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California Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, CA 94102

**SUBJECT:** Southern California Edison Company's Comments on the Draft "Utility Costs and Affordability of the Grid of the Future" White Paper (issued February 16, 2021)

## **I. INTRODUCTION**

Southern California Edison Company (SCE) appreciates the opportunity to submit these comments on the draft report titled *Utility Costs and Affordability of the Grid of the Future* (the white paper), issued by the California Public Utilities Commission (CPUC) on February 16, 2021. SCE understands that this white paper, which provides an analysis of costs and rate trends for the next 10 years and how these trends may impact California's critical policy goals, will ultimately serve as the CPUC's 2021 Senate Bill 695 Report.

SCE appreciates the CPUC staff's white paper, which reflects detailed analysis about rate trends, cost drivers, public policy mandates, and ratemaking items. While SCE has worked hard to keep rate increases at or below the rate of inflation, as reflected in the white paper's charts showing SCE's average rates and bills compared to others in the utility industry, SCE also recognizes that the emergent and time-sensitive need to invest in grid hardening (while not losing sight of clean energy goals) is inviting a harder look at how to maintain a workable balance. SCE reiterates its commitment to sustaining affordable bills for its customers while undertaking the necessary work to provide safe, reliable, resilient, and clean electricity service, and to meet California's policy priorities, including continued wildfire mitigation and increased electrification.

SCE's comments on the white paper fall within two categories: (1) suggested context to add to the white paper to enhance its discussion of utility costs and affordability; and (2) in the spirit of continuing the valuable discussion at the CPUC's February 24, 2021 "En Banc hearing on Energy Rates and Costs" (the *En Banc*), suggested cost reduction strategies that warrant CPUC consideration.

## II. SUGGESTED CONTEXT AND KEY POINTS TO ENHANCE THE WHITE PAPER

SCE appreciates the thoroughness of the white paper and supports its overall objectives. Accordingly, SCE's comments are limited to the following suggestions for additional context that SCE believes would enhance the cost and rate discussions in the white paper and ensure a holistic analysis:

- While SCE has worked hard to mitigate rate increases over the last decade, the time-sensitivity and urgency of needed investments to harden the grid and support California's clean energy goals necessitate rate increases that exceed inflation in the near term but that provide long-term benefits related to both wildfire mitigation and the more resilient grid needed to support increased electrification (Section II.A).
- Growth in utility rate base is largely driven by safety, reliability, and risk mitigation imperatives, provides customer benefits, and undergoes thorough review and vetting by the Commission and other stakeholders in proceedings (Section II.B).
- A compensatory return on equity (ROE) is a critical component of the regulatory compact that benefits customers and shareholders alike by ensuring a financially healthy utility that is able to raise sufficient capital to make improvements to infrastructure and provide safe and reliable service (Section II.C).
- Several factors outside of the investor-owned utilities' (IOUs') control contribute to increases in transmission revenue requirements, including the Renewables Portfolio Standard (RPS), the lengthy licensing process, and changes to the scope, route, or undergrounding obligations of a project during the licensing process (Section II.D).
- When examining the effect of electrification costs on electric rates, it is important to recognize that the pathway to decarbonization and electrification will produce important *overall* energy bill savings for an average household (Section II.E).
- The revenue shift from Net Energy Metering (NEM) participants to non-participants is an inequitable rate structure that should be fixed (Section II.F).

### **A. The time-sensitivity and urgency of the needed investments to harden the grid and support California's clean energy goals necessitate rate increases that exceed inflation in the near term.**

SCE has worked hard to mitigate rate increases for the past decade, as evidenced by the white paper's finding that SCE's bundled system rate has increased just 6% since

