BEFORE THE CALIFORNIA STATE BOARD OF EQUALIZATION
450 N STREET
SACRAMENTO, CALIFORNIA
BOARD MEETING TELECONFERENCE

REPORTER'S TRANSCRIPT
DECEMBER 16, 2020

PROPERTY TAX APPEAL HEARING
APPEAL OF
SOUTHERN CALIFORNIA EDISON COMPANY
(0148)
NO. 1064117
PETITION FOR REASSESSMENT
OF UNITARY VALUE

REPORTED BY: Jillian M. Sumner
CSR NO. 13619

APPEARING TELEPHONICALLY OR THROUGH VIDEOCONFERENCE

For the Board of Equalization:	Honorable Antonio Vazquez Chair
	Honorable Mike Schaefer Vice Chair
	Honorable Ted Gaines First District
	Betty T. Yee State Controller
For Board Proceedings Staff:	Catherine Taylor Chief Board Proceedings Division
For Department:	Sarah Garrett Tax Counsel Legal Department
	Richard Moon Tax Counsel Legal Department
	Jack McCool Supervisor Property Tax, Valuation Unit State-Assessed Properties Division
	Daniel Jenkinson Senior Specialist Property Auditor Appraiser State-Assessed Properties Division
For Petitioner:	Mardiros Dakessian Attorney Dakessian Law Firm
	Andrea Wood Vice President of Tax Edison International
	Karl Matthews Principal Manager Southern California Edison

APPEARANCES CONTINUED

For Petitioner:

Karl Matthews
Principal Manager
Southern California Edison

David Lee
Tax Manager
Edison International

Jason Chow
Ernst & Young

Greg Manos
Ernst & Young

Cornelia Lyons
Ernst & Young

Kevin Alvarado
Ernst & Young

---oOo---

STATE BOARD OF EQUALIZATION
VIDEOCONFERENCE
DECEMBER 16, 2020
---oOo---

MS. TAYLOR: The next item on the agenda is B2, Petition for Reassessment of Unitary Value.

There is one oral hearing, Southern California Edison Company, 0148.

The oral hearing procedures are as follows:

Please be ready to unmute and turn on your camera as requested.

A Legal Appeals Division staff member will introduce your case, stating the issues for the hearing.

Each person on the call will then be asked to introduce themselves and their affiliation with the taxpayer for the record.

Contribution Disclosure forms were required and were received from the petitioner and the representatives prior to the beginning of the Board Meeting.

This is a constitutional function.

All other forms were properly completed and signed. No disqualifying contributions were disclosed.

All parties, agents and participants are on the alpha listings provided to your office.

This matter will be introduced by

Ms. Garrett, who will provide a brief introduction.

MS. GARRETT: Good morning again, Chairman Vazquez.

MR. VAZQUEZ: Good morning.

Go ahead.

MS. COHEN: Pardon me. Pardon me, ladies and gentlemen. I'm sorry.

MR. VAZQUEZ: Oh, yes. Yes.

MS. COHEN: This is Board Member Cohen.

I had my hand raised a couple times, and it was lowered.

But I just wanted to state for the record that I'm going to be -- in an abundance of caution, going to be recusing myself from this item.

I'm going to turn off my camera, and -- and mute myself for the duration of the discussion.

And my staff will signal to me when I can come back on.

MR. VAZQUEZ: Thank you.

MS. COHEN: Thank you.

MR. VAZQUEZ: Go ahead, Ms. Garrett.

MS. GARRETT: Thank you.

In the case before you today, petitioner is Southern California Edison Company, a public utility operating in Southern, Coastal and Central California.

Petitioner has raised 6 primary issues with its 2020 Board-adopted unitary value, which was based on the January 1st, 2020 lien date.

Respondent has reviewed the contentions raised by the petitioner, and has recommended an adjustment as to issue 5, which is related to the treatment of self-insured retention expenses; and issue 6, related to obsolescence.

Additionally, petitioner has indicated agreement to respondent's recommendation on issue 5 and issue 6 for purposes of this hearing.

Accordingly, based on this agreement, the parties are requesting the Board's adoption of their agreement as to issues 5 and 6, and thus will not be substantively presenting on these two issues today.

Today the parties will present on the following four remaining issues:

First, whether petitioner has shown that respondent erred in placing 75 percent reliance on the Historical Cost Less Depreciation value indicator, and 25 percent reliance on the Capitalized Earning Ability indicator of value.

Second, whether petitioner has shown that respondent must adjust the Board-adopted value for petitioner's $4.5 billion accrual for liabilities for the 2017 and 2018 wildfires and mudslides.

Third, whether petitioner has shown that respondent improperly assessed 400 million of wildfire mitigation capital expenditures.

And fourth, whether petitioner has shown that respondent erred in its treatment of Wildfire Insurance Fund-related contributions.

Petitioner has the burden of proof to show that the 2020 Board-adopted assessment is incorrect or illegal.

The parties are present and ready to present their cases before the Board.

MS. TAYLOR: Excuse me, Chairman. This is Ms. Taylor.

MR. VAZQUEZ: Yes. Go ahead, Ms. Taylor.

MS. TAYLOR: Ms. Taylor -- Chairman Vazquez, we've received a request to take a one-hour lunch break from noon to 1:00 p.m. today.

MR. VAZQUEZ: Yes.

MS. TAYLOR: Okay. I just wanted that to be known to our participants.

Thank you.

MR. VAZQUEZ: Yes, I -- I was aware of that. So depending on where we're at, we'll break. I mean, right now we're about 40 minutes out.

MS. TAYLOR: Right.

MR. VAZQUEZ: So if for some reason we're in the middle of this, we'll take a break.

And with that, I'm assuming the folks from Edison are on the line.

And welcome to the Board of Equalization.

You have 30 minutes to make your initial presentation, and then you'll have an additional 10 minutes on rebuttal.

Please unmute and introduce yourselves.

MR. DAKESSIAN: Good morning.

MR. VAZQUEZ: Good morning.

MR. DAKESSIAN: Good morning, Mr. Chairman and Members of the Board.

My name is Mardi Dakessian, and my firm, Dakessian Law, represents Southern California Edison.

With me today are Ms. Andrea Wood, who is the Vice President of Tax with Edison International; Karl Matthews, Principal Manager with Southern California Edison; and David Lee, Tax Manager with Edison International.

Also with me today are Jason Chow, Greg Manos, Cornelia Lyons, and Kevin Alvarado of the international accounting firm of Ernst & Young.

EY studied staff's valuation and issued its written findings, which you have in your materials as Exhibit D.

So before we get started today, I would like to play for you an audio clip that I think will help set the stage for our discussion.

MS. TAYLOR: Mr. Dakessian.

MR. DAKESSIAN: Yes, ma'am

MS. TAYLOR: This is Ms. Taylor.

We do need to swear in all the participants that you listed.

So if everyone would please raise their

right hand and answer, do you swear to tell the truth in these proceedings?

MR. DAKESSIAN: Thank you. Yes.

MR. CHOW: Yes from Jason Chow, EY.

MS. TAYLOR: Thank you.

MR. MATTHEWS: Yes. Karl Matthews.

MR. LEE: Yes. Yes. David Lee.

MR. MANOS: Yes. Greg Manos from EY.

MR. ALVARADO: Yes. Kevin Alvarado from EY.

MS. LYONS: Yes. Cornelia Lyons from EY.

MS. TAYLOR: Thank you.

Mr. Dakessian.

MR. DAKESSIAN: Thank you, Ms. Taylor.

(Whereupon audio was played as follows:)

"UNIDENTIFIED MALE NO. 1: Essentially, you're being chased by the fire. I’ve never seen anything like it.

UNIDENTIFIED MALE NO. 2: My brain remembers it as a nighttime event, but that’s because I never saw the sun. And it was the middle of the day.

UNIDENTIFIED MALE NO. 3: And the way that fires are happening now with warming climates, we can’t stop them in landscapes like this.

UNIDENTIFIED FEMALE NO. 1: When you’re seeing just the magnitude and the power --

(Whereupon audio ended.)

MR. DAKESSIAN: The sound went out. Just a second. For some reason my -- my thing muted. Give me just one moment.

MR. VAZQUEZ: Sure. Go ahead.

(Whereupon audio was played as follows:)

UNIDENTIFIED MALE NO. 2: My brain remembers it as a nighttime event, but that’s because I never saw the sun. And it was the middle of the day.

UNIDENTIFIED MALE NO. 3: And the way that fires are happening now with warming climates, we can’t stop them in landscapes like this.

UNIDENTIFIED FEMALE NO. 1: When you’re seeing just the magnitude and the power and the speed of the fire, seeing a tree blow up in front you --

UNIDENTIFIED MALE NO. 4: We need to do five- to- ten times more per year to really get a handle on this.

UNIDENTIFIED MALE NO. 5: It’s happening now. The worst-case scenario is just starting to set on.

UNIDENTIFIED MALE NO. 6: We are witnessing the beginnings of extinction of forests in a lot of California. It’s not hyperbole. It’s simply happening.

UNIDENTIFIED MALE NO. 7: We have more fire, more destructive fire. All that is the new normal."

(Whereupon the audio ended.)

MR. DAKESSIAN: Thank you for indulging us, Members of the Board.

The clip that I just played for you quite obviously relates to California's unprecedented wildfire crisis.

It seems that every year we're breaking some sort of wildfire record, whether it was the Tubbs Fire, which in 2017 set a record as the deadliest fire in California history, and then the Camp Fire, just one year later in 2018 broke the record of the Tubbs Fire, or the August Complex Fire, which just a few months ago became the largest fire by acreage in California history.

It's pretty clear that the wildfire crisis is no longer something that happens once every few years, nor can we even consider it a season. It is year-round in scope, and it is constant.

As Governor -- former Governor Jerry Brown indicated in that audio clip, it is our new normal.

If I could direct the Board to slide 3 of your slide deck.

Here we have a table that indicates the dramatic increase in acres burned due to California wildfires over the past several years.

If you look at slide 4, you can see the largest wildfires in California history by acreage have occurred -- the top seven have occurred in the last three years.

MR. GAINES: Excuse me.

MR. DAKESSIAN: Yes, sir.

MR. GAINES: This is Member Gaines.

I don't see a chart. I don't see any image of --

MR. DAKESSIAN: Slide -- slide 3 in your slide deck. You should have a slide deck, Member Gaines.

MR. GAINES: Okay. Thank you.

MR. DAKESSIAN: I apologize if you don't have it. But it's a chart that has orange squares on it, black background.

And what it does show is a sweeping parabola, half a parabola, you know, kind of if you follow the trajectory of the line of -- of the increase in wildfires in recent years.

And the same with slide No. 4, and the same with slide No. 5. Which is also a table that shows the most destructive fires in California history by any metric. This happens to be by structures and deaths. But 10 of the top 14 in the past three years.

So, Members of the Board, the evidence is beyond dispute that we have a wildfire crisis unlike anything anyone has ever seen anywhere at any time. And it confirms what we've all been observing in our daily lives. In fact, I'm not sure there isn't a single one of us that hasn't been impacted by the wildfire crisis in some way.

