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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 2023 Executive Compensation Structure Submission Guidelines

Dear Director Thomas Jacobs,

Pursuant to the September 15, 2022 Notice from the Office of Energy Infrastructure Safety ("Energy Safety") releasing the Draft 2023 Executive Compensation Structure Submission Guidelines ("Draft 2023 Guidelines") for public comment, Southern California Edison Company ("SCE") provides the following comments on the Draft 2023 Guidelines.

INTRODUCTION

SCE commends Energy Safety for issuing the Draft 2023 Guidelines that generally conform to the intent and statutory language of AB 1054. However, to bring the Draft 2023 Guidelines further into alignment with AB 1054, SCE respectfully recommends that Energy Safety make the modifications and clarifications suggested below to address certain problematic aspects. SCE thanks Energy Safety for its consideration of these recommendations and looks forward to additional constructive engagement with Energy Safety.

PUB. UTIL. CODE 8389(e)(6)(A) APPLIES ONLY TO EMPLOYMENT CONTRACTS THAT COMMIT TO A COMPENSATION STRUCTURE

Pub. Util. Code 8389(e)(6)(A) specifies certain requirements that apply if the "electrical corporation has **established a compensation structure for** any new or amended **contracts** for executive officers, as defined in Pub. Util. Code 451.5." [Emphasis added.] As SCE has previously explained, SCE understood through discussions in mid-2019, when the language for Pub. Util. Code 8389(e)(6)(A) was being developed, that "established a compensation structure for… contracts" was intended to be interpreted as meaning that an electrical corporation has specified a compensation structure for which it has made a contractual commitment to the executive officer, such as through a term employment agreement that specifies the executive officer's compensation for the agreed-upon term. Pub. Util. Code 8389(e)(6)(A) was not intended to apply in situations where, as is the case with SCE, the electrical corporation advises its executive officers, and they agree, that the electrical corporation may modify their compensation at any time in the corporation's discretion.

However, the Draft 2023 Guidelines try to make Pub. Util. Code 8389(e)(6)(A)'s requirements apply to all executive officers. The Sections in the Draft 2023 Guidelines that are intended to assess compliance with Pub. Util. Code 8389(e)(6)(A) provide that the requirements apply "for each executive officer with a new or amended contract."[1] 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 result in a different meaning not supported by the statutory text. The statute was not drafted to apply to a compensation structure "for each executive officer **with** a new or amended contract." [Emphasis added.] Rather, Pub. Util. Code 8389(e)(6)(A) applies when an electrical corporation "has established" "a compensation structure" "for any new or amended contracts." The use of "for" as the preposition, followed by "new or amended contracts," means that the contracts (and not the executive officer) are the object or purpose of the compensation structure brought into existence. This statutory phrasing requires intentionality—there must be a specific compensation structure and there must be a contractual commitment to it in order for Pub. Util. Code 8389(e)(6)(A) to apply.

The Draft 2023 Guidelines do not account for the above statutory intent and text and instead state that "[f]or the purposes of compliance with section 8389(e)(6)(A), executive officers are presumed to have a compensation contract under California law."[2] That presumption is insufficient to trigger the application of Pub. Util. Code 8389(e)(6)(A) where, as is the case with SCE, the presumed contract includes an agreement between the electrical corporation and the executive officer that the corporation may modify the executive officer's compensation at any time in the corporation's discretion. Since SCE does not make a contractual commitment to continue a compensation structure in effect at a particular moment in time for an executive officer, SCE did not establish that compensation structure for a contract.

SCE respectfully requests that Energy Safety apply the requirements of Pub. Util. Code 8389(e)(6)(A) solely to employment contracts that commit to a specific compensation structure, consistent with the intent and text of the statute.

ENERGY SAFETY SHOULD CONSIDER CLARIFYING ITS PROPOSED TEST FOR PUB. UTIL. CODE 8389(e)(6)(A)(i)(I)

To the extent that Pub. Util. Code 8389(e)(6)(A) applies to executive officers' compensation structures, Pub. Util. Code 8389(e)(6)(A)(i)(I) requires that the "the primary portion of the executive officers' compensation [be] based on achievement of objective performance metrics." Energy Safety has proposed a test requiring that "greater than 50 percent of each executive

[1] This quotation is from Section 5 of the Required Information Template of the Draft 2023 Guidelines (p. A-38), but Sections 6 and 7 include similar phrasing (see p. A-40 and A-43).
[2] Draft 2023 Guidelines, p. A-38.

officer's total direct compensation, at the target performance level"[3] be based on the achievement of objective performance metrics.

SCE supports this test, assuming Energy Safety intends to perform the test by (i) taking data from Table 1.2 on page A-4 of the Draft 2023 Guidelines, (ii) adding the percentage in the Target STIP as a Percent of TDC column and the percentage in the Target LTIP as a Percent of TDC column, and (iii) seeing if the sum (the "Combined Target STIP and LTIP Percentage") is greater than 50 percent. The statute's use of the phrase "based on" means that the achievement of objective performance metrics has to be *a* basis, but does not need to be the sole basis, for the incentive compensation to be counted for purposes of the primary portion. Accordingly, it is appropriate to include the entire Combined Target STIP and LTIP Percentage when determining the portion of compensation based on achievement of objective performance metrics.