2013, compared to 37% for Pacific Gas and Electric Company (PG&E) and 48% for San Diego Gas & Electric Company (SDG&E).<sup>1</sup> Indeed, through February 2021, at 19.7 cents per kilowatt hour, *SCE's bundled system average rate has grown less than inflation over the last 30 years*. It also remains lower than long run inflation and both SDG&E and PG&E's respective bundled system average rates.<sup>2</sup> At the same time, SCE recognizes that if all of its pending requests are approved (including SCE's 2021 General Rate Case (GRC) Track 1 request), SCE's rates would exceed the long run or cumulative rate of inflation for the first time since the California energy crisis over twenty years ago.<sup>3</sup>

While SCE ideally would prefer to keep rate increases closer to the rate of inflation as it has in the past, it is important to understand the reasons why that is not possible in the near term. Catastrophic wildfire risk is an existential problem facing the citizens of this state and requires utilities to take all actions within their reasonable control to reduce wildfire risks to our communities, including making prudent capital investments that place near-term upward pressure on rates. SCE must meet its obligations to harden the grid and ensure safe and reliable service, even if that means that rate increases outpace the rate of inflation over the next few years.

In addition to wildfire risk, legislative mandates are also driving rate increases. As the white paper recognizes, from 2016 to 2020 public policy mandates, such as the RPS, public purpose programs, and the Department of Water Resources bond charge, have contributed to over \$3 billion of revenue requirement in SCE rates.<sup>4</sup> With public policy program costs like these funded through electric rates, it is not reasonable to expect the IOUs to always be able to keep rate increases below the pace of inflation.

For these reasons, it can be problematic to rely exclusively on an external metric like inflation to determine whether a rate increase is reasonable. Instead, rate increases must be viewed in terms of both costs and benefits, taking into account the value to customers, the time-sensitivity and prudence of the investments, and viable alternatives (if any) to the spending. This type of thorough vetting currently occurs in CPUC proceedings, like GRCs, with participation from a broad group of stakeholders who evaluate the utility's cost-of-service forecasts through discovery, testimony, evidentiary hearings, and briefing. This process ensures that the CPUC ultimately authorizes adequate levels of funding to ensure that customers are provided with safe, reliable, clean and affordable service, which is more positively impactful to customers than relying on an external metric like inflation that may result in unintended consequences if

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<sup>1</sup> White Paper, p. 7.

<sup>2</sup> System average rates include the residential California Climate Credit. See SCE Advice 4377-E-A, effective February 1, 2021; PG&E Advice 6004-E-C, effective January 1, 2021; SDG&E Advice 3620-E, effective January 1, 2021.

<sup>3</sup> This statement refers to a comparison of SCE's annual bundled system average rate to inflation starting from a base year of 1990 and is largely an extension of the analysis shown in Figure 2 on page 13 of the white paper.

<sup>4</sup> White Paper, pp. 41-42, Table 12. Per AB 1054 and D.20-09-023, as of October 1, 2020, the DWR Bond Charge related to the Energy Crisis has transitioned to the Wildfire Fund Non-Bypassable Charge.

used in isolation. As discussed more in Section II.C below, cost-of-service ratemaking is an essential component of the regulatory compact. In exchange for the IOU providing universal service and cost-based rates, the IOU has the opportunity to recover its just and reasonable costs, including a fair return on capital investment. Limiting rate increases using an external metric like inflation risks putting an artificial cap on the investments needed to realize the state's clean energy objectives, timely address the urgent risk of wildfires through grid-hardening initiatives, and meet important reliability and other customer service objectives.

**B. The white paper's conclusion about utility rate base growth would benefit from additional context on the cost drivers for utility rate base.**

In the problem statement section, the white paper concludes that "it will be essential to employ aggressive actions to minimize growth in utility rate base."<sup>5</sup> However, it is important to provide context about why and how rate base grows before assuming that policymakers should aim to minimize that growth. Once put in context, it will become evident that minimizing rate base growth is the wrong objective. Instead, the objective should be ensuring that the utilities are making needed investments in the most cost-effective manner.

Growth in utility rate base is largely driven by necessary safety, reliability, and risk mitigation spending, which should not be minimized. SCE has an obligation to provide safe, reliable, resilient, and clean electricity service to its customers. While SCE must ensure that its capital investments in furtherance of that obligation are just and reasonable, SCE cannot defer making necessary capital investments that meet that standard.

