REPLY TESTIMONY OF YAKOV LASKO

Q1. What is the purpose of your reply testimony?

A1. Southern California Edison (SCE) requests that the Commission grant SCE the opportunity to file an application to adjust SCE's authorized capital structure "should new or renewed PPAs [power purchase agreements] (signed after the Commission's approval of this proposal) result in an increase in debt equivalence that causes a significant adverse impact on SCE's credit ratios."[1] My testimony responds to this request. SCE is concerned about the new or renewed PPAs that may be signed after the Commission's approval of SCE's request for authority to procure local capacity requirement (LCR) resources in Rulemaking (R.)12-03-014. SCE's claims that these new LCR PPAs could increase SCE's debt equivalence by an amount ranging from $0.9 billion to $2.9 billion, which SCE contends "could have serious adverse effects on SCE's credit metrics, diminishing SCE's creditworthiness, and even possibly trigger a downgrade of SCE's credit rating that would adversely impact SCE, its suppliers, and its customers."[2]

Q2. What does your reply testimony recommend?

A2. I recommend that the Commission deny SCE's request to file an application to adjust SCE's capital structure outside of SCE's regular cost of capital proceeding.

Q3. What is debt equivalence?

A3. Debt equivalence is a term used by credit rating agencies, specifically Standard & Poor's (S&P) and to a lesser extent Moody's Investors Service (Moody's), and Fitch Ratings (Fitch's) to describe the fixed financial obligations resulting from the company entering into long-term PPAs. The PPA contracts are considered to be debt equivalents by S&P and Moody's because the periodic payments are required to be made and the payments cannot be avoided without defaulting on the contract. The rating agencies' views vary on the financial treatment of PPAs. For example, S&P

[1] 2012 Long-Term Procurement Plan Testimony of Southern California Edison Company on Local Capacity Requirements, June 25, 2012 (SCE Testimony) at. 28:7-8.

[2] SCE Testimony, at. 27:18 to 28:2.

uses a strict quantitative approach that imputes debt on the company's balance sheet, while Fitch ~~Ratings (Fitch) has no debt imputation.~~ and Moody's use a qualitive approach.

Q4. Should the Commission grant SCE an opportunity to file an application to adjust SCE's authorized capital structure outside its usual Cost of Capital Proceeding?

A4. No, the Commission should reject SCE's request for authorization to file an application to adjust SCE's authorized capital structure outside its usual Cost of Capital proceeding.[3] SCE proposes that the Commission allow SCE to request an adjustment in SCE's authorized capital structure solely based on the increase in debt equivalence that would result from potential new LCR PPAs. Debt equivalence is only one of the many components that are used to establish SCE's authorized cost of capital in the Cost of Capital Adjustment Mechanism. The authorized cost of capital is computed based on weighted average cost of long-term debt, common equity and preferred equity. As the market conditions change (such as risk-free rate, market risk premium, liquidity of funds, beta, growth rate projections, etc.), the assumptions that go into computation of cost of debt and equity will also change, which will affect SCE's cost of capital. Therefore, it is inappropriate to look at the impact of debt equivalence on SCE's cost of capital in isolation without considering all of the other components. The appropriate venue to consider the potential impact of new or renewed PPAs on SCE's debt equivalence is the Cost of Capital proceeding, not a separate application.

Finally, SCE in its *Testimony Supporting Southern California Edison's Application for Authority to Establish Its Authorized Cost of Capital for Utility Operations for 2013 and to Reset the Annual Cost of Capital Adjustment Mechanism,* Application (A.)12-04-045 filed on April 20, 2012, states on page one that "SCE is requesting the Commission continue with SCE's existing capital structure, the three-year cost of capital cycle and the cost of capital mechanism that governs SCE's cost of capital between applications." If SCE is concerned about the impact new LCR procurement contracts would have on SCE's debt equivalence in the immediate future, necessitating some kind of remedy between the three-year cost of capital cycle, it is unclear why

[3] See D.08-05-035, which established a multi-year cost of capital mechanism for SCE, as well as for Pacific Gas and Electric Company and San Diego Gas and Electric Company.