SOUTHERN CALIFORNIA EDISON

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Caroline Thomas Jacobs
Director, Office of Energy Infrastructure Safety
California Natural Resources Agency
715 P Street, 20th Floor
Sacramento, CA 95814

SUBJECT: Southern California Edison Company's Comments on the Office of Energy Infrastructure Safety's Draft 2022 Executive Compensation Guidelines

Dear Director Thomas Jacobs,

Pursuant to the December 2, 2021 Notice from the Office of Energy Infrastructure Safety ("Energy Safety") releasing the Draft 2022 Executive Compensation Guidelines ("Draft 2022 Guidelines") for public comment, Southern California Edison Company ("SCE") provides the following comments on 2022 executive compensation submittals and the public process to develop 2023 guidelines.

INTRODUCTION

The Draft 2022 Guidelines require electrical corporations to complete a Required Information Template for their 2022 executive compensation approval requests ("2022 Template"). The Draft 2022 Guidelines also state that "Potential changes discussed at [Energy Safety's September 29, 2021 public workshop on 2022 and 2023 executive compensation guidelines] that would likely require more substantive changes in executive compensation structures have been temporarily held in abeyance for consideration in the 2023 Executive Compensation Guidelines."[1] SCE's comments below make recommendations and request clarification for the 2022 Template and propose a timeline for developing the 2023 executive compensation guidelines. SCE appreciates the efforts that Energy Safety has taken to engage with stakeholders to develop guidance for executive compensation submittals and looks forward to continuing that constructive engagement with Energy Safety.

COMMENTS ON THE DRAFT 2022 GUIDELINES

I. Sections 5-7 of the 2022 Template Do Not Follow the Statutory Text

Pub. Util. Code 8389(e)(6)(A) specifies certain requirements that apply to the extent an electrical corporation "has established a compensation structure for any new or amended contracts for executive officers, as defined in Pub. Util. Code 451.5." As SCE explained in its October 15, 2021 comments on Energy Safety's September 29, 2021 public workshop, SCE understood through discussions in mid-

[1] Draft 2022 Guidelines, p. 7.

2019, when the language for Pub. Util. Code 8389(e)(6)(A) was being developed, that Pub. Util. Code 8389(e)(6)(A) was intended to apply solely to new or amended employment contracts that commit to a specific compensation structure for an executive officer. The employment contract announced by PG&E Corporation in April 2019 for William D. Johnson to become its CEO and President was discussed during the mid-2019 legislative discussions as an example of the type of contractual commitment to which Pub. Util. Code 8389(e)(6)(A) was intended to apply. In that contract, PG&E committed to a specific compensation structure for three years.[2]

Sections 5, 6, and 7 of the 2022 Template are intended to assess compliance with Pub. Util. Code 8389(e)(6)(A).[3] However, the 2022 Template states that Section 5 applies "for each executive officer with a [sic] new or amended contracts." Sections 6 and 7 of the 2022 Template use similar phrasing. This phrasing switches the order of the relevant prepositional phrases in Pub. Util. Code 8389(e)(6)(A) and uses a different preposition, and those changes suggest a different meaning not supported by the statutory text. The statute was not drafted to apply to a "compensation structure" "for executive officers" *with* "new or amended contracts." Rather, Pub. Util. Code 8389(e)(6)(A) applies when an electrical corporation "has established" "a compensation structure" "for any new or amended contracts" "for executive officers." Establishing a "compensation structure" for "contracts" is appropriately interpreted as meaning that an electrical corporation has specified an entire compensation structure for which it has made a contractual commitment, such as through a term employment agreement and the contracts for components of compensation incorporated by reference in the employment agreement. In contrast, new or amended contracts for executive officers that reflect a contractual commitment by an electrical corporation to one component of compensation (e.g., an agreement to the terms and conditions for a new long-term incentive grant), but are not part of a contractual commitment to an entire compensation structure, do not establish a compensation structure and therefore do not trigger the application of Pub. Util. Code 8389(e)(6)(A).

SCE respectfully requests that Energy Safety revise Sections 5-7 so that they directly align with Pub. Util. Code 8389(e)(6)(A): (i) those Sections should apply only to the extent that an electrical corporation has contractually committed to a specific compensation structure through new or amended contracts for an executive officer; and, as a corollary, (ii) the 2022 Template should clarify that Sections 5-7 do not apply if the electrical corporation advises its executive officers, and they agree, that the electrical corporation may modify their compensation at any time in the electrical corporation's discretion.