And -- and for us, just as obvious as the wildfire crisis itself, is the impact to the crisis on the viability of our electric utilities.

The wildfire crisis -- this is a matter of public record -- has pushed PG&E into bankruptcy. In what Columbia University professor John McWilliams called the first climate-change bankruptcy in history in his testimony before the United States Congress this past January.

The new normal has created un -- (audio failure) -- Edison, as we're going to discuss.

Scholars and scientists have warned that this is going to get much worse. And experts are saying that the ongoing viability of our electric utilities has been called into question.

Slide 6, for example, captures just one headline. If you do any sort of even basic Google search for this, you'll see it all over the Internet.

So our discussion today concerns an important related subject, mainly the impact of the wildfire crisis on the value of our electric utilities for property tax purposes.

This impact, Member of the Board, can be felt in terms of overall business risk, but also in terms of the specific operating expenses that my client must bear. Expenses that are part of this new normal, such as government-mandated mitigation expenses, increased insurance costs, and claims expenses, liability claims.

These are unprecedented, and they all bear upon the value of Southern California Edison for state-assessment purposes.

As a duly-elected constitutional body in place since 1879, the State Board of Equalization is responsible for keeping public utility values consistent with current market realities to ensure that the utilities, and ultimately their ratepayers, are paying property taxes at fair market value.

Members of the Board, because you, alone, wheeled this power, not the staff, not the CPUC or anyone else. And because this is squarely within your core constitutional function, we are asking you today to intervene in a matter of great importance to my client, and the nearly 14 million ratepayers it serves throughout Central, Coastal and Southern California. And I believe each of you represent Edison ratepayers.

So what is our quarrel? What is our quarrel?

Our quarrel with staff, Members of the Board, is that they simply don't account for the important realities presented by the wildfire crisis, and the undeniable impact of these realities on Edison's property tax value.

Now, staff will tell you that they already have accounted for the wildfire crisis, and that they've made certain adjustments to account -- certain adjustments to Edison's value.

But when they say that -- when they say that, keep in mind that staff has levied what we believe to be the largest value increase in the history of state assessment. This is even after the revised value that they submitted.

So from Edison's perspective, it's bad enough to incur these massive expenses, and to be facing this existential threat to its overall business. It's insult to injury when those expenses are not taken into account to reduce Edison's property tax value accordingly.

So you may also hear from staff that this is all super technical or super complicated, or that we need to trust and defer to their appraisal judgment.

Well, I say to you, this is a simple case. It's a simple case. The specific issues -- and there are four of them we will address below -- to be sure Edison's positions on these issues, which the independent EY report confirms are 100 percent grounded in sound appraisal theory.

But more fundamentally, Members of the Board, they're 100 percent grounded in common sense, given the wildfire crisis and the new normal. We'll get into this detail shortly with the assistance of the EY team.

Staff will tell you, as they have told us, that they just did what they always do, and treated Edison fairly. When they do that, please keep in mind three major red flags concerning staff's valuation.

If I could draw your attention to slide No. 7.

The first major red flag, Members of the Board, is that this assessment this year is a total outlier. A total outlier.

The 2020 value hike against my client is well above the average increases it has sustained over the past 10 years, and it makes no sense in the context of the wildfire crisis.

Staff will try and explain it in a way by saying that they've added 6 billion in new assets. But we know that asset additions and value increases do not, alone, determine value. In fact, there's no correlation at all if you look at it historically, which is what we see in slide 8.

In slide 8, you'll see the orange bars representing the asset additions. And the blue bars -- with the exception of the red bar, which is the current year assessment -- represent the value increases.

Now, you'll note in 2015, with the retirement of the San Onofre plant, there's actually a net decrease in asset additions. But that didn't correlate to a decrease in property value. There was an increase there.

And so you can see that -- the red bar is an outlier, and it becomes even more pronounced when you look at the past three years, since the surge in wildfires in California beginning in 2017.

You can see the asset additions, and you can see the value increases. There's a true comparison for you. It's an outlier, Members of the Board. That's flag No. 1.

The second red flag is that staff keeps referring to these wildfire-related expenses as nonrecurring or non-ordinary. That's one of the basis upon which they have denied these expenses.

They're insisting, as we sit here today, that this new normal, that the wildfire-related expenses are simply one-offs. And that isn't true.

Now, if you can see in slide 10 that we have an increase in wildfires due to climate change, it's quite pronounced.

And, you know, the expert we cited to earlier, John McWilliams, said that while climate changes lead to more frequent and intense wildfires, storms and flooding, and that they could become 900 percent more destructive in certain regions by mid-century. And that, importantly, utility assets will be -- also be increasingly exposed.

So as staff says that these are non-ordinary or nonrecurring expenses, keep that in mind.

The third red flag, Members of the Board, has to do with the internal inconsistency of staff's approach. And for that, we turn to slide 11.

And when I say internal inconsistency -- we'll get into this a bit later with the EY team -- but for now, understand that we have two main value indicators that we're relying on. Actually, two. There aren't any others. Historical cost and income. And they're both designed to measure the earning power of Edison.

That's -- that's -- that's effectively what they are. It's called historical cost, but it's meant to address the earning value of a regulated company.

And as the years have gone on, you've seen a wide disparity between these two value indicators. And your Board's own guidance calls for that difference to be reconciled. And it wasn't reconciled here.

In fact, the difference between the two is $9 billion. That's a disconnect that really calls this into question.

So Edison filed a petition. This is the first Board hearing they've had in -- that any of us can recall. And they retained EY to help with this.

And so what we're asking for the Board is quite simple. We want to see Edison's value reflect the existential challenges its facing with the ongoing wildfire crisis.

And the solution we're proposing is actually simple and straightforward. We would like the Board to enroll the value consistent with the EY report.

Now, with this in mind, I would like to take the opportunity to address the specific issues that are before you that Ms. Garrett mentioned.

So the first issue, beginning on slide 12, is the wildfire mitigation capital expenditures. These are expenses that Edison was required by the Legislature to incur in order to mitigate the risk of wildfires.

Slide 16 shows you an image, a visual of some of the things that they've been doing. But the important thing to know here is that these are expenditures that must be made. They're required by the Legislature. And they are -- must be made without a return on equity.

And at this point, I am going to ask you to turn to slide 15, which talks about the concept of historical cost and rate base.

And I would like to call upon my colleagues from Ernst & Young to walk us through what we're seeing here, and how AB 1054 impacts the treatment of capital expenditures for property tax purposes.

MR. CHOW: Thanks, Mardi.

And this is Jason Chow with Ernst & Young.

Good morning, Members of the Board.

What I would like to do is expand upon HCLD, and -- and what you see on slide 15.

So as we approach the appraisal, and reading through the Assessors' Handbook and related guidance, we noted also the following statements:

HCLD is one of the more important indicators of value for closely regulated public utilities.

HCLD approach to value shall be considered if the income from the property is regulated by law.

HCLD shall be considered if the regulatory agency uses historical cost less depreciation as the rate base.

It also, in further guidance, we see that the general practice of the California Public Utilities Commission, and most other regulatory agents, is to use historical cost or original cost less depreciation with various adjustments as the rate base.

So with all of this, it is our view that HCLD is the primary driver for rate base.

And then further, and if you look on slide No. 15, rate base drives the earnings of a utility. And the earnings of the utility will allow it to achieve its allowed rate of return.

These are the economic parameters that Edison's business operates in. And, thus, when considering a closely-regulated utility, we have the following situation. If the capital expenditures can't earn the allowed required return, they cannot be included in the rate base. And if it's not included in the rate base, it should not be included in the HCLD indicator of value.

So when we considered how to approach the HCLD valuation, and when we think about the capital expenditures being mandated by AB 1054, that clearly falls into this situation.

So with that, Mardi, I will turn it back to you.

MR. DAKESSIAN: Thank you, Mr. Chow.

So the take away, Members of the Board, here is that rate base -- HCLD is all about rate base. Rate base is about the public utilities earning on these assets. And the Legislature has legally precluded Edison from earning on these assets.

They need to be taken out of historical costs. It's just that simple. It's not more complicated than that.

And the next issue that we wanted to talk to you about is insurance-related. And it begins on slide 17. It is entitled "Wildfire Insurance Fund contributions."

And these are -- these are expenditures that are made into the Wildfire Insurance Fund, and, specifically, Edison's initial contribution of that fund of $2.4 billion.

These must be allowed, but staff has disallowed them. And their argument is as a general rule that they are concerned only with future expenses.

Our counter to that is -- and this expenditure took place in December of 2019, just months before the January 2020 lien date.

So they are viewing this as a past expense. And that, as a general rule, is true. But our counter to that is that the Board's own published guidance, as we see on slide 18, the Assessors' Handbook, the Board's own Assessors' Handbook, says that there are certain expenses that, if they're prepaid, you annualize.

I'm going to have Ms. Wood tell us about that in just a moment. But the specific example it cites is directly on point, prepaid insurance expenses. They call it a premium, but these are -- these are equivalent to that. The annual contribution is prepaid insurance, and it should be annualized.

So I'm going to have Ms. Wood, Ms. Andrea Wood, the VP of tax of Edison, join me on camera here.

Ms. Wood, are you available?

MS. WOOD: Yes, I'm here. Good morning.

MR. DAKESSIAN: So to give you some context, Members of the Board, I'd like Ms. Wood to tell you what challenges that Board -- that Edison is facing in procuring insurance for wildfire-related claims.

MS. WOOD: Yes.

So to kind of give you some background as to how the Wildfire Insurance Fund came into existence, you know, taking you back to the 2017 Napa Valley fires, which created devastating losses, you know, around that time it came very difficult for utilities in California to get wildfire insurance.

This is primarily due, which I'm sure you know, to the California's law of strict liability, or inverse condemnation, which makes the utility reliable for all damages of any fire in which their equipment is involved, regardless of fault.

So that means that if a bad driver runs into one of our poles and it starts a fire, you know, burns down a strip mall, we're held liable, even if the poles and wires were maintained and in good shape.

So within SCE's territory, back in 2017 and 2018, we experienced, at that time, two of California's largest fires, the Thomas Fire, and followed by the Montecito mudslides, and the Woolsey Fire.

You know, by then, insurance costs were just prohibited. And many carriers even refused to write policies.

For example, in 2018, our cost of a billion dollars in insurance coverage was over $300 million. And we've stated that in our 10-K filings for interfinancial statements.

So if you acquaint that to homeowner's insurance policy, you know what that means, your annual insurance premium for a million-dollar home would be $300,000 a year. So it just -- the costs are just through the roof.

And then to make matters worse, PG&E filed for bankruptcy. You know, which, you know, eventually led to the passage of AB 1054 that established the Wildfire Insurance Fund.

In this context the utilities would pay upfront an amount, and an amount over time to pull their funds together to cover claims for future fires.

And, you know, SC -- as Mardi said, SCE's premium was $2.4 billion, with a roughly $100 million for the next 10 years.

