DIRECT TESTIMONY OF JAMES WEIL

Application 12 11 009, Investigation 13 03 007
Pacific Gas and Electric Company
Test Year 2014 General Rate Case

Served May 17, 2013

on behalf of

The Utility Reform Network
115 Sansome St #900
San Francisco, CA 94104

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Pursuant to the procedural schedule adopted in the January 22, 2013 scoping ruling of Assigned Commissioner Michel Florio, this direct testimony is served on behalf of The Utility Reform Network (TURN) in the test year 2014 general rate case (GRC) of Pacific Gas and Electric Company (PG&E). In the testimony I respond to PG&E's showing in Exhibit (PG&E 10), Chapter 12. I also analyze PG&E's financial health, and recommend findings of fact.

Concurrent with service of this testimony, TURN will serve a volume of Supporting Documents associated with the testimony. I intend that the Supporting Documents will be marked and received into evidence during evidentiary hearings in this matter.

1. Summary

On behalf of TURN, I recommend that the Commission:

- Disregard PG&E's request that the Commission endorse the company's efforts to earn its authorized rate of return;
- Find that PG&E is financially healthy; and
- Find that granting PG&E all of its test year and attrition requests is not necessary for the company to maintain the financial health it requires to provide adequate utility service.

2. Relief Requested

With its application, PG&E filed seven pages of prepared testimony titled, "Alignment of Investor and Ratepayer Interests." (Exhibit (PG&E 10), Chapter 12, sponsored by Walter Campbell and Jay Dore.) The testimony claims that it is essential that the Commission ensure that PG&E has a reasonable opportunity to earn its authorized rate of return, and asserts that access to capital markets "provides benefits to customers and aligns shareholder and customer interests." (Exhibit (PG&E 10), p. 12 1.) Following discussion of the workings of competitive capital markets, PG&E requests only one specific item of relief: "In this GRC, the

Commission should endorse PG&E's efforts to earn its authorized rate of return." (Exhibit (PG&E 10), p. 12 7.)

3. Rate Case Decisions

Irrespective of PG&E's requested relief, the Commission should recognize that providing an opportunity to earn authorized returns does not require approval of every dollar of revenue requirement requested in this general rate case. TURN has reviewed the history of PG&E general rate case decisions. Table 1 below shows that in the past seven GRCs filed by PG&E the Commission authorized revenue requirements in the range of 83% to 97% of requested amounts. (See Supporting Documents, p. 8, PG&E response to discovery request TURN_024 10; GRCs for the seven test years did not always cover the same costs.)

TABLE 1. Rate Case Results

	Revenue Requirement ($ million)		
Test Year	Requested	Adopted	Percent
	(a)	(b)	(c)
1990	$4,675	$4,268	91.3%
1993	$5,200	$5,041	96.9%
1996	$4,584	$4,346	94.8%
1999	$3,534	$2,919	82.6%
2003	$4,637	$4,332	93.4%
2007	$5,224	$5,043	96.5%
2011	$6,778	$6,169	91.0%

Wall Street is well aware that regulatory commissions do not generally approve all utility rate case requests. For example, on October 5, 2009, at the annual meeting of the Conference of California Public Utility Counsel, Philip Smythe, Senior Director for Fitch Ratings, stated that rating agencies do not assume that this Commission will approve utility rate requests in full. His opinion was based on historical experience.

I do not suggest that the Commission should resolve this general rate case by simply authorizing a percentage of the dollars that PG&E requests. However, history shows that Commission approval of PG&E's entire showings is not the norm.

In a test year 2004 general rate case decision for Southern California Edison Company (SCE), issued in July 2004, the Commission addressed investor confidence:

> "[W]e find no evidence convincing us that granting SCE the full amount of its requested test year base revenue is a necessary precondition for the company to achieve the financial health it requires to provide adequate utility service.
>
> * * *
>
> "In summary, our concept of 'supportive regulation' includes support for ratepayers as well as the interests of the utility and its investors." (Decision (D).04 07 022, discussion, slip op. at 11 12; see also Finding of Fact 1 at 308.)

