State of California – A Natural Resources Agency
Gavin Newsom, Governor

OFFICE OF ENERGY INFRASTRUCTURE SAFETY
715 P Street, 20th Floor | Sacramento, CA 95814
916.902.6000 | *www.energysafety.ca.gov*
Caroline Thomas Jacobs, Director

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Michael Backstrom, Vice President, Regulatory Policy
Southern California Edison
8631 Rush Street
Rosemead, CA 91770

Subject: **Office of Energy Infrastructure Safety Approval of Southern California Edison Company's 2021 Executive Compensation Structure Pursuant to Public Utilities Code Sections 8389(e)(4) and (e)(6)**

To Mr. Backstrom:

This letter approves Southern California Edison Company's (SCE) 2021 executive compensation structure. The Office of Energy Infrastructure Safety (Energy Safety) finds that SCE's executive compensation structure minimally satisfies the requirements of Public Utilities Code sections 8389(e)(4) and 8389(e)(6).

Background

On December 22, 2020, the Wildfire Safety Division (WSD) of the California Public Utilities Commission (CPUC)[1] issued guidance directing electrical corporations seeking a Safety Certification for 2021 to submit a formal request for approval of its executive compensation structure by January 15, 2021. SCE timely submitted a request for approval of its 2021 executive compensation structure on January 15, 2021. On March 1, 2021, SCE submitted a supplement which provided its final 2021 annual incentive goals and metrics as approved by the SCE Board of Directors' Compensation and Executive Personnel Committee (Compensation Committee) on February 24, 2021.

On January 29, 2021, the Public Advocates Office (Cal Advocates) and The Utility Reform Network (TURN) submitted comments on SCE's and other electrical corporations' 2021 executive compensation plans. On February 5, 2021, SCE submitted reply comment. On April 30, 2021, Cal Advocates and TURN submitted comments on SCE's and other electrical corporations' supplemental executive compensation submissions. On May 7, 2021, SCE submitted reply comments in response to the April 30, 2021 comments.

Pursuant to Public Utilities Code section 8389(e)(4), to receive a safety certification, an electrical corporation must, among other things, have its executive compensation structure be approved by Energy Safety. The executive compensation structure must be "structured to promote safety as a priority and to ensure public safety and utility financial stability with performance metrics, including

[1] On July 1, 2021, the WSD transitioned to Energy Safety, a new department under the California Natural Resources Agency. In accordance with Public Utilities Code section 326, all functions of the WSD are transferred to Energy Safety.

incentive compensation based on meeting performance metrics that are measurable and enforceable, for all executive officers, as defined in [Public Utilities Code section] 451.5."

Public Utilities Code section 8389(e)(6)(A) further requires:

> The electrical corporation has established a compensation structure for any new or amended contracts for executive officers, as defined in [Public Utilities Code] Section 451.5 to be based on the following principles:
>
> (i) (I) Strict limits on guaranteed cash compensation, with the primary portion of the executive officers' compensation based on achievement of objective performance metrics.
> (II) No guaranteed monetary incentives in the compensation structure.
>
> (ii) It satisfies the principles identified in [Public Utilities Code section 8389(e)(4)].
>
> (iii) A long-term structure that provides a significant portion of compensation, which may take the form of grants of the electrical corporation's stock, based on the electrical corporation's long-term performance and value. This compensation shall be held or deferred for a period of at least three years.
>
> (iv) Minimization or elimination of indirect or ancillary compensation that is not aligned with shareholder and taxpayer interest in the electrical corporation.

In addition to the requirements set forth in Public Utilities Code sections 8389(e)(4) and (e)(6), the guidance letter required an electrical corporation seeking approval of its 2021 executive compensation structure to submit the following information:[2]

- An explanation of executive compensation components, including base pay, annual bonus/incentive information, and long-term incentive pay, including percentages of overall compensation for each component.
- A description all metrics, including safety metrics, used to calculate incentive compensation, including an explanation of whether safety metrics are outcome or input based (e.g., number of ignitions versus number of miles of distribution lines inspected).
- A breakdown of the percentage of executive compensation based on safety metrics versus other metrics (e.g., financial performance).
- A description of how safety performance is calculated for incentive compensation.
- Examples of incentive compensation reduced or withheld in the last five years as a result of failure to meet safety metrics.

Lastly, CPUC Decision 20-05-053 required Pacific Gas and Electric Company to comply with the requirements of Assigned Commission Ruling (ACR) Executive Compensation Proposal 9.[3] The guidance letter encouraged other electrical corporations, including SCE, to review and consider adopting the measures from ACR Executive Compensation Proposal 9 in the spirit of transparency and furthering the

[2] WSD Executive Compensation Submission Guidance Letter, page 2.
https://energysafety.ca.gov/wp-content/uploads/docs/misc/wsd/wsd-executive-compensation-guidance-20201222.pdf

[3] Investigation 19-09-016, Assigned Commissioner Ruling and Proposals, February 18, 2020:
https://docs.cpuc.ca.gov/PublishedDocs/Efile/G000/M327/K303/327303409.PDF.

purpose of AB 1054.[4] Energy Safety's review of SCE's executive compensation submission has taken this additional guidance into consideration.

Discussion

Energy Safety reviewed the three elements of SCE's executive compensation structure: 1) base salary, 2) annual incentive awards, and 3) long-term incentive awards. Base salary is a fixed amount of income for the year. Annual incentive awards are variable, paid in cash, and designed to focus attention on specific safety, operational, financial, and strategic objectives. Long-term incentive compensation is largely tied to underlying stock performance and focuses on the company's long-term goals and financial health.