So after an internal cost-benefit analysis, we decided that it made sense to opt into the insurance fund. Because it provided as coverage that we would -- might not be able to -- to even be able to procure in the open market.

So that's -- that's to sort of put some things in context for you.

I'm going to turn it back to you, Mardi.

MR. DAKESSIAN: Thank you, Ms. Wood.

So, Members of the Board, I don't think there's any dispute that these are insurance expenses, insurance premiums.

And -- and to kind of remove the issue from doubt, I'd direct you to slide 19.

And I'm going to call on Mr. Manos here in a second, who is also on camera.

But just take a look at slide 19 if you could for a second.

So this is -- this is the Legislature's own uncodified bill language to AB 1054. They refer to this as a Wildfire Insurance Fund. Okay? And they indicate their intent to provide a mechanism for the public utilities that's more cost effective than traditional insurance.

This is insurance. There is no question about it. Staff says it's not insurance. I don't understand how they can make that argument.

And with that, I'm going to turn it over to Mr. Manos from Ernst & Young and ask:

In your view, from a valuation and appraisal perspective, should this expense be treated as prepaid insurance?

MR. MANOS: Thank you, Mardi.

Good morning, Members of the Board.

So while SAPD includes the $95 million annual payments over 10 years, they do not consider the 2.4 billion initial outlet to participate in the AB 1054 Wildfire Insurance Fund.

Their reasoning is it's considered a single, one-time required payment. However, in this view --

this is -- this is considered a prepayment to participate in this insurance fund.

And a prepayment is an amount paid in advance of goods or services being received. So prepayments would relay to required, you know, upfront payments in full or in part before goods or services are provided. And this is exactly what the initial $2.4 billion payment represents

The initial portion of the full contribution required for coverage of, you know, one billion or more in damages or claims for wildfires based on AB 1054.

So based on the Assessors' Handbook as Mardi had mentioned, prepayments, you know, insurance prepayments should be annualized when applying a direct capitalization method such as the CEA.

Otherwise, the results of the analysis would be distorted by what is considered normal -- normal levels of operating expenses, given that the CEA is capturing the property value based on a single period in time.

So based on the Assessors' Handbook, the treatment of the prepaid expenses is that they are annualized, even though some expenditures may not actually occur on an annual basis.

So in this case, SCE has prepaid the 2.4 billion, but would still need to account for that expense going forward, if you were doing a capitalized-earnings approach.

So by excluding the initial payment, the CEA is resulting in an artificially higher value.

So in lieu of participation, as Ms. Wood had mentioned, SCE did an analysis. And they would obviously be required to spend well above the approximately $340-odd million that we've included in the SCE calculation, if they were even able to get private insurance to cover anything beyond a billion dollars.

So in our -- in our estimation, I mean, this is exactly prepaid insurance, and should be annualized over the term of the -- of the AB 1054 wildfire fund.

MR. DAKESSIAN: Thank you, Mr. Manos.

Members of the Board, the third issue that we have concerns liability claims relating to the wildfires and mudslides that Ms. Wood referenced that took place in 2017 and 2018.

So as staff has disallowed these expenses as past and nonrecurring, but this is -- this is just wrong.

Staff says that this is a past event because of an accrual that Edison took for financial accounting purposes. And because that accrual took place before January of 2020, that that makes it a past expense. But that's wrong.

And I'd like to call upon Ms. Wood to join us again to explain the accrual to us, and to talk about what these claims relate to.

MS. WOOD: Yes. Okay.

So going back to the Thomas and the Woolsey fires in 2017 and 2018 that I mentioned earlier, SCE had estimated their potential claims to be about $4.5 billion, and made that accrual in their financial statements.

These are amounts that are to be paid over time as the investigations are completed, and fault is determined, and then settlements are reached.

The payment of these claims started in 2019 with about $300 million paid to local public entities. And that was followed by $1.6 billion payments in 2020 this year.

And, in fact, the estimate of the cost of the liabilities was further increased in 2020 by an additional 1.4 billion, for a total of almost $6 billion in estimated liabilities.

Payments in 2021 and beyond are expected to reach $4 billion.

So, you know, clearly this is an ongoing expense, the cash payments that will be going out over time.

Back to you, Mardi.

MR. DAKESSIAN: Thank you. Thank you.

So, Members of the Board, if I -- if I may, I'd like to address the fourth issue that has to do with weighting.

And this is where -- you know, we mentioned this earlier in the discussion when I mentioned slide 11.

And slide 26, if you could turn to, contains the key passage here.

So this is the difference between the value indicators. Remember, HCLD and income, the value indicators are supposed to roughly approximate -- you know, roughly approximate the same value. They don't always line up exactly. I mean, in fact, they never do.

But -- but significant differences are called out in the Assessors' Handbook. This is, again, your Board's own guidance that says that if you've got an HCLD indicator, historical cost indicator that's much higher, in this case it's $9 billion higher than the CEA indicator, the income indicator, then that indicates that something's wrong. There's obsolescence.

And so we have asked, you know, for the Board to consider this in the weighting. And the staff has maintained the 75/25 weighting.

Historically, even as the value indicators have grown further and further apart, as you can see on slide 27, this is an overlay, right?

This is the previous -- the slide that we saw earlier, with the flat line of just no additional weighting being given to CEA.

And slide 28 also shows that despite the wildfire crisis, which is another variable that has changed significantly that the CEA weighting has stayed flat.

And if we have a few minutes before we wrap up, I would like to -- I would like to ask Mr. Manos or Mr. Chow from Ernst & Young to step in here and to -- to tell us from an appraisal standpoint, how did you -- how did you address this issue? What is meant by obsolescence? And how does it apply? How does obsolescence apply in this case?

MR. CHOW: Sure. And thanks, Mardi.

This is Jason Chow again with EY.

So, you know, as part of the appraisal process, and certainly when you look at the, you know, the deviations, then, that Mardi had illustrated. You know, the concept of obsolescence, and certainly in this new normal, which is being caused by the wildfires, you know, this -- this impact of the wildfires certainly has a negative impact on Edison's business.

And this negative impact is really a form of obsolescence. And with this, it should be reflected in the value indicators.

Measuring this obsolescence will need to be quantified, and then reflected as adjustments in each of these indicators; both the CEA, as well as the

HCLD.

And how you measure this adjustment is going to be based on data -- data available. And the use of this data, then, in quantifying this obsolescence adjustment.

Furthermore, you know, as we perform the valuation analysis, really, it is better -- the better the data, the more reliable, and the more supportable that adjustment is.

And certainly that is a key consideration then as we applied, you know, both of these indicators of value, the CEA and the HCLD.

So with that, Mardi, I'll turn it back to you.

MR. DAKESSIAN: Thank you.

The takeaway, Members of the Board, is that it is appropriate, based on the circumstances of this case, to give more weight to income than to historical cost. That's an appropriate recognition of the new normal. Which brings us to our conclusion. And thank you for your patience in hearing our case today.

But in closing, Members of the Board, the wildfire crisis is real, and it's here to stay.

This new normal has been incredibly disruptive and confusing, because it means that the world, as we used to know it, will no longer exist for the foreseeable future.

And it's understandable for human beings to resist change as long as possible, to avoid the challenge of trying to figure out how to deal with a world that's different from the one that we've known, and the one that we prefer.

And one way that we resist change is we fall back on what's familiar and routine in hopes that we can just sort of ride out what we hope is a rough patch.

But this is not a rough patch. I mean, this is -- this is it, right? This is our new reality. And in a sense, it appears that that's what staff has done with the 2020 valuation.

Instead of embracing the new normal and exercising proper appraiser judgment in new ways in response to this new state of affairs, staff has relied on routine approaches, which result in the outlier value we have this year, and trying to put square pegs into round holes.

So referring to wildfire expenses as nonrecurring when there's near unanimity in the scientific community of the contrary is -- well, it's problematic, to say the least.

So, Members of the Board, when proper appraiser's judgment has not been exercised, as is the case here, deference to that judgment is not appropriate.

The members -- Members of the Board, we

request that you perform your constitutional duty to intervene, to adjust SCE's 2020 valuation so that true fair market value under this new normal is established.

Only then will SCE and its ratepayers not be further harmed by the new normal of the wildfires, and the mudslides, and so forth, that will only increase in severity.

It's been an incredibly challenging time for the company, as you can imagine. And the property value has to reflect that.

So for this reason, and all the reasons we've discussed, we respectfully request that you enroll the value consistent with the EY report.

Thank you, Members of the Board.

MR. VAZQUEZ: Thank you.

Now we'll go to presentation by Mr. Moon.

Is Mr. Moon available from our State-Assessed Properties Division?

MR. MOON: Yes, I'm available.

Richard Moon from the Legal Department. And with me are Jack McCool and Dan Jenkinson for the state -- with the State-Assessed Properties Division.

In this matter, petitioner is requesting a unitary value of $22.9 billion, which is a $6.9 billion reduction from the Board-adopted value.

Petitioner states that it's requesting this large reduction because of increased risks due to catastrophic wildfires, specifically in 2017 and '18.

But their $22.9 billion request in value is less than even their 2016 value, which was before the 2017 wildfires.

As well, they're requesting the $6.9 billion reduction, even though this past year they've added about 5 billion in assets. And since 2016, they've added about $15 billion in assets.

And we want to be very clear that SAPD is not arguing that wildfires are irrelevant, or that they're not catastrophic, or that they appear to be growing in frequency, or that they will not recur, or that they do not represent risk.

What staff is saying is that after considering all of the effects of the increased wildfire risks, all appropriate adjustments have been recommended or made to account for those risks.

In 2019, those adjustments totaled about $2.1 billion. And in 2020, this year, those adjustments totaled about $1.9 billion.

Staff's treatment of wildfire risks is consistent with that of the California Public Utilities Commission, which is the regulatory agency responsible for determining how these risks will affect petitioner's business, including in light of AB 1054's passage.

And as you know, AB 1054 was enacted in 2019 specifically to help mitigate utility's risks from wildfires, and to ensure their continued liability.

As part of its responsibilities, the PUC decides the rate of return a petitioner is allowed to earn. And this rate of return takes into account all factors that might affect their business, including risks related to wildfires.

Prior to the passage of AB 1054, Edison petitioned PUC to raise its equity rate of return by 6 percent to account for increased risks. So it's business associated with wildfires.

But after the passage of AB 1054, the commissioner -- the commission ordered petitioner to review its request.

Petitioner did such review, and concluded that its risk had been mostly mitigated, and lowered its request from 6 percent to 0.85 percent.

But the PUC rejected even this smaller request. And they concluded as follows:

We find that the passage of AB 1054, and other investor-supported policies in California, have mitigated wildfire exposure faced by California's utilities.

Notably, the reasons petitioner asked for a smaller .85 percent increase at the PUC, are the same general reasons it's asking for a reduction in value here.

Specifically, the magnitude and recurrence of the wildfires to counter the effects of inverse condemnation, or what they refer to as a strict liability standard, and increase regulatory risk from lowered credit ratings.