In PG&E's test year 2007 rate case decision, issued in March 2007, the Commission addressed PG&E's financial health. The Commission explicitly found:

> "29. PG&E is financially healthy.
>
> "30. Today's Opinion provides PG&E with sufficient revenues to maintain its financial health, to provide good, safe, and reliable utility service, and to make necessary capital investments." (D.07 03 044, slip op. at 275.)

In PG&E's test year 2011 rate case decision, issued in May 2011, the Commission approved a settlement agreement that resolved most revenue requirement issues and addressed PG&E's financial health. The Commission found:

> "15. PG&E is financially healthy and has very stron g access to capital because of its strong balance sheet and its ability to raise capital from both equity and debt financing.
>
> "16. For the time period covered by this GRC, the Settlement Agreement will provide PG&E with sufficient revenues to maintain its financial health, provide adequate service, and make necessary capital investments." (D.11 05 018, slip op. at 82 83.)

4. Necessity for Requested Revenue Requirements

In testimony, PG&E asserts, "Through its GRC requests, PG&E asks for the resources we believe are <u>necessary</u> to safely operate the majority of our utility and deliver the safe and reliable service our customers expect." (Exhibit (PG&E 1), p. 2 4, emphasis added.) Despite the implication that all of its GRC requests are necessary, PG&E elsewhere states, "PG&E seeks to balance the objective of providing safe and reliable service with its aspiration to provide low utility rates, both today and over time. PG&E considers earning a reasonable rate of return to be necessary to achieve this balance." (Supporting Documents, p. 10, PG&E response to discovery request TURN_024 16, which affirms a PG&E statement made in the test year 2011 GRC.)

The Commission should not accept PG&E's claim that every dollar of its GRC request is necessary to provide safe, reliable service or to maintain PG&E's financial health. If the Commission does not grant all of the 2014, 2015 and 2016 revenue requirements requested by PG&E, which would be typical of major utility GRC decisions, PG&E has flexibility to adjust its budgets and spending levels. PG&E explains:

> "With the goal of providing safe, reliable, affordable, and customer focused service to its customers, PG&E attempts to operate its business within the cost levels authorized by the Commission. Should the Commission not grant PG&E's test year and attrition year revenue requirement requests in this proceeding, PG&E would, as it does in any given year, evaluate the work priorities and circumstances to determine an appropriate level of spending." (Supporting Documents, p. 9, PG&E response to discovery request TURN_024 11.)

PG&E also realizes that unanticipated changes in operating expenses or capital expenditures can "affect the Utility's ability to earn its authorized rate of return. … In addition, the CPUC or the FERC [Federal Energy Regulatory Commission] may not allow the Utility to recover costs that it has already incurred on the basis that such costs were not reasonably or prudently incurred or for other reasons." (Supporting Documents, p. 12, PG&E Corporation and PG&E, 2009 Annual Report.) Despite these warnings, PG&E met or exceeded its authorized returns from 2005 through 2008, and just missed in 2009 and 2010. (Supporting Documents, p. 6, PG&E response to discovery request TURN_024 09.) Recorded returns were somewhat lower in 2011, which was the test year for PG&E's last GRC. PG&E voluntarily settled the great majority of 2011 GRC revenue requirements.

5. Financial Health

The Commission should view this general rate case in the context of PG&E's financial health, which is very good.