II. SERPS Should Not be Categorized as Perquisites

The Draft 2022 Guidelines categorize supplemental executive retirement plans ("SERP") as "Perquisites."[4] However, as the Securities and Exchange Commission ("SEC") has recognized, SERPs are not perquisites, and should instead be treated in the same manner as regular retirement or pension benefits. For purposes of disclosing compensation in proxy statements, the SEC has a separate category for "Change in Pension Value and Nonqualified Deferred Compensation Earnings"

[2] Form 8-K jointly filed by PG&E Corporation and Pacific Gas & Electric Company on April 16, 2019, available at https://www.sec.gov/Archives/edgar/data/0000075488/000095015719000456/form8k.htm.
[3] Draft 2022 Guidelines, p. 42.
[4] Draft 2022 Guidelines, pp. 45, 46, 56.

that includes both "tax-qualified defined benefit plans and supplemental executive retirement plans."[5] In contrast, "Perquisites" are included in the "All Other Compensation" category.[6]

This separate categorization is meaningful for proxy statements because the compensation in the "Change in Pension Value and Nonqualified Deferred Compensation Earnings" category is the *only* compensation that is *excluded* from the total compensation calculation for each executive officer that is used to identify the company's named executive officers ("NEOs") for the proxy.[7] Perquisites are included in that total compensation calculation.[8]

The Draft 2022 Guidelines require that SERP benefits be valued using the same "value that is disclosed in proxy statement summary compensation tables."[9] The value that is used for SERPs and other pension benefits in proxy statements is based on accounting rules and is highly volatile and sensitive to external variables, such as assumptions about life expectancy and changes in interest rates. These external variables are functions of actuarial and economic factors that are outside the control of the Compensation Committee, which is one of the reasons why the SEC decided to exclude "Change in Pension Value and Nonqualified Deferred Compensation Earnings" from the total compensation used for the NEO determination.[10] The external variables also result in an accounting value that may not accurately reflect the actual amounts that ultimately will be paid to the individual, since the assumptions used for benefit accruals and payments from SERPs and other pension plans may differ from assumptions used for accounting purposes and may change from time to time.

Another reason that the SEC decided to treat SERP and pension plan benefits similarly to each other and differently from other compensation is that the annual value of SERP and pension plan benefits is influenced so much by years of service.[11] Including the annual value of the SERP in the denominator for purposes of the "primary portion"[12] or "significant portion"[13] tests that Energy Safety is presumably considering for 2023 would bias those tests against long-serving executive officers. That runs counter to the goals of AB 1054. Retaining well-qualified, long-serving executive officers with a deep knowledge of how to run the electrical corporation is important for meeting safety and financial stability goals.

Energy Safety is already excluding regular pension plan benefits from the definition of "Total Direct Compensation."[14] SCE excludes both SERPs and regular pension plan benefits from Total Direct Compensation.[15] SCE respectfully requests that Energy Safety follow the approach of the SEC, and treat SERP benefits in the same manner as regular pension benefits, in particular excluding them

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[5] 17 C.F.R. §229.402(c)(2)(viii), Instruction 1.
[6] 17 C.F.R. §229.402(c)(2)(ix)(A).
[7] 17 C.F.R. §229.402(a)(3), Instruction 1.
[8] *Ibid*.
[9] Draft 2022 Guidelines, p. 44.
[10] SEC Release No. 33-8732A, p. 119 (dated August 29, 2006).
[11] *Ibid*.
[12] Pub. Util. Code. 8389(e)(6)(A)(i)(I).
[13] Pub. Util. Code. 8389(e)(6)(A)(iii).
[14] Regular pension plan benefits seem to be included in the definition of "Benefit Programs." Draft 2022 Guidelines, p. 55. Benefit Programs are not included in the definition of "Total Direct Compensation." *Id.*, p. 57.
[15] *See* 2021 Executive Compensation Submission of Southern California Edison Pursuant to Assembly Bill 1054, filed January 15, 2021 ("January 15, 2021 Submission"), p.1.

from a definition of total compensation (in the case of the 2022 Template, Total Direct Compensation) for which inclusion would result in skewed and problematic results. The Draft 2022 Guidelines already define "Benefit Programs" as including plans that "[p]rovide financial security in the case of death… or retirement."[16] SERPs, like regular pension benefits, do provide financial security in the case of death or retirement. Accordingly, for all the reasons discussed in this section, SCE suggests that SERPs, like regular pension benefits, be included in the Benefit Programs definition and excluded from the Perquisites definition.