With regard to inverse condemnation, the PUC effectively found that even though AB 1054 did not change the liability standard, it provided a mechanism for petitioner to be reimbursed for what they pay out.

Not only that, but PUC held that the new prudency standard created by AB 1054 -- and this is their words -- does not introduce a new risk, but is rather a solution that is expected to limit utilities' financial exposure to wildfire liabilities in the future.

With respect to increased credit risk, SCE, itself, in its 2019 annual report, acknowledges that credit rating agencies upgraded its credit outlook from negative to stable.

CPUC, for its part, emphasized that SCE has an investment-grade bond rating, and that after AB 1054 passed, they concluded these investment grade ratings are a good indication that California regulatory risks are low.

Even though PUC rejected Edison's request for a .85 percent increase, SAPD allowed that increase. And it resulted in about a 1.3 billion value reduction for this year.

And it's important to remember that Edison asked PUC for that increase to cover additional risks they felt AB 1054 does not mitigate.

But now they're effectively telling your Board that .85 percent is actually not enough, and they need billions more deducted.

But, again, the general reasons being given here were also given to the PUC. And the commission, who, again, are the experts in this area, rejected each and every reason.

In doing its assessment, SAPD took all relevant information into account, and appropriately computed both an HCLD and an income indicator of value.

Because the HCLD indicator of value begins with the actual assets PUC allows the petitioner to earn a return on, staff considers it the most reliable indicator, and weighed it more heavily than the income indicator.

Petitioner citations do not apply here, and actually fully support staff's position. Specifically, Rule 8 says the income method is preferred when the cost approach is unreliable.

HCLD is not unreliable. It is actually the most reliable.

Petitioner also assumes that any difference between HCLD and CEA is because the HCLD is too high. But there's nothing that makes that necessarily true. It's entirely possible that the CEA is far too low.

With respect to their specific issues, first the $4.5 billion accrual for the '17/'18 wildfire lawsuit liabilities, petitioner misunderstands what we're arguing.

The $4.5 billion accrual is an estimate of expected lawsuit settlements that arise from those wildfires that occurred in '17 and '18.

And while this lawsuit liability may affect the value of the company, in other words, the business as a whole, it does not affect the value of the taxable property.

Petitioner claims that this is not really a liability, and so it should be allowed as an expense. Notwithstanding the fact that the appraisal report done by Ernst & Young says that this represents an actual outstanding liability.

The EY report also states this amount is not a liability. This is the accrual of a future expense required as part of the ongoing operations of SCE.

And we agree with this. This is exactly right, and exactly why a liability is not allowed as a deduction for property tax valuation.

A liability -- a liability like this one is accrued on its books, and not paid in cash at the time of accrual.

And while it might be part of the ongoing operation of the company, it is not part of amounts paid to operate the taxable property.

And in this regard, the EY reports -- report admits even more clearly that this liability affects the value of the entire business, not the taxable assets.

It states it is reasonable to assume that a perspective buyer would consider this expense as part of the going concern of the business operations; therefore, this liability can be thought of as affecting what a potential buyer might pay if they were buying the entire company. But it does not affect what a buyer would pay for only the taxable assets.

And Rule 8(c) cited by the petitioner fully supports staff. It says the net return, which a reasonably well-informed owner, and reasonably well-informed buyers, may anticipate on the valuation date that the taxable property existing on that date will yield under prudent management.

Just as importantly, however, SCE -- SCE has indicated that they've applied to PUC to recover these amounts through a rate increase.

Now, PUC may deny that request if it finds petitioner acted imprudently. But either way, a reduction is not appropriate.

If PUC allows the rate increase, petitioner will recover these amounts, and, thus, the deduction is not appropriate.

And if PUC does not allow rate increases because of a failure to meet the prudency standard, petitioner's property tax value should not be reduced, because property must be presumed to be operated prudently, as was just cited in Rule 8.

If the assets aren't worth as much because they're operated imprudently, that may be the fault of management, but it's not the fault of the assets.

And in this regard, the PUC has stated in Edison's rate-increase request, undisputed in this proceeding, is the notion that the investor-owned utilities should not be awarded with an increased return based on risk that is associated with imprudent management.

Similarly, it should be undisputed here. And undisputed, there should be no reward in the way of a decreased property tax valuation for imprudent management of assets. Thus, either way, it's inappropriate to allow this amount as an expense.

With regard to the $400 million wildfire mitigation capital expenditure required by AB 1054, as stated previously, PUC determines a rate of return to apply to petitioner's assets.

This rate, the capitalization rate consists of two parts; an equity rate and a borrowing rate. AB 1054 only prohibits petitioner from earning its equity rate of return on these assets. And this is acknowledged by petitioner.

Therefore, SAPD appropriately removed the equity portion of the cap rate, and left in only the borrowing portion.

Petitioner made much during the appeal's conference of how these assets are financed. But how these are financed is not relevant to its value.

What's important is that petitioner owns the assets, and is able to recover its investment.

Again, petitioner states itself in the EY report that proceeds from the financing entity will be transferred to SCE, at which point SCE will consider their initial $400 million investment repaid.

It also states that ratepayers will be paying a fixed charge for recovery of this amount.

Finally, for the AB 1054, required initial contribution to the wildfire fund, this is not a deductible expense.

Petitioner requests reduction for the $2.4 billion initial contribution. But it's not deductible, because it's a one-time cost, paid in the past, specifically in 2019, that will not recur in the future. In other words, it will never need to be paid again.

Petitioner, again, itself, acknowledges this, identifying it as a noncore item in its annual report.

And it defines noncore item as including income or loss from discontinued operations, and income or loss from significant, discreet items that management does not consider representative of ongoing earnings, such as income and expense related to changes in law. That's exactly what this payment is.

Petitioner, however, calculates and amortizes a future expense for accounting purposes over ten years. But that is a pure estimation.

When they do that, what they're actually acknowledging is that that future accounting expense is not a cash flow, and they don't really know how long the fund is actually going to last.

And it's telling that they state in their annual report, changes in the estimated period of coverage could lead to material changes in future expense recognition.

Again, it's an important -- important to remember that this amount is not actually paid in future years. It's only an expense to compute accounting income. It is not an expense to compute capitalized income for property tax purposes, because it's not part of cash flow. And this is a fundamental tenet of appraisal practice.

Petitioner points to our Assessors' Handbook 502 as supposedly supporting its position that accounting expense can be deducted.

However, when that language is read properly, and in conjunction with Rule 8, that language fully supports staff's position.

What AH 502 is referring to is recurring prepaid amounts that represent future cash flows. The example given in the Assessors' Handbook is -- is of insurance that is prepaid for three years.

The handbook allows annualization, because there's an assumption that after the initial three years, there will be another outlay of cash that covers the next three years.

It is there for estimating an annualized payment, only because it will recur every three years as a cash flow. That is not what is happening here.

Although we do not believe this payment is best characterized as insurance, whether it is or isn't is a red herring, and it's meant to distract from the main point. Which is that this payment is a past, noncash expense that will not recur.

Petitioner has made much of the fact that these wildfires will continue to occur. But any predictions that additional contributions to this fund as required by AB 1054 must be made, are pure speculation.

The only thing that's known is that contributions will need to be made for an additional eight years. And we've allowed those contributions.

And, again, petitioner, itself, acknowledges this. Petitioner admits that the time period the fund lasts is highly dependent on assumptions.

And as an example, in its annual report it gives a scenario where the fund might last for 20 years.

Before the PUC, petitioner argued the fund could run out by 2035, which is about 15 years. But the PUC said arguments positing that the fund may be exhausted before 2035 are premature.

Also, the entire purpose of AB 1054 was to reduce wildfire risks to utilities like petitioner, in part, by requiring mitigation plans, safety certifications, and capital expenditures. Assuming it's successful, presumably it will lengthen the life of the fund.

It may be that more, perhaps even huge sums of money, will have to be paid into this fund or to a similar fund. But it's also possible that no money, or something far less than 2.4 billion will need to be contributed. But that's the entire point. Nobody knows.

And so in conclusion, SAPD acknowledges the serious consequences and the risks of wildfires. But SAPD has recommended or made all appropriate adjustments.

Petitioner, on the other hand, is requesting a $6.9 billion reduction in value, even though making such reduction would violate generally-accepted appraisal practices.

Even though a $6.9 billion reduction takes them below their unitary value in years prior to the '17/'18 wildfires, even though they added $5 billion of assets in 2019, and $15 billion in assets since 2016, even though it admits AB 1054 has brought a material improvement in risk, even though PUC has stated petitioner has no additional risk for wildfire that has not been accounted for, and even though SAPD has made additional reductions to petitioner's unitary value for wildfire risk that CPUC denied.

And the petitioner requested of CPUC to account for additional risk not mitigated by AB 1054.

And for all of these reasons, we recommend the reduction in value as reflected in the hearing summary, and denial of the petition in all other respects.

And we would be happy to take any questions.

Thank you.

MR. VAZQUEZ: Thank you, Mr. Moon.

I see Mardi Dakessian is still on the line here.

You have 10 minutes for your rebuttal.

MR. DAKESSIAN: Thank you, Mr. Chairman.

And I am going to turn it over to some of my colleagues from the EY team.

But some introductory remarks, first of all, I seriously -- I take issue with the characterization of the largest tax increase in the history of the

State Board of Equalization as -- as we're requesting some kind of a reduction.

That, to me, is just like the old sales mark-up trick. We're going to mark this up as the highest tax increase in history, and when we request for it to be brought back down to normal reasonable levels, we're asking for a tax decrease. I -- I question that. I -- I -- I take issue with that.

So there is a lot of material here to go through. And in the limited time we have, I'll try to pick up on some of the highlights.

First of all, we're not inconsistent with CPUC. The CPUC has prevented us -- or the Legislature has precluded us from earning on the capital expenditures to the tune of $400 million. And that is the heart and soul of rate base, and we want it removed from rate base, consistent with the CPUC.

Now, this concept of the risk premium, and Mr. Moon spent a lot of time talking about that, but as Ms. Garrett mentioned in the introduction, we're not contesting the risk premium issue. So let's just take that off the table completely. That -- that has nothing to do with this appeal anymore.

We're asking for specific wildfire related adjustments, and Mr. Moon went back and forth. He said we're not saying it's not recurring -- nonrecurring, and then he said that they're nonrecurring.

And in his brief, he says on page 9 of their brief, lines 11 through 13, that the cost for which petitioner seeks reduction are both past expenses which are not anticipated to be incurred again in the future.

That says it all. That says it all. They say one thing to the Board today, they write something else totally different.

So they believe it's not recurring. You've heard that a few different times during his presentation.

And we have specific wildfire-related adjustments we are seeking. And they do affect the business as a going concern. And that's what unitary valuation is all about. It's not picking of an asset here and picking of an asset there, and looking at the value in a vacuum. The unitary concept is the value of the business is a going concern.

In terms of the earning issue, the -- there is no earning on debt. We can get into that in a moment.