SCE's compensation meets the requirements of Public Utilities Code section 8389(e)(6)(A)(i)(I). While the percentage of total performance-based compensation varies depending on position, the majority of compensation for all executive positions is performance based.

SCE's executive compensation structure does not guarantee monetary incentives and thus complies with Public Utilities Code section 8389(e)(6)(A)(i)(II). SCE explains in its submission that annual and long-term incentive awards are considered "at risk" and are only awarded if important goals and objectives are met. Failure to meet these goals may result in a reduction or elimination of annual incentive award payouts. SCE also explains that its Compensation Committee provides independent oversight of compensation and has discretion to reduce or eliminate annual incentive awards should circumstances warrant.

SCE's executive compensation structure appears to promote safety as a priority and includes appropriate measurable and enforceable performance metrics as required by Public Utilities Code sections 8389(e)(4) and 8389(6)(A)(ii). For example, in its January 15, 2021 submission, SCE provided its draft 2021 annual incentive goals, "success measures" and metrics, and scoring matrix. In its March 1, 2021 supplement, SCE provides its final, Compensation Committee-approved 2021 goals, which include final metrics and replace "x, y, z" metric value placeholders for multiple success measures. Additionally, in this later submission SCE revised its Public Safety Power Shutoff (PSPS) goal. While the draft PSPS success measures focused on achieving customer restoration time, the final version proposes improving "PSPS customer experience by executing comprehensive improvement plan focused on enhancing notifications and other PSPS capabilities." No metric targets were provided for the PSPS goal.

SCE minimally met the requirements of Public Utilities Code section 8389(e)(4). SCE's annual incentive awards use a scoring matrix to calculate the annual payout. The scoring matrix is comprised of goal categories, which are allocated target scores. For example, the "Safety & Resiliency" goal category makes up fifty percent (50%) of the total target score (a slight increase from last year). The "Financial Performance" and "Operational Excellence & Strategic Advancement" goal categories each comprise twenty-five percent (25%) of the total target score. All goal categories are comprised of success measure subcategories and corresponding metrics. For example, within SCE's Safety & Resiliency goal category, subcategories include Worker Safety, Public Safety, and Wildfire Resiliency, among others, each with corresponding metrics. While SCE provides target scores for the overarching goal categories, it is unclear how the subcategories are weighted and how, if certain subcategory metric targets are met and others

[4] WSD Executive Compensation Submission Guidance Letter, page 3.

are not, they each contribute to the target scores. Energy Safety expects SCE to focus on providing greater transparency next year in relation to the weighting of subcategories and metrics and how they contribute to target scores, and therefore, how they contribute to annual incentive award payouts. Greater transparency and granularity in these areas will help Energy Safety better assess the ways in which SCE is structuring its executive compensation package with safety as priority, including ensuring public safety, pursuant to Public Utilities Code section 8389(e)(4).

SCE's long-term incentives (LTIs) fulfill Public Utilities Code section 8389(e)(6)(A)(iii). Each of the three components that contribute to the LTI's are equity-based payouts contingent on financial performance. The LTI compensation comprises a majority of Executive Officers' compensation, with fifty percent (50%) of the total possible compensation subject to three-year cliff or performance vesting requirements. The remaining fifty percent (50%) of the compensation consists of stock options which vest in equal installments over four years.

SCE's executive compensation structure does not include compensation that is not aligned with shareholder or taxpayer interests and therefore meets the requirements set in Public Utilities Code section 8389(e)(6)(A)(iv).

In comments, TURN's primary criticisms of SCE's 2021 executive compensation structure include the following:

- SCE's annual incentive goals do not provide a breakdown of how success measures contribute to the scores for each goal category.
- The majority of SCE's success measures rely on input-based metrics.
- SCE's "Overarching Goals Framework" leaves too much discretion to its Compensation Committee in determining whether overarching goals are achieved.

Cal Advocates' comments emphasize the following:

- SCE should set metric targets that are quantifiable and enforceable. Cal Advocates highlights multiple metrics in SCE's "Safety & Resiliency" goal category that do not provide numerical targets.
- SCE's compliance-based metrics should include metric target values of 100% compliance.
- SCE should provide more information on how its "Safety & Resiliency" metric target values are set.

Energy Safety recognizes the concerns of TURN and Cal Advocates. While SCE has revised and added to its annual incentive goals and metrics, SCE must continue developing its executive compensation structure to reflect the spirit of Public Utilities Code 8389 and provide measurable and enforceable performance metrics that promote safety as a priority.

Conclusion

Energy Safety finds that SCE has met the minimum requirements set forth in Public Utilities Code sections 8389(e)(4) and (e)(6), and the additional requirements set forth in the 2021 guidance letter.

The statutory requirements for the structure of an executive compensation program are detailed and complex, and SCE must do more work to align executive compensation metrics to those used in the

Wildfire Mitigation Plans. A more robust understanding of an executive compensation structure that promotes safety as a priority will be developed through a public process and incorporated into future guidelines. Energy Safety is initiating the development of the 2022 executive compensation guidelines and anticipates holding a public workshop related to that effort in fall 2021.

Sincerely,

Lucy Morgans

Lucy Morgans
Acting Program Manager, Safety Policy Division
Office of Energy Infrastructure Safety

cc: Diana Gallegos, Southern California Edison Company