III. The Final Guidance Should Clarify Long Term Incentive Reporting Requirements

SCE requests that Energy Safety clarify information that needs to be reported for the Long-Term Incentive Program ("LTIP"), such as:

- The Draft 2022 Guidelines define the LTIP in two different ways: "all performance-based compensation awarded on a performance term of three or more years"[17] and "all incentive-based compensation held or delayed for three or more years."[18] SCE suggests a different approach. The LTIP should be defined as "all incentive-based compensation with a performance term or a vesting term greater than one year." The 2022 Template could separately request information regarding the portion of the LTIP that is "held or deferred for a period of at least three years." The Draft 2022 Guidelines appropriately provide that determining whether compensation is held or deferred three or more years is accomplished by subtracting the calendar year of grant from the calendar year of payment.[19] This suggested approach follows the text of Pub. Util. Code 8389(e)(6)(A)(iii), which requires (for new or amended employment contracts) that a significant portion of compensation be held or deferred for a period of at least three years, but does not require that the LTIP only consist of such delayed compensation. If Energy Safety uses this approach, then SCE suggests that STIP be re-defined as "all incentive-based compensation with a performance term of one year or less."
- The Draft 2022 Guidelines require electrical corporations to provide LTIP information on "Earned Value as a percentage of TIC… at the date of vesting,"[20] "Actual % of TIC at Vesting Date,"[21] and "Earned Value as a percentage of TDC… at the date of vesting."[22] However, SCE's LTIP grants have different vesting dates: SCE's performance shares have cliff-vested as of the last day of the three-calendar-year performance period, restricted stock units have generally cliff-vested as of the first New York Stock Exchange ("NYSE") trading day of the third year after grant, and stock options have vested ratably over a four-year period, generally as of the first NYSE trading day of each of the four years after grant. Not only do different types of LTIP have different vesting dates, but other components of compensation do not neatly tie to those vesting dates. For example, SCE's 2022 annual incentives will not vest until the payment date, which will likely be in early- or mid-March 2023. In addition, SCE values stock options at their grant date using a Black-Scholes calculation and values performance shares at

[16] Draft 2022 Guidelines, p. 55.
[17] *Id.*, pp. 30, 47.
[18] *Id.*, p 56.
[19] *See Ibid.*
[20] *Id.*, p. 30.
[21] *Id.*, p. 41.
[22] *Id.*, p. 47.

their grant date using a Monte Carlo calculation. It would be extremely burdensome to perform these calculations for other dates. SCE suggests a different approach. For consistency among executive compensation approval requests and to avoid an unnecessary and unhelpful burden on electrical corporations, electrical corporations should not be required to provide "Earned Value" or "Actual %" as of the date of vesting. Instead, the 2022 Template should request that electrical corporations provide the intrinsic value as of December 31, 2021 of LTIP grants from 2019. Those intrinsic values could be combined with actual annual incentive paid for 2019 performance to determine an earned value as a % of Total Incentive Compensation for 2019 incentive grants. Actual salary paid for 2019 could then be added to determine earned value as a % of Total Direct Compensation.

- The current definition of "Grant Value" provides that it is "specified in the proxy statement."[23] However, that is only true for proxy officers. SCE suggests that the definition be revised to provide that "Grant Value" should be determined using the same methodology used to determine grant value for that form of compensation for the electrical corporation's officers whose compensation is disclosed in a proxy statement (or if none of the electrical corporation's officers have compensation disclosed in a proxy statement, then the grant value would be determined using the methodology that would apply if Item 402(c) of Regulation S-K applied to the disclosure of the compensation for the electrical corporation's executive officers).

IV. Considerations for 2023 Guideline Development

A. SCE's Recommendations for the Process for 2023

The Draft 2022 Guidelines state that "Energy Safety will hold a public process for the 2023 Guidelines in the first half of 2022."[24] SCE recommends that as part of this public process, Energy Safety hold a public workshop regarding the 2023 guidelines in mid-May, 2022, followed by a comment period, the issuance of draft 2023 guidelines, and another comment period. Starting the public process for 2023 in early or mid-May is advisable because the public process for 2023 guidelines should start promptly after briefing on 2022 executive compensation approval (which has a late April 2022 reply comment deadline)[25] in order to allow enough time for a constructive public process that concludes with appropriate final guidance for 2023 issued in the summer or early fall of 2022. Such timing will provide SCE and other electrical corporations sufficient time to thoughtfully structure their executive compensation structures for 2023.