And this is clearly prepaid insurance. I mean, you heard what he said. This is a form of insurance.

And so in the -- in the middle of this wildfire crisis, what Governor Brown calls the new normal, at the end of the wildfire fund, if it -- if it goes to the end, we're not going to have to replace that with other insurance in the middle of this wildfire crisis?

The only reason that the Wildfire Insurance Fund exists is because private companies won't write insurance.

So the insurance is going to be an ongoing cost. I don't understand how he can say that.

Now, I -- I would like to call upon Ms. Wood.

Are you there?

MS. WOOD: Yes, I'm here.

MR. DAKESSIAN: Ms. Wood, would you take a moment to address the -- the -- the comments Mr. Moon made regarding the 2017/2018 claims.

MS. WOOD: Yeah. I would just say that, you know, those particular claims are obviously not covered by AB 1054.

AB 1054 only applies to, you know, claims in fires that occur after its existence in 2019.

So, you know, those claims are going to have to continue to be paid.

I understand that they want to ignore the accrual. But it's hard to say you're going to ignore the cash flow of the payments over the next few years.

And as far as the comments about a willing buyer being able to buy the assets without assuming the claim liability, that's just not -- that's not possible. The CPC [sic] would never allow that to happen, because then there's no collateral for the claims themselves.

So I -- I don't know.

Mardi, was that sufficient?

MR. DAKESSIAN: Yes, thank you. Thank you. That's very helpful.

And then in terms of the -- I'm going to turn it over to the EY team in just a moment.

But in terms of the disparity between value indicators, staff seems to pooh-pooh that. Staff seems to say, Well, of course we can have variances. And we heard this repeated in the hearing summary.

Nine billion dollar difference, whether CEA is too low or HCLD is too high, needs to be reconciled. That's $9 billion. I mean, let's put it into perspective. The -- the budget for the city of San Francisco is $12 billion. Okay?

There are many publicly-traded companies that have market caps below that amount. Many household-name public companies that have that.

Nine billion dollars is a lot of money, and they utterly failed to reconcile the two. They've just applied the same 75/25 weighting, without reconciling, without -- without looking at it, and saying there's obsolescence here, like our Assessors' Handbook tells us that if we have a value difference, this -- this is profound that -- that we need to reconcile, and we need to look to obsolescence.

So if the EY team is available, I'd like to call on somebody to address the issue of the -- the claims liability and the prepaid insurance.

And that would be Greg Manos.

Greg, are you able to --

MR. MANOS: Yeah, I'm -- yeah, I'm on.

So, you know, as I mentioned before, clearly, you know, the $2.4 billion is considered a prepaid insurance.

In -- in light of the fact that there is AB 1054, if there wasn't AB 1054, there would be, you know, as Ms. Wood said, public insurance -- or private insurance that would be required, which would be cost prohibited, obviously, on an annual basis.

So in our -- in our view, what AB 1054 does is provide that insurance, you know, for SCE, any other utilities in the state, in lieu of going out and getting, you know, public or private insurance on their own.

Now, if -- let's just say, for instance, the fund does exhaust in five or ten years -- or it could be even sooner, I guess, if the wildfires are ongoing and as large as they've been -- the utility would be required to go out and get insurance to replace that.

So, you know, by disallowing that expense, you know, they're artificially, you know, increasing the value of the HCA -- or the -- I'm sorry, the CEA, when, in fact, that is an ongoing expense, and would need to be paid, but for AB 1054.

So in our view, you know, if petitioner didn't have -- didn't participate in AB 1054, they would be required, or they would have to go out and get insurance on their own. And it would be far and excessive of the $340 million adjustment per year that we're claiming.

So just because they made this payment in the past, you know, doesn't preclude it from being considered prepaid insurance. Because that's exactly what it is. And it's required to participate in this public insurance fund, if you will.

MR. DAKESSIAN: Thank you, Mr. Manos.

So I would also draw your attention, Members of the Board, to slide 20.

And staff utterly ignores this.

Edison treated this as prepaid insurance on its financial statements, and its public filings. So that's -- that's something that the Board should consider.

The bottom --

MR. MANOS: And, Mardi, one other -- one other quick question --

MR. DAKESSIAN: Yes.

MR. MANOS: -- or one other quick mention is they've included the 95 million per year, which is the amount that they're paying, you know, in addition to the 2.4.

But that doesn't cover the full normalized expense level that would be required going forward, you know, if AB 1054 didn't exist.

So, you know, you kind of have to take the two together in order to be able to assess how much, you know, the insurance would be on a go-forward basis.

And by just disallowing it -- again, just by disallowing it completely, you've over-valued the CEA method.

MR. DAKESSIAN: Thank you, Mr. Manos.

Would somebody from the EY team address the claims liability portion?

Because it seems like staff wants to have it both ways, right?

So they want to talk about cash for purposes of the prepaid insurance, Oh, this is a past expense. But then when we have claims accrual, liability accrual, and accrual of an expense in a -- in a previous year that's supposed to forecast a future expense, right? Now they want to have their cake and eat it too.

Could you walk us through that, please?

MR. MANOS: Yeah.

And so we're not contesting that this was a past event. I mean, it clearly was. And it clearly was prior to AB 1054.

So it would not be, you know -- obviously would not be covered in AB 1054.

But just because it's a past offense, a past event, and an accrual on the statements of SCE, does not mean that it -- one, that it's not ongoing. Because clearly it is. And I think the petitioner even had mentioned that. You know, even in '19 and '20, they're still accruing for, and will have expenses out in the future for wildfire liabilities that -- that aren't covered under AB 1054.

And as Mardi had said, you know, this has not been paid yet. So it's clearly an expense that's going to happen in the future. And in this case, we know it's going to happen in 2021. The amount is known at this point in time, hence, why Edison has put it on their books as such.

And really we're not arguing that it's all 4 billion. Because some of that 4 billion is covered under insurance.

We're really arguing the amount that is not covered under insurance that will need to be paid out of operating cash flow of SCE over the next year.

MR. DAKESSIAN: Right.

And -- and the whole point of having to accrue this liability and disclose it in a public filing is to let the world know that there's a high level of certainty that these expenses are going to recur.

And so, you know, I think that that's a very significant point.

Mr. Manos.

MR. MANOS: Well, and the fact that we know they're going to -- to occur. And the fact that any potential, you know, purchaser of these assets would take that into consideration when they're looking at the value of this business as a whole, or unitary value as, as Mardi had mentioned. I mean, it clearly is a factor.

Because they know out of the operating income of these assets, they're going to have to pay about $2 billion worth of claims next year.

MR. DAKESSIAN: So let's just underscore this point.

So in the real world, right, a perspective purchaser -- in the real world, right, a perspective purchaser is going to have to account for these future liability expenses in considering whether to buy these assets, right? And at what -- at what purchase price?

MR. MANOS: That's 100 percent correct.

MR. DAKESSIAN: So -- so for staff to say that, you know, that this isn't going to recur, or prospective buyer wouldn't have to factor this in makes no sense.

Same with the insurance piece. These are all -- it's all part of the same theme, Members of the Board. Staff says it's not recurring.

If the wildfire fund, let's just say for purposes of discussion, is never replenished, which it will have to be. But let's just say it's wound up. It's never replenished. You don't think that Edison is going to have to go find insurance somewhere else? Right?

I mean, is this -- is this sort of what it's come to? I mean, you know, if staff agrees that the wildfires are the new normal, then they need to accept this level of expenditure as the new normal. And they're not doing it. They say they are, but they're not.

MR. VAZQUEZ: Okay. Thank you.

Members, we went over -- we went over quite a bit here. I just want to check in with, one, staff, and the Members in terms of our lunch break here.

I'm wondering if we can get away with instead of doing a full hour, I'm wondering if like -- I don't know, is a half hour, 45 minutes plenty or sufficient?

MR. SCHAEFER: We're used to -- Vice Chair Schaefer.

We're used to 20 or 30 minutes.

MR. VAZQUEZ: You want -- you want half an hour?

MR. GAINES: That's fine.

MR. SCHAEFER: Yes.

MR. VAZQUEZ: Is staff okay with that?

UNIDENTIFIED MALE: Yes, sir.

MR. DAKESSIAN: We are prepared to take a break, and we're also prepared for any questions to move forward. Whatever the Board's pleasure.

MR. VAZQUEZ: Okay. Why don't we go ahead and take the -- at least a half-hour break right now.

So it's almost 12:30. What do you say we reconvene at 1:00 o'clock, and then get into our questions and decisions? Is that good?

I'm seeing nods.

MR. SCHAEFER: I'm okay with that. Is it -- have we heard from Ms. Cohen?

MR. VAZQUEZ: Well, she's on a -- she's actually abstaining from this whole discussion. So she should be okay.

I think originally we were looking to take the break to accommodate her. But actually she's on break right now until we finish this item. So I think we're okay. I think it's pretty much on us.

MR. SCHAEFER: Is Ms. Yee still with us, Controller Yee?

MR. VAZQUEZ: I believe she is.

MS. YEE: I'm still here. I have a hard stop at 1:45. So I'm fine with the half-hour break.

MR. VAZQUEZ: Okay. Why don't we do a half-hour then.

All right. So we'll reconvene at 1:00 o'clock.

Thank you all, and we'll see you at 1:00 o'clock.

(Whereupon the lunch break was taken.)

MR. VAZQUEZ: Members, we're going to reconvene.

And we left it with the rebuttal. And now it's time for questions of staff or of the petitioner.

Do we have any questions of any -- of either one?

MS. YEE: Mr. Chairman.

MR. VAZQUEZ: Yes. Controller Yee, go ahead.

MS. YEE: Thank you.

I appreciate the presentation by the petitioner, and certainly on the part of the staff as well.

First let me just say, it's hard for this not to be an emotionally-charged issue given the devastation of the wildfires.

And certainly I know that Southern California Edison, as well as all the utilities in the state, are doing their best to be sure that we, hopefully, are mitigating some of the risk going forward.

But to Mr. Dakessian's point, this is a new normal going forward. I think if all of us are recognizing that perhaps, you know, any of those that thought climate change was not upon us, is upon us.

But I guess what I want to say is this; I found this case to be -- on the one hand, fairly clear-cut.

On the other hand, almost -- and this is -- I don't know how to describe this without it sounding derogatory. But I feel like some of the issues that are brought before us now as the Board of Equalization for value-setting purposes, a little bit of venue shopping in that some of these issues were before the CPUC.

MR. DAKESSIAN: I agree.

MS. YEE: And the CPUC ruled, and some of these issues are back to us.

I think the staff has actually been quite generous in making some adjustments in terms of the value that's currently before us. Mr. Moon enumerated some of those.

And then some of the things that I think -- and I will be the first to say, you know, I think when we have our state-assesee valuation process, I'm always looking for how we get ahead of, you know, trends that are going to be affecting industries.

And I think particularly for this -- this industry, it is one that I'm going to ask State-Assessed Properties staff just to continue to try to be out in front around this to see how we might need to pursue our value-setting process differently as a result.