In April 2001 PG&E defaulted on bond payments and voluntarily entered bankruptcy. The recovery process began earlier that year, when the Commission authorized electric rate increases of 4.5 cents per kilowatt hour to improve cash flows for PG&E and SCE. In December 2003, following an investigation into PG&E's bankruptcy, the Commission approved a settlement agreement that included a $2.21 billion regulatory asset meant to provide PG&E with sufficient cash to achieve investment grade credit ratings. (D.03 12 035, Appendix C, p. 7.) The regulatory asset, which PG&E financed with Energy Recovery Bonds, led to an after tax gain to PG&E of approximately $2.95 billion, or $6.92 per share of common stock, reported in 2004. (PG&E Corporation, Annual Report 2005, p. 31.) The regulatory asset and resulting shareholder gain were not related to PG&E's cost of service, but were meant to improve PG&E's financial health.

The financial community responded to the bankruptcy settlement by returning PG&E's credit ratings to investment grade. In March 2004, Moody's Investor Service raised PG&E's corporate credit rating to Baa3; in April 2004, Standard & Poor's raised its rating to BBB minus. (Supporting Documents, p. 4, PG&E response to discovery request TURN_024 04.) In early 2005, Moody's raised PG&E's rating another two notches to Baa1, and Standard & Poor's raised its rating one notch to BBB, stable. In May 2007, Standard & Poor's raised its rating another notch to BBB+, stable. In December 2007, Moody's raised PG&E's rating to A3, stable. Four years later, in December 2011, Standard & Poor's reduced PG&E's rating from BBB+ to BBB, stable. The decreased rating was a result of the September 2010 explosion on PG&E's natural gas system in San Bruno. Concurrent with the reduced rating Standard & Poor's stated:

> "Our rating action reflects what we view will be a multiyear rebuilding of the company's natural gas operations, customer reputation, and regulatory relationships following the 2010 San Bruno, Calif. gas transmission explosion that resulted from the utility's inadequate controls." (Supporting Documents, p. 46, PG&E response to discovery request TURN_024 07, Attachment 15.)

PG&E's prospects for increased earnings in test year 2014 are good. The consensus of Wall Street forecasts is that PG&E earnings will decline in 2013, due largely to regulatory impacts of the San Bruno explosion, followed by increased earnings in 2014. PG&E Corporation's earnings guidance for 2013 is $2.55 to $2.75 per share of common stock. (Earnings from operations, non GAAP; Supporting Documents, p. 13, PG&E Corporation website.) Recent equity analyst earnings forecasts for 2014 are generally in the range of $3.15 to $3.32 per share. (PG&E response to discovery request TURN_024 06, various reports: Deutsche Bank $3.15; Citi Research $3.16; Credit Suisse $3.19; FB Capital $3.21; Jefferies Equity Research $3.25; BernsteinResearch $3.32.)

Since the depths of the 2000 2001 financial crisis,PG&E Corporation's shares have risen from around $8 to more than $46. (Supporting Documents, p. 59.) The central feature of these financial improvements has been strong cash flows. Table 2 below shows that PG&E earnings from operations have grown steadily since emergence from bankruptcy. PG&E Corporation has raised common stock dividends to $1.82 per share (annual), up 51% over 2005 levels.

(Supporting Documents, p. 15, PG&E Corporation website.) PG&E's holding company did not reduce its dividends in response to San Bruno risks.

TABLE 2. PG&E Earnings

Year	Earnings per share from operations (a)	April quarterly dividends (b)
2004	$ 2.12	
2005	$ 2.34	$ 0.30
2006	$ 2.57	$ 0.33
2007	$ 2.78	$ 0.36
2008	$ 2.95	$ 0.39
2009	$ 3.21	$ 0.42
2010	$ 3.42	$ 0.455
2011	$ 3.58	$ 0.455
2012	$ 3.22	$ 0.455
2013		$ 0.455

