



OFFICE OF ENERGY INFRASTRUCTURE SAFETY

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Caroline Thomas Jacobs, Director

August 11, 2021

By Email: DSkopec@semprautilities.com

Dan Skopec, Senior Vice President
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8330 Century Park Court, CP33A
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Subject: Office of Energy Infrastructure Safety Approval of San Diego Gas & Electric Company's 2021 Executive Compensation Structure Pursuant to Public Utilities Code Sections 8389(e)(4) and (e)(6)

To Mr. Skopec:

This letter approves San Diego Gas & Electric Company's (SDG&E) 2021 executive compensation structure. The Office of Energy Infrastructure Safety (Energy Safety) finds that SDG&E's executive compensation structure minimally satisfies the requirements of Public Utilities Code sections 8389(e)(4) and (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. SDG&E timely submitted a request for approval of its 2021 executive compensation structure on January 15, 2021. On February 25, 2021, SDG&E submitted a supplement which detailed the minimum, target, and maximum values of the metrics in its 2021 Variable Pay Plan.

On January 29, 2021, the Public Advocates Office (Cal Advocates) and The Utility Reform Network (TURN) submitted comments on SDG&E's and other electrical corporations' 2021 executive compensation plans. On February 5, 2021, SDG&E submitted reply comment. On April 30, 2021, Cal Advocates and TURN submitted comments on SDG&E's and other electrical corporations' supplemental executive compensation submissions. On May 7, 2021, SDG&E 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 must, among other things, have its executive compensation structure be approved by Energy Safety. and the executive compensation structure must be "structured to promote safety as a priority and to ensure

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.

public safety and utility financial stability with performance metrics, including 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 of 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 SDG&E, 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 SDG&E's executive compensation submission has taken this additional guidance into consideration.

Discussion

Energy Safety reviewed the three components of SDG&E's executive compensation structure: 1) base pay, 2) variable pay plan, also referred to as the Incentive Compensation Plan (ICP), and 3) long-term incentives.

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

SDG&E's executive compensation plan appears to satisfy the principles identified in Public Utilities Code section 8389(e)(4) and meets the requirements of Public Utilities Code section 8389(e)(6)(A)(ii). SDG&E's variable pay plan places 19% to 20% of an executive's compensation at risk, subject to achievement of the plan's performance measures. In its January 15, 2021, submission, SDG&E presents the performance metrics of its variable pay plan; in its February 25, 2021, supplement, SDG&E provides the minimum, target, and maximum for each metric.

For its 2021 variable pay plan, SDG&E made several changes to the metrics from 2020. The following metrics were added:

1. Average days for Tier 3 Level 1 corrections.⁵
2. Vegetation contacts in the High Fire Threat District (HFTD).
3. Public Safety Power Shutoff average circuit restoration time.
4. Near misses in the HFTD (i.e., overhead faults that could result in ignition).⁶

The following metrics were removed:

1. Wood-to-steel pole replacements.
2. Substation breaker replacements.
3. Tee replacement program locations.

The changes are an incremental improvement over 2020 and moves SDG&E's executive compensation structure towards true safety performance metrics and away from program targets. For executive officers, 59% of the variable pay is based on "employee and public safety operations" goals,⁷

⁴ WSD Executive Compensation Submission Guidance Letter, page 3.

⁵ Measures the average time between the recognition of a Level 1 risk in Tier 3 HFTD and a corrective action being completed to mitigate the issue. Level 1 infractions are issues on power lines found during inspections that have the potential to be an imminent hazard to public safety or fire risk that requires immediate action to either correct or make safe.

⁶ Near misses are events that had no injuries or illnesses but could have easily resulted in an injury or illness.

⁷ SDG&E's Executive Compensation Supplement, February 25, 2021, Attachment A.

representing approximately eleven and one-half percent (11.5%) of executive officer's total compensation.⁸

In comments, TURN's primary criticisms of SDG&E's 2021 executive compensation structure are that SDG&E's executive compensation program does not sufficiently promote safety as a priority and that its metrics are not objective, measurable, and enforceable. Cal Advocates similarly emphasize that SDG&E should be setting metric goals that promote safety as a priority. Cal Advocates also criticized SDG&E's metric targets as stagnant rather than encouraging improvements over past performance. Energy Safety recognizes the concerns of TURN and Cal Advocates. While SDG&E has replaced several programmatic targets with safety performance metrics, SDG&E must continue developing its executive compensation structure and refine its performance metrics to reflect the spirit of Public Utilities Code section 8389 and promote safety as a priority.

SDG&E's long-term incentives meet the requirements set in Public Utilities Code section 8389(e)(6)(A)(iii). Long-term incentives constitute 36% to 53% of an executive officer's total compensation and at higher levels of responsibility, a greater portion of an executive officer's pay is tied to long-term incentives. Long-term incentives are granted in the form of Sempra Energy company stock and vest over a three-year period.

SDG&E's executive compensation structure meets the requirements set in Public Utilities code section 8389(e)(6)(A)(iv) since it does not include compensation that is not aligned with shareholder or taxpayer interests.

Conclusion

Energy Safety finds that SDG&E 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 guidance letter.

The statutory requirements for the structure of an executive compensation program are detailed and complex. 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
Acting Program Manager, Safety Policy Division
Office of Energy Infrastructure Safety

⁸ Variable pay plan constitutes 19 to 20% of an executive officer's total compensation, of which, 59% is based on "employee and public safety operations" goals.