And perhaps even maybe a little sawdust going forward, to the extent that these are going to be expenses and factors that are going to affect the valuation, generally, for companies like Southern California Edison.

Having said that, I think with respect to what we are trying to do here, what I'm trying to reconcile is, how do we -- how do we adjust the value downwards as requested by the petitioner that gets us below the 2016 valuation, while at the same time, we are seeing increases in capital expenditures.
I can't wrap my head around that.

And I know some of this has to do with how we're characterizing some of these expenditures. But at the same time, you know, these are expenditures that are going to, you know, kind of earn a return I think. And so I -- I'm just having a hard time wrapping my head around that.

I do want to address the insurance fund, however. And this is particularly troubling to me, because it appears that there are two parts of this.

So obviously the initial contribution and how the staff is treating that as a past expense, and the treatment of that has been -- essentially, that initial contribution I believe has been amortized.

And so I don't know how we -- how we are able to deduct that from anticipated income to be capitalized. I don't think we have the authority to do that. So that's troubling to me.

But we did -- I think the staff did recognize that certainly with respect to the required annual contributions to the fund, that those are allowable, ordinary expenses. And we've made some adjustment related to that.

So I guess what I'd like to do, Mr. Chairman, is to see if Mr. Moon and the staff can just help me. And I want to -- I have a question for Ernst & Young as well.

Can you just tell me -- I'm sorry, there's some feedback.

Could you just help me just walk through the adjustments that we've made, and to what issue that responds to what the petitioner has raised.

MR. MOON: Ms. Yee, this is Richard Moon.

MS. YEE: Sorry about that feedback.

MR. MOON: I'm sorry. Can I go ahead?

MS. YEE: Yeah. Yeah.

MR. MOON: This is Richard Moon with the Legal Department.

I will leave that to Jack McCool and Dan

Jenkinson from SAPD to walk you through those.

MS. YEE: Okay. And before you do that, I guess I have a threshold question that's to Ernst & Young. And that is: What is the -- I mean, what is the waiting of the indicators that you're seeking that, you know, with respect to how you reconcile the -- the two indicators that are at issue here, the CEA indicator, as well as the -- the initial indicator, the HCLD indicator?

MR. DAKESSIAN: Madam Controller, this is Mardi Dakessian.

I'm going to hand it off to Ernst & Young to answer your question in just a moment.

MS. YEE: Okay.

MR. DAKESSIAN: And I would like the opportunity to respond to some of the comments you made, the introductory comments you made.

MS. YEE: Okay.

MR. DAKESSIAN: In terms of the weighting, the weighting is an algebraic equation. It's not complicated. And I'll let EY describe it.

But the bottom line is we took issue with the way that staff was approaching it. We feel that weighting is something that should be done on the back end. It's not a driver of value. And I'll let the EY team -- maybe Mr. Chow can respond.

MR. CHOW: Sure.

So, again, this is Jason Chow with EY.

So on the waiting aspect of, you know, how we arrived at our ultimate opinion of value, again, there is no, you know, mathematical necessarily formula that we can refer to.

And I think Ms. Yee even said or noted in the Assessors' Handbook and guidance.

But the way in which we consider the weighting is we knew that historically, the way that SAPD, as well as the petitioner, had been weighting both approaches. You know, and that's -- call it given, you know, the pre-new normal with the impact of the wildfires.

And the way that we approach, then, determining, well, how would we change this weighting, and how would we conclude the ultimate opinion of value here, is that we knew that it was a 75 percent weighting to the HCLD. We knew that it was a 25 percent weighting to the CEA indicator of value.

And really it ended up for us being, you know, based on a bit of appraisal judgment. And the way that this appraisal adjustment would be applied here is that knowing that there are a number of factors that go into, you know, this change with wildfires, and that when you look at the impact of these changes, whether it's the additional risk that's being applied to the capitalization rate, whether it's the impact of the insurance, and whether it's the impact of the -- the claims amounts due to the litigation and due to the lawsuits, all of these amounts are impacts to the earnings of the business.

And, therefore, because it's being impacted to the earnings of the business, the most appropriate measure, then, is the CEA indicator of value.

And that's something that we've spoken a good bit about when we look to each of these adjustments, and that they are being reflected in the CEA indicator of value.

And, therefore, because of that, we felt -- and it was our judgment that instead of a 75 percent and 25 percent weighting, that the weighting should be slightly higher on the CEA methodology.

Certainly, when you look at our indicator of value, and if you were to run a calculation, it certainly would not suggest a 50/50 weighting. We still believe that the HCLD does warrant a predominant weighting.

But, again, how we arrived at our overall conclusion is looking at both indicators of value, and then using appraisal judgment as to why we believe the CEA indicator value should be weighted a little bit more.

MR. DAKESSIAN: And, Mr. Chow, as to the specific percentage, it ended up being -- just for the record and for Madam Controller?

MR. CHOW: So, for the record, the

approximate amount is 65 percent HCLD, 35 percent CEA.

MS. YEE: Great. Thank you.

And then I know Mr. Moon is going to speak.

And, Mr. Moon, when you kind of walk through, or have the team walk through the adjustments, could you also explain the concept of regulatory life?

MR. MOON: Yes. Jack McCool will answer that.

MS. YEE: Okay.

MR. JENKINSON: Actually, Jack, did you want me to jump in here? This is Dan Jenkinson.

MR. McCOOL: Yeah. Feel free, Dan. Go ahead.

MR. JENKINSON: Yeah, Madam Controller, this is Dan Jenkinson with the State Board.

So you had asked for basically a rundown of the adjustments made? Okay.

So there were three wildfire adjustments made during the appraisal. The first was the adjustment for the $95 million paid over 10 years into the wildfire funds.

We actually discounted that back to a present value and applied that to our CEA, which resulted in $156 million reduction to value.

The second was related to the $400 million -- $400 million of capital expenditures that they were not able to earn in equity return. We removed the benefit associated with the equity return from the HCLD calculation.

So we basically calculated what the equity benefit would be, and removed that from HCLD. Which left the benefit of the return of, and the return on from the debt, using the debt rate as a discount rate.

The third is we did allow the .85 percent of additional equity-risk premium to be added to their cap rate.

That was what -- that was the -- the request that the CPUC actually denied. And we did add that,because we wanted to ensure that -- that all obsolescence was -- or all risk was mitigated. So that's really why we gave them that.

So those three adjustments ended up being $609 million in reduction to value during the appraisal season.

During the appeal, we -- we did make an -- we made an obsolescence adjustment to the HCLD to account for the fact that we gave them the .85 percent additional equity-risk premium. And that resulted in a $1.2 billion reduction to value.

And then we also removed $23 million in expenditures for the SIR expenses. Which resulted in a $52 million reduction to value.

Excuse me.

Now, as far as regulatory lag, regulatory lag is essentially -- it's a temporary delay in the petitioner's ability to earn a rate of return on some of their capital assets, is the way that I would phrase it.

And our opinion is that -- or -- excuse me -- regulatory lag. I'm sorry. Regulatory lag.

So our opinion is that regulatory lag is really the majority of the reason why the indicators are so far apart.

And this is why we do give some weighting to the CEA, because we want to acknowledge that fact.

So I hope that answers your questions.

MS. YEE: No, it does answer it.

And so, I mean, I suspect that going forward we're going to be seeing, I guess, some of this reconciled because of the lag, right?

And so -- and then obviously, then, the indicators will -- will -- will reconcile according to that.

MR. JENKINSON: Say that -- I'm sorry, can you say that again?

MS. YEE: No, no. I'm just saying with respect to the regulatory lag and what you've done in terms of having indicators reflect that.

MR. JENKINSON: Oh, yes, ma'am.

MS. YEE: You know, I mean, that's going to be carried forward with respect to when we realize the -- the effects of that lag, and the indicators will be reflective of that --

MR. JENKINSON: Yes, ma'am.

MS. YEE: -- going forward as well.

MR. JENKINSON: Yes, ma'am.

MS. YEE: Yeah. Okay. All right.

MR. DAKESSIAN: Madam Controller, may I respond to some of the points, please?

MS. YEE: Yes. Yes.

MR. DAKESSIAN: So I want to start at the outset. And I understand that you're -- you're trying to couch your comments carefully.

I can assure you that there is -- I -- I can assure you that there is no venue shopping taking place here. We -- we have no choice but to come to the Board, because the Board's the one that sets and equalizes the value.

So in terms of what may or may not have taken place with respect to CPUC, that is not binding on the Board, first of all. And is -- is just sort of beside the point.

If we're going to talk about CPUC, the CPUC recognizes that we cannot earn an equity return on these assets.

And to Mr. Jenkinson's point, there's no money being made on the debt side either. And I can have Ms. Wood attest to that if you would like. That's why we're asking for the entire amount to be pulled out.

These other concepts that Mr. Jenkinson is talking about in terms of value concepts, Members, are not part of the HCLD calculus.

HCLD is concerned strictly with ability to return, which is what rate base is.

So if you can't return on it, it needs to come out of HCLD. Point No. 1.

So point No. 2, in terms of the asset additions, I think Mr. Jenkinson just made our point for us. That's why you have net asset additions of $5 billion in the current year.

And you have a -- the -- the value increases don't necessarily follow. I mean, I direct you back to slide 8.

I mean, look at the asset additions in the previous years, and look at the value increases. Why didn't staff reduce our value in 2015 when we retired SONGS, and had a net asset decrease?

Those two things don't go together because of that regulatory lag.

And some of these assets, there's a permanent lag, because we can't earn on them. Like the capital expenditures. The Legislature has precluded us from earning on them.

And so -- so I wanted to address that.

And in terms of the insurance fund and amortization, I don't want us to get locked into certain terms. This is not the amortization of a capital asset.

This is asking for a prepaid expense to be ratably spread over a period of years to properly reflect the position of the company.

This was a prepaid insurance expense made. The -- the Legislature made it crystal clear that this is insurance.

And so for the staff to now come in and say, We don't think it's insurance, or, We don't think it's going to be replaced, you know, if they thought that this was a nonrecurring expense, they wouldn't have allowed the 95 million in the annual contributions.

We're just saying that the front-loaded expense, which was needed to capitalize the wildfire insurance fund, we're asking for that to be ratably spread, so it gives a proper picture, and as Mr. Manos says, doesn't distort the picture of the company in any given year.

All the sudden we have a 2.4 billion, and then nothing the following year. That kind of distorts the picture.

So I wanted to just make those points, Madam Controller. Thank you.

MS. YEE: Thank you.

And I guess -- I mean, I don't know that we -- I'm going to go back to Mr. Moon and the team.

But in terms of our limitations on looking at how they treat that amortization, I mean, I thought that we had some limitations or maybe justifications.

MR. MOON: Ms. Yee, this is Richard Moon from Legal Department again.

Yeah, you're absolutely correct. The reason why that $2.4 billion initial contribution is not deducted is because that AB 1054 mandated initial contribution will not recur. That $2.4 billion is not going to happen again.

