission (ICC). In this position, I performed a variety of analyses for both formal and informal investigations before the ICC, including marginal cost of energy, central dispatch, avoided cost of energy, annual system production costs, and working capital. In October of 1986, I was promoted to the position of Senior Analyst. In this position, I assumed the additional responsibilities of technical leader on projects, and my areas of responsibility were expanded to include utility financial modeling and financial analyses.

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

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

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

At BAI, I also have extensive experience working with large energy users to distribute and critically evaluate responses to requests for proposals (RFPs) for electric, steam, and gas energy supply from competitive energy suppliers.

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

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

Q HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?

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

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

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