Additionally, a discussion about whether the pace of rate base growth is appropriate should also consider the benefits that customers and the public receive from investments in a safer, more reliable, and cleaner system. As the white paper recognizes elsewhere, recent rate base growth is being driven by the IOUs' necessary investments to harden the grid, implement wildfire mitigation plans, and fulfill California's public policy mandates regarding clean energy and electrification.<sup>6</sup> These investments directly benefit customers and should not be minimized.

It is also important for the white paper to acknowledge the thorough review and vetting process that the CPUC and other stakeholders engage in during proceedings that examine capital approval requests. SCE's proposed mitigations for safety risks associated with the operation of our assets are evaluated by the CPUC and stakeholders in the Risk Assessment Mitigation Phase proceedings. SCE's capital investments are reviewed and vetted in proceedings such as GRCs and other wildfire mitigation proceedings. Numerous parties participate in these proceedings, including consumer advocates, environmental advocates, and trade associations, and, before there is a final decision in these proceedings approving rate base additions, there is

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<sup>5</sup> White Paper, p. 7.

<sup>6</sup> White Paper, p. 3.

typically detailed discovery about SCE's proposed capital investments, expert review and analysis to inform the record, written party testimony, evidentiary hearings with cross-examinations, post-hearing briefing supporting positions with evidence from the record, and an opportunity for parties to comment on a proposed decision. These, and other forums such as the Safety Model Assessment Proceeding, annual risk spending accountability reports, and public participation hearings, ensure that additions to rate base are providing value to customers, reflect prudent decision-making, and should appropriately be recovered in rates.

Finally, the white paper's apparent attribution of rate base growth to profit-motivated incentives overlooks several important facts:

- As shown in testimony in SCE's 2021 GRC, from 2009-2019, SCE's capital expenditures spending came within 1% of GRC-authorized capital funding, demonstrating that there is no systematic attempt to over-spend above authorized amounts that were fully vetted and approved by the CPUC.<sup>7</sup>
- Over the last several GRCs, SCE has appropriately tried to increase net salvage rates, which, all else equal, reduces or acts as an offset to rate base. However, in part due to concerns about impacts on near-term customer rates, the CPUC has adopted net salvage rates that are both lower than SCE has requested and lower than is consistent with expected future costs of removal, which results in shifting costs to future customers. Pushing depreciation costs into the future is not an appropriate rate reduction measure, is inconsistent with cost recovery principles, and actually results in higher rate base.

**C. A more complete discussion of the regulatory compact would enhance the white paper's discussion of Return on Equity (ROE).**

The white paper frames return on equity (ROE) as incentivizing IOUs to make investments to increase rate base and, therefore, shareholder profitability.<sup>8</sup> This incorrectly assumes that utilities do not consider customer impacts, including affordability, when proposing to make such investments. This framing also fails to acknowledge the essential role ROE plays in the regulatory compact and how an authorized ROE that is commensurate with utility risk benefits customers.

Under the regulatory compact, customer and shareholder interests are *balanced*. Customers are provided with universal service and regulated cost-based rates. Additionally, instead of requiring customers to provide the entire cost of capital investments up front, the IOUs finance the up-front capital costs and then spread the recovery of those costs over many years. In exchange, the IOU has the opportunity to recover its just and reasonable costs from customers including a fair return opportunity on capital investment, as measured by the cost of obtaining capital in a competitive

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<sup>7</sup> A.19-08-013, Ex. SCE-18, Vol. 1, p. 8, Table II-4.

<sup>8</sup> White Paper, p. 24.

capital market. As the white paper acknowledges, this fair return opportunity is vital to ensure the IOU is able to raise sufficient capital to make improvements to infrastructure and provide safe and reliable service to all customers.<sup>9</sup> Without a fair return opportunity that is consistent with returns investors might expect from employing their capital in an alternative use with similar risk, the IOU would be unable to raise the money necessary for the proper discharge of its public duties. Reasonableness review and CPUC oversight under this compact further incentivize the IOUs to operate cost effectively and to make prudent investments and decisions.