It's not necessarily that because we think it's not best characterized as insurance, although we don't. And Mr. Dakessian had mentioned that AB 1054 makes that clear. We would disagree.

It is true that AB 1054 calls it an insurance fund in the intent language. However, in the operative position -- in the operative portions of the legislation, it is not referred to as insurance at all.

And petitioner itself points out a passage, I believe, from its annual report that says it accounted for the funds similar to prepaid insurance.

Well, if it is prepaid insurance, there would be no need to treat -- need to treat it similarly to prepaid insurance. They would just treat it as prepaid insurance.

But, again, that's not the main point of why we are not allowing this as a deduction. It's because that 2.4 billion will not recur. They've annualized that or amortized that over 10 years.

If in the future they need to make another initial contribution or series of contributions, we would allow that.

In the future, if they can't -- if this fund ends, and they need to go out and get private insurance, we would allow that as well.

But at this point, it's just unknown what's going to happen. And nobody even knows how long this fund will last. It could last until next year. It could last 10 years, 15 years, 50 years. We just don't know.

MR. DAKESSIAN: Madam Controller, may I?

MS. YEE: Yes, please, Mr. Dakessian.

MR. DAKESSIAN: So first of all, our -- I think -- this is part of the problem. So staff is sort of -- staff is sort of relying on sort of the routine way of doing things, and not looking at this new normal.

This is clearly insurance. I -- I don't understand the argument. The fact that the -- the -- you had Ms. Wood testifying before you that this was the best option they had available.

There's all kinds of public insurance. It doesn't need to be a private company. What about FAIR Plan? Okay. What about Medicare? What about, you know -- there are all kinds of public insurance vehicles. This seems to me like FAIR Plan, right?

I mean, it's infeasible for private insurance companies to fill this void, and so the government steps in and sets up an insurance fund. They call it an insurance fund whether it's in the codified language, or it's clear that that's what the intent of the Legislature is.

And for staff to sit here and just look at us -- look us in the face and say that this is not insurance -- it looks like insurance, it walks like insurance, it talks like insurance, it is insurance.

And so -- and then, you know, in terms of the amortization, again, we're asking for it to be ratably spread. It's not the amortization of the capital asset, which is what the De Luz case that they cite talks about.

This is a spreading of the expense on the front end. It was used to capitalize the insurance fund. So was it an insurance payment? Well, what was it? And it's going to be replaced.

I mean, do we seriously -- I mean, they can't sit here on the one hand, Madam Controller, Members of the Board, and say, Oh, we fully recognize this is the new normal. And then say, Oh, well, we don't know what's going to happen when the wildfire fund runs out.

Well, if that's the case, why did you allow the annual contributions? Of course we know something is going to take its place, some substantial level of expense. It's either going to be replenished, or they're going to go into an even greater level of expense as Ms. Wood indicated.

You know, $3 billion of coverage for a billion dollars? I mean, you know -- I mean, I just -- I think we're stuck in the old way of doing things.

And your Board's own guidance, the Assessors' Handbook, this is the Board's own published guidance, says prepaid insurance premiums are allowed to be annualized. So we don't have any distortion in the year-to-year value.

Thank you.

MR. GAINES: Question if I could. This is Member Gaines.

MR. VAZQUEZ: Controller Yee, I think you were muted. You were speaking.

MS. YEE: Yes. I was --

MR. GAINES: Oh, I'm sorry.

MR. VAZQUEZ: Go ahead.

MS. YEE: No, that's okay, Board Member Gaines. I just wanted to --

MR. GAINES: Sure.

MS. YEE: -- conclude my questions and remarks with this.

Clearly this is a situation to monitor. We have a set of rules and guidance that still governs how we do our value setting. You can argue whether it meets the test of reality or not.

And I would say that part of what we need to do in terms of our diligence is to continue to monitor how our companies like Southern California Edison are going to be operating going forward.

Certainly the CPUC will continue to focus on risks. And -- and -- and all I'm saying is I do think there will probably come a point in time of where we're going to need to make some potential adjustments in terms of how we approach the value setting. But I don't think we're there yet.

You know, there are -- there have been expenses, there have been expenditures that have been characterized. I think we're applying the appropriate guidance and standards in terms of how we reach the value.

And, again, I mean, there are still expenditures that are going to yield a benefit, you know, down the road.

And so I think I'm -- I'm comfortable with where we are at this point with what the staff is recommending.

But also just to say I want all parties to be just vigilant about monitoring the situation. It is clearly getting into a little bit of uncharted territory.

But at the same time, I'm -- I'm comfortable with where we are today.

Thank you.

MR. VAZQUEZ: Thank you.

Is that Member Gaines? Did you have a --

MR. GAINES: Yeah. Yes. Thank you.

I just want to focus on this insurance issue. Because I -- I don't -- I don't understand why the -- the prepaid aspect of this insurance is not considered an expense.

And the fact that you've set up this Wildfire Insurance Fund seems to me that that is an answer for a lack of insurance available within the marketplace.

And so we have the petitioner in this case putting money aside for, I think, existing in future claims.

And so it does -- it just baffles me as to how that could be included within the valuation. Why wouldn't that be separated and treated as an insurance expense?

It just doesn't -- doesn't -- doesn't seem to add up in my mind.

These utilities have real challenges on their hands, all of them, in terms of this definition of strict liability. So not just what's occurred in the past, but what will occur in the future in terms of wildfire risk.

I don't think that's going away any time soon. We have a history of dry climate in California. We've had droughts in the past. We've got issues with management of forest that we're lacking. We've had beetle rot. We've had all sorts of challenges.

So I think this is something that's going to have to be addressed by all utilities, not just this petitioner.

And the strict liability, the definition is so broad that the exposure on the utility really lies with the utility itself.

And so it seems to me that if there's a lack of market availability, certainly the Legislature stepped in and came up with a solution with AB 1054.

But that sure looks like insurance. It looks like something that you might -- that might even happen in the private sector if you were having trouble getting insurance.

There are mechanisms through creating a captive insurance -- insurance company to provide a market, because the risk is so high it doesn't exist in the regular free market.

So that's a -- that's a stumbling block for me. And I just feel that it doesn't seem to -- doesn't seem right to include that as assessed value. But should be, instead, treated as an expense.

And I'd love to hear from both Mr. Dakessian and Mr. Moon on those comments.

MR. JENKINSON: Board Member Gaines, I'd like to jump in, if you don't mind.

MR. GAINES: Sure.

MR. JENKINSON: This is Dan Jenkinson with the Board.

Yeah. So the reason that the amortization is not considered an expense is because our income model is based on cash flows. So this is not a cash flow.

And the reason it's based on cash flow is because an investor, a potential investor, one, they're going to look towards the future, right? They're looking forward. They're not looking back.

But they also care about cash. You know, they care about how much money they're going to make, how much cash they're going to make.

They are not concerned with the accounting adjustments that may come through their income statement that were based on the seller, you know, seller's running of the business.

I mean, the only benefit that a potential purchaser would get from the amortization is maybe a little bit of a tax break, you know.

I mean, it's not -- it doesn't -- it's not a cash flow, and, therefore, wouldn't be considered by a potential investor.

So that's why we don't allow --

MR. GAINES: Okay. But if I were -- but if I were interested in buying a company, I would want to take a look both forward and back.

I'd want to know what the liabilities are that exist from something that's occurred in the past, but also what the potential risk is of something that occurs in the future.

And -- and as that investor in that company, you would have to, you know, assess what the -- you'd have to -- to make a calculation in terms of what that expense would be into the future, and your pricing would be adjusted accordingly.

MR. McCOOL: So, Mr. Gaines, this is Jack McCool with the State-Assessed Properties Division.

I think a couple points I want to make. So what we're actually trying to accomplish is not to value the company as an entity. What we are -- what we are tasked with is coming up with a value for the property.

So in some of these items that we're discussing, we might be hung up on terms and things of that nature. But from that standpoint, about potential purchases, I think that, you know, we sometimes have to step back and ask what we're actually trying to -- to value.

So -- and then the other point --

MR. GAINES: Okay. But -- okay. Can I ask a question to that then?

If these were premiums paid to an insurance company, would they not be expensed?

MR. McCOOL: So -- so I think the way that we have approached this fund is the Legislature has created a fund. And I -- and, you know, I think there's disagreement on whether we characterize it prepaid insurance or not.

But for our purposes, the fund has two components. We have an initial contribution of $2.4 billion, which participating utilities were required. There's a different amount for the participating utilities.

For Edison, they required to pay this $2.4 billion to participate in the fund. And they paid that in 2019.

And after the initial contribution, there were ten annual payments of -- what is it -- $95 million.

So when we look at our income approach indicator, our CEA indicator, it is a perpetual-life cash flow forward-looking model.

So for our purposes, the -- to include, or to quote/unquote annualize that initial contribution in conjunction with the annual payments is a violation of our CEA model, which is looking at known cash flows in the future.

And the argument we have made is the

$2.4 billion initial contribution, there's no -- there's no entity that knows for a fact something like that, that giant contribution, will be made in the future.

So we've made our adjustment based on the facts that we do know, which are the remaining annual payments.

MR. GAINES: Well, it seems to me the model is not -- the model's not working.

MR. MOON: Mr. Gaines, if I might jump in here very briefly.

With regard to your question of whether if that $2.4 billion was undisputedly prepaid insurance, if that $2.4 billion initial contribution was paid sometime in the past, we would not allow that. We would not allow that for future, for 2020.

MR. DAKESSIAN: Member Gaines, staff has had ample opportunity to respond. May I respond to some of these points?

MR. JENKINSON: May -- may I just say one more thing, and then I'll -- then I'll mute here.

But I do also want to remind everyone that in 2019 the Board did make a $2.1 billion adjustment related to the idea of -- of wildfires.

So, you know, we weren't sure exactly what was going to happen back then, and so we made an adjustment based on the estimate that we thought was sufficient. And it's very [inaudible] talking about.

MR. GAINES: I'm shocked. That's going to be a reoccurring -- I think -- I think you're going to have a reoccurring exposure.

So, yeah, you've made an adjustment for one year, but I just -- this is not going to go away. I think we're going to continue to have challenges into the future, and until we dramatically increase management practices.

But also coupled in that are weather conditions. And I just don't -- I think it's an ongoing expense that's not going to go away.

Thank you.

MR. DAKESSIAN: Member Gaines, is it okay for me to respond?

MR. GAINES: Please do.

MR. DAKESSIAN: Thank you, sir.

So -- so first of all, if all they care about is cash, right, as they've stated, then give us the claims expense accrual, right? Because that's a future expense. That's point No. 1.

Point No. 2, that's massive inconsistency. So that's point No. 1.

Point No. 2, the reason that this prepaid -- I'm getting some feedback.

The reason this prepaid expense provision exists in the Board's own Assessors' Handbook is because you don't want a situation where, exactly as we have here, where shortly before the valuation date, we had a massive expense.

And that taxpayer gets treated one way, and then shortly after, right, you get the same expense, and that taxpayer gets treated differently. That's what is happening here.