PG&E operates in a supportive state regulatory environment. This conclusion is backed by the Commission's emphasis on credit ratings during PG&E's bankruptcy, and by recent financial community writings. For example, in February 2011, five months after the San Bruno explosion, Standard & Poor's stated, "Although we expect the CPUC will remain constructive, the ongoing assessments of PG&E's system, its records, and management's response to the accident will undoubtedly influence the process of arriving at a fair allocation of costs to ratepayers versus shareholders. ... Outside of San Bruno, regulatory outcomes and other aspects of the company's financial performance continue to be stable." (Supporting Documents, pp. 40 41, PG&E response todiscovery request TURN_024 07, Attachment 11.) In April 2012, Moody's gave PG&E a Regulatory Framework score of "A" and stated, "In recent years, CPUC regulation has been increasingly more predictable and credit supportive, driving capital market support for investment in large infrastructure projects within the state." (Supporting Documents, pp. 36 and 33, PG&E response to discovery request TURN_024 07, Attachment 27.) In October 2012 Wells Fargo Securities stated, "We view California regulation as reasonably constructive. However, the outcomes in

PG&E's pending regulatory proceedings are likely to be impacted by the San Bruno incident." (Supporting Documents, p. 58, PG&E response to discovery request TURN_024 06, Attachment 330.) In December 2012, Deutsche Bank Securities stated, "We view the California regulatory framework as constructive ...." (Supporting Documents, p. 30, PG&E response to discovery request TURN_024 06, Attachment 370.) In January 2013, BCG Financial cited "increasingly supportive CA regulation" and gave PG&E Corporation a "Buy" rating. (Supporting Documents, pp. 19 21 and 16, PG&E response to discovery request TURN_024 06, Attachment 381.)

I am aware of a 2012 analyst report that evaluated public utility regulatory climates among the 50 states and the District of Columbia, from an investor perspective. California's ranking is significantly higher than the report's median ranking. (PG&E response to discovery request TURN_048 02; TURN has declined to pay the fee required to include a page from the report in supporting documents.) Clearly, the financial community thinks well of California's regulatory climate.

Access to capital is an important aspect of a utility's financial health, as PG&E has explained at length, but PG&E exaggerates the hazards of "difficult capital market or energy market conditions." (Exhibit (PG&E 10), p. 12 4.) TURN asked PG&E to cite "specific problems that PG&E has experienced in attracting or competing for capital" since PG&E emerged from bankruptcy. PG&E described certain situations that arose during 2008 and 2009. (Supporting Documents, p. 1, PG&E response to discovery request TURN_024 01.) During the financial crisis of that period, PG&E maintained investment grade credit ratings. However, according to PG&E, "Despite these relatively stronger credit ratings, PG&E was temporarily unable to access the debt markets at the peak of the financial crisis." In its testimony, PG&E cites problems obtaining adequate short term credit facilities during 2008 and 2009 "when banks refused or were unable to provide credit to PG&E, due primarily to the severe global economic recession coupled with financial distress within the banking industry." (Exhibit (PG&E 10), p. 11 10.) These stories reflect problems with short term credit markets, not with debt or equity markets. None of the cited problems was driven by PG&E's credit ratings or company specific financial risks. PG&E experienced financial stresses in the same way that other firms felt the financial crisis of 2008 2009. I expect that PG&E will continue to have reasonable access to capital markets during the test year 2014 rate case cycle. My expectations will be strengthened if the Commission reduces authorized capital spending in this proceeding, relative to PG&E's requests, due to reduced demand for new capital.

PG&E's credit metrics are adequate to support investment grade ratings. Standard & Poor's assigns PG&E a "strong" business risk profile, and it expects that PG&E's funds from operations (FFO) to debt ratio will weaken to about 16% in 2013 then improve in 2014. In December 2012, Standard & Poor's stated, "Starting in 2014, we expect that the cash flow measures will gradually improve so that FFO to debt is about 18.5% ...." (Supporting Documents, pp. 53 55, PG&E response to discovery request TURN_024 19.)