Critically, an ROE that fails to adequately compensate investors for their risk would lead to increased customer costs in the long run by impairing key credit metrics that rating agencies use to evaluate and establish SCE's credit rating, including cash flow to debt ratios. In addition to credit metrics, ratings agencies review the regulatory environment of an entity as part of their ratings process, and actions they view as weakening the regulatory compact may be viewed as less credit supportive. Any ratings downgrade would result in higher debt borrowing costs for customers and would require multiple years to reverse. In the long-run, higher embedded debt costs and a lower authorized ROE make it more costly to raise the capital necessary to provide essential electric service to our customers and to support California's policy priorities.

The white paper would benefit from a discussion of this important context around ROE.

**D. The white paper's discussion about recent increases in transmission costs would similarly benefit from additional factual background and context.**

The white paper points to increases in transmission revenue requirements between 2016 and 2021 as another driver behind increases in electrical rates.<sup>10</sup> As an initial matter, unlike PG&E and SDG&E, SCE's transmission revenue requirement over that period actually decreased as shown in Table 6 of the white paper.<sup>11</sup> More importantly, however, the white paper's discussion of transmission cost increases needs important additional context.

Although not explicitly discussed in this section of the white paper, several factors outside of the utilities' control contribute to increases in transmission revenue requirements. First, recent increases in transmission costs have been largely driven by RPS requirements and transmission to support renewable generation. For example, major projects such as Tehachapi, West of Devers, and the Mesa Loop-in all play a primary role in supporting the delivery of low/zero greenhouse gas (GHG)-emitting energy.<sup>12</sup> Second, the licensing process (Certificate of Public Necessity and Convenience, and Permit to Construct) can place upward pressure on transmission

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<sup>9</sup> White Paper, p. 24.

<sup>10</sup> White Paper, p. 36.

<sup>11</sup> White Paper, p. 36, Table 6.

<sup>12</sup> For Tehachapi, see CPCN Segment 1 D.07-03-012, Segments 2-3 D.07-03-045, and Segments 4-11 D.09-12-044. For West of Devers, see CPCN D.16-08-017. For Mesa, see PTC D.17-02-015.

costs. As discussed during the *En Banc*, it can take ten years or more for a transmission project to move from the proposal stage to execution. Streamlining that process could save customers money. Moreover, there can be significant changes to the scope, route, or undergrounding obligations of a project during the licensing process, which can significantly impact costs. For example, because of the CPUC's mandate to underground just over three miles of lines in Chino Hills over SCE's objections, costs for the Tehachapi Renewable Transmission Project increased \$350 million.<sup>13</sup> Greater consideration should be given to the cost impact for orders requiring undergrounding of transmission lines.

Finally, as the white paper recognizes, much of the cost of transmission is Federal Energy Regulatory Commission (FERC)-jurisdictional. While the white paper appears to indicate that FERC ROE incentives drive costs upward, some important context is missing. Those ROE incentives are designed to promote the efficient use of transmission and provide other benefits to customers through market efficiencies (both via participation in an Independent System Operator (ISO)), or to improve reliability and affordability by increasing the likelihood of investment in projects that involve significant risks. All such projects are still approved through the California ISO's transmission planning process and the CPUC's licensing process and provide valuable benefits to customers. In SCE's case, these FERC-jurisdictional ROE incentives helped California realize three key policy-driven transmission projects to support greater renewable integration.<sup>14</sup>

**E. The white paper should emphasize that, over time, electrification will produce important overall energy bill savings for an average household even as electric bills increase.**

The white paper questions whether IOU investments in transportation electrification (TE) will place a significant downward pressure on rates to counteract a potential increase in spending on infrastructure needed to support TE.<sup>15</sup> This focuses too narrowly on the short term and does not adequately reflect the critical role that TE plays in meeting California's goal to reach carbon neutrality by 2045. SCE's Pathway 2045 analysis demonstrates that the most cost-effective way to achieve the state's GHG reduction goals is to decarbonize electric generation and significantly increase electrification of transportation and buildings. Pathway 2045 calls for electrification of 75% of light-duty vehicles, 65% of medium-duty vehicles, and 33% of heavy-duty vehicles by 2045. Over time, increased electrification will create downward pressure on customer rates as fixed costs are spread across a broader base of kilowatt hour sales and new load is able to help incorporate increased renewable generation.