Electrical corporations would then be required to make their 2023 submissions in mid-March 2023. Energy Safety's subsequent review of those 2023 submissions should be limited to (i) determining whether the electrical corporation substantively complied with the key elements of Energy Safety's final guidance for 2023 (i.e., Energy Safety should approve an electrical corporation's submission and not require changes to the electrical corporation's 2023 executive compensation structure unless the structure clearly violates fundamental aspects of Energy Safety's final guidance for 2023) and (ii) evaluating changes to Energy Safety's guidance for purposes of 2024 executive

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[23] Draft 2022 Guidelines, p. 55.
[24] *Ibid.*, p. 8.
[25] *Id.*, p. 9.

compensation structures. As SCE has previously explained, it is too late to make changes to SCE's incentive compensation structure for a year after the beginning of March of that year. The annual grant date for long-term incentives is on or about March 1 of each year. In addition, SCE establishes and communicates its annual incentive goals to *all* employees (executive officers, represented employees, etc.) in January and February of the goal year to set expectations and incent the intended performance for the year. SCE's philosophy is to use the same goals for all employees and to communicate those goals to employees early in the year so that the entire company works together to achieve the company's goals.

B. SCE's Executive Compensation Structure Substantially Tracks Assigned Commissioner Ruling Executive Compensation Proposal 9

The Draft 2022 Guidelines encourage electrical corporations other than PG&E to review and consider adopting the executive compensation requirements that apply to PG&E pursuant to the final decision approving PG&E's reorganization plan (D.20-05-053), which obligated PG&E to comply with the requirements proposed in Assigned Commission Ruling Executive Compensation Proposal 9 (ACR 9). SCE has reviewed these executive compensation requirements for PG&E. SCE's executive compensation program substantially tracks the ACR 9 requirements for PG&E; to the extent SCE's program differs, those differing features reflect the judgment of SCE's independent Compensation and Executive Personnel Committee, with input from the committee's independent compensation consultant, regarding how SCE's executive compensation structure can best serve the long-term interests of SCE and its stakeholders, including promoting safety as a priority and helping ensure public safety and utility financial stability.[26] SCE respectfully requests that Energy Safety not impose ACR 9 requirements on SCE for 2023 or future years. Such a requirement would not be supported by the statutory language of AB 1054 and would impinge on the authority and duty of SCE's independent Compensation and Executive Personnel Committee under state and federal law to exercise its judgment in setting the compensation structure for executive officers to best serve the long-term interests of SCE and its stakeholders.

C. Energy Safety Should Not Require its Categorization of Safety Metrics to be Used to Pre-Set Safety Weightings

The Draft 2022 Guidelines require that electrical corporations' submissions assign metrics according to Energy Safety's categories and sub-categories.[27] SCE cautions against the use of these categories and sub-categories for (i) assessing whether an electrical corporation's executive incentive compensation is structured to promote safety as a priority and to ensure public safety and utility financial stability, or (ii) prescribing pre-set weightings for safety for 2023 or later years. Many of Energy Safety's non-safety categories are driven by and support advancement of safety. For example, operational and improvement metrics like quality conformance are focused on improving asset performance that leads to better safety outcomes. SCE also designates some of its goal metrics that

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[26] January 15, 2021 Submission, *supra* note 15, at 17-19.
[27] *Id.*, p. 59.

span safety and other categories to a non-safety category.[28] Accordingly, SCE respectfully requests that Energy Safety keep in mind that goal categorization can underrepresent the totality of goals and success measures associated with safety or financial stability.

Also, with a few exceptions, SCE does not pre-set weightings at the goal level. Allocating small percentages to numerous subcomponents would mask the importance of the overarching goal categories. SCE strongly believes that what is important is that Safety and Resiliency, as a whole, is heavily weighted. Though the subcomponents provide guidance on specific metrics to focus on, weighting at the subcategory level at the beginning of the year can result in the unintended consequence of individuals making tradeoffs between subcomponents. This takes away from executives' and employees' focus on the objective of the overall goal and removes the flexibility needed to address emergent issues, based on the latest available information, without incremental value in inspiring a strong safety culture and enforcing accountability for all aspects of grid safety and resilience.

CONCLUSION

SCE appreciates the opportunity to submit these comments and to engage with Energy Safety and its consultant NorthStar Consulting, intervenors, and other stakeholders in this proceeding to refine executive compensation guidelines.

If you have any questions, or require additional information, please contact me at michael.backstrom@sce.com.

Sincerely,

//s//

Michael A. Backstrom
VP Regulatory Policy
Southern California Edison

[28] *See* January 15, 2021 Submission, *supra* note 15, at 8-13, for an explanation regarding how SCE's proposed 2021 success measures and metrics would promote safety, including success measures not included in SCE's Safety and Resiliency goal category.