I have reviewed PG&E's projected income statements, balance sheets, cash flow statements, and relevant credit metrics. (PG&E confidential responses to discovery requests TURN_024 02 and TURN_048 01.) PG&E has prepared two sets of projections. The first set of projections assumed GRC revenues consistent with the Notice of Intent that preceded this application. The second set "presents a negative outlook, which assumed, among other things, a 2014 GRC revenue increase that included large unidentified reductions from PG&E's requested expense and capital expenditure funding levels ...." (Supporting Documents, p. 2, PG&E narrative response to discovery request TURN_024 02) I would characterize the assumption that the Commission will not authorize PG&E's entire request as realistic, not negative. Nonetheless, I commend PG&E for preparation of financial projections that reflect likely outcomes in this GRC. (At the time of PG&E's last GRC, PG&E had prepared only the first set of projections.) Based on my review of both sets of projections, I believe that PG&E's financial metrics will remain strong throughout the 2014 2016 rate case cycle. My chiefconcern with PG&E's financial projections is the implied increase in retail rates during upcoming years.

The San Bruno explosion has affected PG&E's financial picture, but the financial community expects that those risks will be resolved in 2013 and 2014 without long term harm to the company. PG&E has shown no good cause for the Commission to approve PG&E's requested GRC revenues in order to improve PG&E's financial condition.

The evidence presented herein clearly demonstrates that PG&E's finances are sound. As it has in previous GRCs, the Commission should issue explicit findings that PG&E is financially healthy, and that granting PG&E all of its test year and attrition requests is not necessary for the company to maintain the financial health it requires to provide adequate utility service.

The Division of Ratepayers Advocates did not serve direct testimony on PG&E's financial health.

6. Conclusion

The Commission should disregard PG&E's request that the Commission endorse the company's efforts to earn its authorized rate of return. Financial cheerleading from the Commission is neither necessary nor useful.

Based on the evidence presented herein, the Commission should find that PG&E is financially healthy, and that granting PG&E all of its test year and attrition requests is not necessary for the company to maintain the financial health it requires to provide adequate utility service.

* * *

This completes my direct testimony. A statement of qualifications is appended.

APPENDIX

Statement of Qualifications

My name is James Weil. My business address is: PO Box 866, Novato, CA 94948. I am a retired administrative law judge. I have worked since 1997 as a regulatory consultant, expert witness and Director of Aglet Consumer Alliance.

I hold a Bachelor of Science degree in Mechanical Engineering from the Massachusetts Institute of Technology, a Master of Science degree in Engineering from the University of California at Berkeley, and a Doctor of Philosophy degree in Engineering, also from the University of California at Berkeley. The subject of my doctoral dissertation was mixing of power plant cooling water discharges. I have completed courses in administrative law and alternative dispute resolution given by the National Judicial College, University of Nevada, Reno.

I am licensed as a Mechanical Engineer by the State of California (M14340).

I was employed at the California Public Utilities Commission for 14 years. During the first half of that tenure I served as an engineer and expert witness, research specialist, supervisor and branch chief, and Commissioner advisor. In seven years as an administrative law judge, most of my cases were high stakes electric and gas proceedings, including major general rate cases. Since leaving State service I have participated in many Commission proceedings.

Earlier in my professional career I worked for: Pacific Gas and Electric Company, Department of Engineering Research, performing model studies and laboratory and field testing; the Swedish Meteorological and Hydrological Institute, testing computer models and lecturing on hydrodynamics; and the American Samoa Government, Territorial Energy Office, building energy conservation and renewable energy demonstration projects.

I have previously testified before the California Public Utilities Commission and the American Samoa Power Authority, and in civil courts.

This completes my statement of qualifications.

CERTIFICATE OF SERVICE

I certify that I have by electronic mail this day served a true copy of the original attached "Direct Testimony of James Weil" on all parties of record in this proceeding or their attorneys of record. I will mail paper copies of the testimony and supporting documents to Assigned Commissioner Michel Florio and Administrative Law Judge Thomas Pulsifer.

Dated May 17, 2013, at San Francisco, California.

/s/

Jessica German