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<sup>13</sup> See D.13-07-018.

<sup>14</sup> SCE has received ROE incentives for its Rancho Vista, Tehachapi, and DPV2 projects. See FERC's November 16, 2007 Order under Docket No. EL07-62, Cite 121 FERC ¶ 61,168. The DPV2 project was subsequently modified under FERC Docket No. ER10-160.

<sup>15</sup> White Paper, p. 69.

More importantly, however, the pathway to decarbonization and electrification will produce important overall energy bill savings for an average household. While electricity bills increase over time due to higher usage, SCE's Pathway 2045 analysis shows that the overall energy bills for an average household decrease by one third by 2045, driven primarily by reduced gasoline consumption and significant energy efficiency gains resulting from electrification of vehicles and buildings in California. The white paper would benefit from considering this broader context when examining the effect of electrification costs on electric rates, and should recognize the importance of making strategic near-term investments to support electric transportation in order to achieve long-term benefits that lead to lower costs for customers, improve public health, and enable the state to achieve carbon neutrality.

**F. SCE appreciates the white paper's recognition of the inequitable Net Energy Metering (NEM) revenue shift.**

Finally, SCE agrees with the white paper that the revenue shift from NEM participants—who are disproportionately older homeowners in high-income areas—to lower-income non-participants is inequitable.<sup>16</sup> On a per participating customer basis, the NEM subsidy (\$1,800) dwarfs the low-income California Alternate Rates for Energy (CARE) subsidy (\$375). This significant subsidy continues because the current NEM tariff not only allows participating customers to avoid paying for fixed distribution- and transmission-related costs, but also overcompensates energy exported by these customers by eight times compared to what it costs to procure solar energy from utility scale resources. On March 15, 2021, SCE submitted proposals in Rulemaking 20-08-020 to revise the rate and compensation structures provided to customers installing rooftop solar to address this inequity and cost-shifting.

**III. POTENTIAL STRATEGIES FOR COST REDUCTION THAT WARRANT CONSIDERATION**

With cost pressures from public policy initiatives, necessary wildfire mitigation work and grid hardening, increasing customer expectations, safety measures, and the need to integrate new technologies, SCE continues to take a broad and thoughtful approach to finding areas where costs can be reduced to help offset some of these necessary cost pressures and keep rates affordable for its customers. As it has for more than a decade, SCE will continue to proactively pursue cost reduction opportunities through its operational excellence efforts. SCE also continues to advocate for timely rate recovery decisions and authorization of interim rate relief to help smooth out rate increases during this period of upward pressure on rates.

SCE also respectfully submits the following additional cost reduction strategies for the CPUC's consideration:

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<sup>16</sup> White Paper, p. 28.



- Specifically authorizing customer-funded self-insurance against wildfire risk (Section III.A);
- Modifying existing power procurement mechanisms by eliminating the fixed energy option for must-take contracts, extending the SoCalGas Operational Flow Order (OFO) reduced penalty structure, and permitting greater flexibility for selling Renewable Energy Credits (RECs) (Section III.B); and
- Complementing customer contributions to public policy programs with broader statewide funding (Section III.C).