And that's why the prepaid expense provision is in the Assessors' Handbook to normalize expenses, right? So that you don't distort the company value from year to year. That's -- it's just that simple.

And so -- and so for -- for staff to say that, you know, this is a past expense, read the Assessors' Handbook. It's right there. That's the general rule.

Yes, cash on an annual basis year to year. Exception for prepaid expenses. And this is insurance. I don't -- you know, I don't know how to say it any differently.

And in terms of, you know, not caring about what perspective buyers think, that we're only valuing the assets, totally wrong. We're valuing the company as a going concern. Unitary value.

We're not picking off assets one by one and looking at value. We're looking at the values of going concern. And that's what Rule 8 talks about, a reasonably well-informed buyer, what would they think about this. The Board's own rec.

And so, you know, in terms of labels, we're not attached to certain labels, they're attached to the amortization label. Let's -- let's stop with that. Let's talk about what the substance of what this really is, spreading of a payment over time. That's all -- that's all we're talking about, spreading of a payment over time. Not a capital asset that we're depreciating.

So thank you for the opportunity.

MR. GAINES: Great. Yeah, thank you for that clarification.

I -- I still feel that that ought to be expensed on an annual basis in terms of this insurance wild fund -- Wildfire Insurance Fund and the prepaid insurance.

So thank you. No further questions.

MR. VAZQUEZ: Thank you.

MR. SCHAEFER: Vice -- Vice Chair Schaefer here.

MR. VAZQUEZ: Vice Chair Schaefer, go ahead.

MR. SCHAEFER: Yeah. I defer to all that Member Gaines has had to say. He's a insurance professional, and has, you know, decades of experience in this field that most of us don't.

If no AB 1054 insurance is available, SCE would have to go into the private market to buy it at a greater expense. Do we know what that greater expense is? What the cost deferential they'd have to pay the private market for the same kind of coverage that's required?

And is that extra expense going to factor into their ultimate valuation as a going business?

MR. DAKESSIAN: Excellent question, Vice Chair Schaefer. If I may -- if I could have Ms. Andrea Wood, the Vice President of Tax of Edison answer that question for you.

MS. WOOD: Yeah, this is Andrea. I'll try to do my best.

Again, kind of going back to the example that I had before, you know, back before AB 1054, for just a billion dollars of insurance, we were having to pay, you know, $300 million.

And it was -- it was -- at that point it was actually very, very difficult for us to try to get insurance even beyond that. Which we know we needed beyond that because the level of the fires and the liabilities that we were incurring.

When we did the math to try to valuate whether or not we actually wanted to participate in AB 1054, there -- there were some, you know, inquiries into the different markets and models that were done that showed that -- if you look at our financial statements, the upfront contribution in, so the premium, the upfront premium paid, and then the annual premium requirement, if you look at the 10-years period that we would be covered by the fund -- and the fund was designed economically to cover a 10-year period based on the cost.

That was approximately $300 million a year. Which is very similar to what we had been paying in the past; however, our coverage is greater.

The prices I was quoting before were for a billion dollars of insurance. The fund could conceivably pay for -- for much more than that.

Again, because we're in a fund with PG&E in San Diego, we're pulling our risks.

And so, you know, you could have a situation where one company has a devastating wildfire in one of their territories and could exhaust the fund. Which would require more contributions in, and that could certainly happen.

But, again, it was -- it was designed conceivably to cover 10 years worth of exposure. And that, coupled with our mitigation expenses that we're having to pay, is -- is really designed to kind of prevent over time these catastrophic wildfires.

We're still going to have them. They're still going to happen. But you could conceivably control the claims a little bit if you're constantly mitigating.

So that's how the fund was set up.

And I'm sorry, Mr. Schaefer, I can't quote you exactly what it would have cost before. But when our -- when our internal folks in our treasury group did those analyses, they did it based on input from our risk management team.

And they came to the conclusion that it was much -- it was a much better -- an insured deal that we would get the coverage if we went ahead and opted to participate in the fund.

MR. SCHAEFER: All right. Thank you. Thank you, Ms. Wood.

MS. WOOD: Sure.

MR. SCHAEFER: I have nothing further.

MR. VAZQUEZ: Thank you.

Folks, man, I'm really torn on this one.

And I really agree with several of the comments that were made by our Controller, and then especially from our Member Gaines who is in the insurance business and understands it probably better than all of us.

I guess my question is, on this formula that I think was made by one of the presenters, or the petitioners, I'm saying, to possibly adjust the percentage, I guess, from the HCLD, 65 percent to the CEA at 35 percent, if I could ask the staff what that difference would mean financially.

MR. MOON: This is Richard Moon from Legal.

We would have to work that out. But I think perhaps even more important than that, we're not -- we're not even sure what the judgment or calculation -- I think I may have heard them say that it was not a mathematical formula. We're not even sure that we would agree with that 65/35, or what goes into it.

So, you know, we could certainly do the math. But that would take a little bit of time.

MR. VAZQUEZ: Okay.

MR. DAKESSIAN: Mr. Chairman, we can -- we can run the numbers on our end as well. And it was 65/35 is what it ended up.

MR. VAZQUEZ: And what are -- do we know what those numbers are?

MR. DAKESSIAN: We -- we can have someone --

MR. VAZQUEZ: Let me -- if there's no other questions or comments from the Members, let me just check with Ms. Taylor and see if there's any members of the public.

Ms. Taylor, are there any written comments or public comments on this?

MS. TAYLOR: Yes, Chairman Vazquez. We do have one submitted comment, which I will read into the record.

It was submitted Monday, December 14th. It's anonymous. And the comment is as follows:

Please don't take away school funding in the middle of a pandemic by giving a kick-back tax break to Southern California Edison.

End of comment.

Oops, you're muted, sir.

MR. VAZQUEZ: I'm sorry.

Was that the only comment we had?

MS. TAYLOR: That is the only comment.

We certainly could turn to the AT&T operator to see if there's any public commenters on the line.

MR. VAZQUEZ: Please.

MS. TAYLOR: AT&T moderator, could you please let us know if there's anyone on the line who would like to make a public comment regarding this matter at this time.

AT&T MODERATOR: Okay.

Ladies and gentlemen, if you wish to make a public comment, please press one, then zero at this time. One, zero.

And we have no one queuing up for comment.

MS. TAYLOR: Thank you.

MR. VAZQUEZ: Thank you.

Members, this item is now before us.

MS. YEE: Mr. Chairman.

MR. VAZQUEZ: Yes, Controller Yee. I hear you in the back. I can't see you, but I can hear you.

MS. YEE: Okay. I'm here.

MR. VAZQUEZ: Go ahead.

MS. YEE: I'll make a motion to grant the petition in part to reflect the recommended adjustments as it relates to issues 5 and 6. And -- and deny all other issues raised.

MR. SCHAEFER: Vice Chair Schaefer, I second the motion.

MR. VAZQUEZ: Any other comments or questions from the other Members?

MR. GAINES: Yeah. Question, if I could.

MR. VAZQUEZ: Yes, Member Gaines. Go ahead.

MR. GAINES: Okay.

So can you just clarify those items, those two items that would be included in the motion in favor of the petitioner?

MS. YEE: Sure. I think the agreed-upon adjustments related to issue 5. And that was the self-insured retention expenses.

MR. GAINES: Okay.

MS. YEE: And then issue 6 was the economic obsolescence adjustment.

MR. GAINES: Okay. Okay. But not addressing the fire -- Wildfire Insurance Fund?

MS. YEE: No, not at this time.

MR. GAINES: Okay. All right. Thank you.

MR. VAZQUEZ: All right. So it's been -- we have our motion, and it's been second.

Seeing no other questions or comments, let me get Ms. Taylor to call the roll.

MS. TAYLOR: Thank you.

Chairman Vazquez.

MR. VAZQUEZ: Aye.

MS. TAYLOR: Vice Chair Schaefer.

MR. SCHAEFER: Aye.

MS. TAYLOR: Member Gaines.

MR. GAINES: No.

MS. TAYLOR: Member Cohen is not participating.

Controller Yee.

MS. YEE: Aye.

MR. VAZQUEZ: So that passes by a three-to-two, Members, so --

MS. YEE: Actually three-to-one. Three-to-one.

MR. VAZQUEZ: Oh, I'm sorry. I had Cohen. Yeah, I'm sorry, I had Cohen. That's right.

So it's three-to-one, and then one abstention.

MS. YEE: Right.

MR. VAZQUEZ: I'm sorry. You're right.

So it still moves forward.

So this is now past us now. And it sounds like obviously there's -- in listening to the Members, there's definitely some interest in following this a little bit closer, and hopefully -- and I know I can hear from -- especially from listening to the comments from Member Gaines, I think we need to follow this a little bit closer.

And I know staff seems to be open. And I'm sure we're going to hear from Southern Cal. Edison afterwards to see what we can do.

Because I think we all know that, you know, wildfires are not going to end. Climate change is upon us, and we're going to have more disasters.

And at the end of the day, we need to come up with, I think, a better formula that incorporates some of these expenditures.

You know, I'm still a little -- I was still on the fence on this whole insurance piece. To me that was a little bit confusing.

But not having anything else to -- to judge it by, or to really make that adjustment, I sided with the motion.

But I'm hoping we can come up with a better formula moving forward.

Thank you for your time.

And especially the Controller. I know you're a little bit here. I know you had to move on.

MS. YEE: That's all right, Mr. Chairman. If I could.

MR. VAZQUEZ: Sure.

MS. YEE: There are several nonappearance items. I'm happy to take action on those before I hop off the meeting call.

MR. VAZQUEZ: Perfect. All right.

If we can get Ms. Taylor to call those.

MR. GAINES: Could I comment briefly before we --

MR. VAZQUEZ: Sure. Sure. Member Gaines, go ahead.

MR. GAINES: Yeah. I want to -- thank you, Chair Vazquez, for looking at this issue.

Because I think we do need an update in terms of how we treat, not just premiums, but money going into wildfire fund. And, in my view, ought to be flexibility in that in the future.

So I'm hoping that we as a Board can take a look at that.

MR. VAZQUEZ: Yes, I'm definitely on board with that.

MR. GAINES: Great. Thank you.

MR. SCHAEFER: Chair Vazquez, Vice Chair Schaefer. I second Member Gaines' comments.

MR. VAZQUEZ: Thank you.

With that, Ms. Taylor, if you would move on to the next item.

---o0o---

REPORTER'S CERTIFICATE

State of California)
) ss
County of Sacramento)

I, Jillian Sumner, Hearing Reporter for the California State Board of Equalization, certify that from December 16, 2020 videoconference, I recorded verbatim, in shorthand, to the best of my ability, the proceedings in the above-entitled hearing; that I transcribed the shorthand writing into typewriting; and that the preceding pages 1 through 49 constitute a complete and accurate transcription of the shorthand writing.

Dated: January 6, 2021

Jillian Sumner
____
JILLIAN SUMNER, CSR #13619
Hearing Reporter