**A. Customer-funded self-insurance against wildfire risk could result in substantial savings for customers over a multi-year period.**

As discussed during the *En Banc* hearing, the cost of wildfire insurance premiums, which are a traditional cost of service collected through rates, has increased significantly for IOUs in recent years. Although the Assembly Bill 1054 Wildfire Fund covers claims that exceed \$1 billion in the aggregate over a policy year, the IOUs must procure commercial insurance for or self-insure the first \$1 billion.<sup>17</sup> While SCE has aggressively pursued insurance at the lowest cost possible, SCE's current wildfire insurance premiums cost around \$450 million per year for approximately \$1 billion of coverage, subject to up to \$80 million of co-insurance and \$50 million of self-insured retention, which results in net coverage of approximately \$870 million.<sup>18</sup> By foregoing some of the highest cost commercial insurance, and instead self-insuring the risk with customer funded self-insurance, customer savings could be substantial over a multi-year period, potentially in the hundreds of millions of dollars, assuming actual claims costs do not exceed the avoided cost of the insurance over the multi-year term.

**B. Eliminating the fixed energy option for must-take contracts, extending the Operational Flow Order (OFO) reduced penalty structure, and permitting greater flexibility for selling Renewable Energy Credits (RECs) would save customers money.**

SCE has also identified potential changes to power procurement mechanisms that would reduce costs. First, eliminating the fixed energy price option for must-take contracts with Qualifying Facilities (QFs) would prevent mandated procurement of QFs at above market prices. While FERC recently issued Order 872 that would allow states to no longer require a fixed energy price option for these must-take contracts with QFs, the CPUC to-date has declined IOU requests for the CPUC to eliminate (or even suspend) the fixed price option. Second, extending the SoCalGas OFO reduced penalty structure for the summer months would help keep gas costs stable, which helps to stabilize electricity prices. The reduced penalty structure, which is set to sunset at

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<sup>17</sup> See Cal. Pub. Util. Code Section 3280(f); see *also* Cal. Pub. Util. Code Section 3293 (requiring that “[a] participating electrical corporation shall maintain reasonable [wildfire] insurance coverage”).

<sup>18</sup> See A.20-12-010, at p. 2.

the end of September 2021, was adopted by the CPUC in D.19-05-030 in response to significant gas and resulting electricity price spikes in summer 2018 due to limited access to storage on the SoCalGas system. Extending (or permanently reducing) the lower OFO penalty structure would help manage price volatility in the electricity market and mitigate a potential market spike again. Third, permitting the sale of RECs below annual RPS targets while still using the Tier 1 Advice Letter approval process, eliminating the price floor on the sale of RECs, and providing more flexibility in increasing the terms of contracts up to 10 years would provide SCE with more flexibility to better monetize its RECs, which are held solely for the benefit of SCE's customers, and avoid stranding its RPS bank.

**C. Complementing customer contributions to public policy programs with broader statewide funding could help control customer costs while preserving the benefits of utility administration of these programs.**

Finally, to cost-effectively achieve carbon neutrality and encourage the economics of fuel switching, SCE believes that California should continue to assess opportunities to move costs out of electric rates to other methods of socialization when appropriate. When assessing specific opportunities to fund programs and decarbonization efforts that benefit the broader public in addition to electric customers, the state should consider a number of factors, including the need to keep electricity affordable, the need to decarbonize quickly and cost effectively, the fact that the benefits of decarbonization extend beyond the utility's service territory, and the ability of other actors to take on new costs and shoulder new responsibilities in delivering these broader public benefits.

There will be many public policy programs that still benefit from utility administration and electric customer funding. IOUs are well-positioned to move at scale towards the state's environmental goals. They are the strongest partner the state has in preparing the electric grid for a carbon-neutral future and adapting that system to a changing climate. However, even where public policy programs still benefit from utility administration and some level of electric customer funding, the state should consider opportunities to complement those customer contributions with broader statewide funding beyond just electric utility customers. Bringing state funds to these public policy programs that remain with the electric utilities could help control customer costs while at the same time ensuring that the unique benefits of utility administration remain.

**IV. CONCLUSION**

SCE appreciates the opportunity to submit these comments and looks forward to continuing to work with the CPUC and stakeholders on these critical cost and affordability issues.

Sincerely,

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