However, the Draft 2023 Guidelines are not clear about whether Energy Safety will use the Combined Target STIP and LTIP Percentage to perform the test. If Energy Safety does not, then Energy Safety may need to revise the test. For example, the statutory requirement is to test for the "primary portion," which means the biggest portion among the comparison group. If the comparison group contains three or more items, then the "primary portion" can be less than 50 percent. If Energy Safety is conducting the Pub. Util. Code 8389(e)(6)(A)(i)(I) test by comparing the Combined Target STIP and LTIP Percentage to the percentage for Target Base Salary as Percent of TDC, then the comparison group contains a total of two items and the "greater than 50 percent" requirement in the Draft 2023 Guidelines is appropriate. However, if Energy Safety does not treat all incentive compensation as being based on achievement of objective performance metrics, then, in order for the test to correctly reflect the statutory language (i.e., to test for "primary portion"), the test should be whether incentive compensation that is based on achievement of objective performance metrics is, as a percentage of total direct compensation at the target performance level, (i) greater than the percentage comprised of target base salary and (ii) greater than the percentage comprised of target incentive compensation that is not based on the achievement of objective performance metrics.

SCE assumes that Energy Safety will treat stock options and restricted stock units as incentive compensation that is "based on the achievement of objective performance metrics." The change in the price of Edison International ("EIX") common stock is the objective performance metric for both stock options and restricted stock units granted to SCE executive officers. The exercise price for the stock options equals the closing EIX stock price on the date of grant. If the stock price stays flat or decreases compared to the exercise price, then the options will have zero value. If the stock price increases above the exercise price, then the executive officer will gain from that increase when exercising the stock option and the gain is directly dependent on the extent of that appreciation in value. Similarly, the objective performance metric for restricted stock units is the change in price of EIX common stock. If the stock price at payout is above the closing stock price on the grant date, then the payout value will be more than the grant value. If the stock price at payout is less than the closing stock price on the grant date, that will result in a lower value.

[3] Draft 2023 Guidelines, p. A-36.

SCE suggests that Energy Safety consider clarifying that stock options and restricted stock units are incentive compensation based on the achievement of objective performance metrics.

SERPS ARE NOT INDIRECT OR ANCILLARY COMPENSATION

The Draft 2023 Guidelines categorize supplemental executive retirement plans ("SERPS") as "indirect or ancillary compensation,"[4] while categorizing regular retirement or pension benefits as "benefit programs"[5] that aren't indirect or ancillary compensation. However, as the Securities and Exchange Commission ("SEC") has recognized, SERPs should be treated in the same manner as regular retirement or pension benefits, and not in the same manner as the perquisites that are included in the Draft 2023 Guidelines' definition of indirect or ancillary compensation.

For purposes of disclosing compensation in proxy statements, the SEC has a separate category for "Change in Pension Value and Nonqualified Deferred Compensation Earnings" that includes both "tax-qualified defined benefit plans and supplemental executive retirement plans."[6] In contrast, perquisites are included in the "All Other Compensation" category.[7] 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 that is used to identify the company's named executive officers ("NEOs") for the proxy.[8] Perquisites are *included* in that total compensation calculation.[9]

The SEC decided to exclude SERPs and other pension benefits from the total compensation used for the NEO determination because the value disclosed for SERPs and other pension benefits in proxy statement summary compensation tables (i) is highly volatile and sensitive to actuarial and economic factors that are outside the control of the Compensation Committee and (ii) is influenced so much by age and years of service.[10] SERPs and other pension benefits are forms of compensation that are tied to each other and are very different from other forms of compensation. The Draft 2023 Guidelines already define "benefit programs" as including plans that "[p]rovide financial security in the case of death… or retirement."[11] SERPs, like regular pension benefits, do provide financial security in the case of death or retirement. Accordingly, for the reasons discussed in this section, SCE suggests that SERPs, like regular pension benefits, be included in the benefit programs definition and be excluded from the indirect or ancillary compensation definition.

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[4] Draft 2023 Guidelines, p. A-51. See also p. A-41.
[5] Draft 2023 Guidelines, p. A-50.
[6] 17 C.F.R. §229.402(c)(2)(viii), Instruction 1.
[7] 17 C.F.R. §229.402(c)(2)(ix)(A).
[8] 17 C.F.R. §229.402(a)(3), Instruction 1.
[9] *Ibid*.
[10] SEC Release No. 33-8732A, p. 119 (dated August 29, 2006).
[11] Draft 2023 Guidelines, p. A-50.

SERPS ARE ALIGNED WITH SHAREHOLDER AND TAXPAYER INTEREST EVEN IF THEIR BENEFITS ARE NOT PARTLY TIED TO SAFETY PERFORMANCE

Energy Safety considers SERPs aligned with shareholder and taxpayer interest if they "are structured so that electrical corporation contributions are based at least in part on executive officer Short-Term Incentive Payment program awards based at least in part on wildfire and other public safety performance."[12] SCE's SERP for executive officers satisfies this condition set by the Draft 2023 Guidelines, but there are other important reasons why SCE's SERP is aligned with shareholder and taxpayer interest in SCE. The SERP is part of a competitive compensation package used to attract qualified executive officers and to retain qualified executive officers with a deep knowledge of the company. Longevity is important not only for continuity of performance, but also because avoiding excess turnover helps the company minimize the significant time, resources, and costs involved in searches for new executive officers. Furthermore, pension and retirement programs (such as SERPs) are encouraged by the government, as is reflected by the deferred taxation for SERP benefits that are accrued but not yet paid. SCE suggests that Energy Safety revise the guidelines to acknowledge these other important ways that SERPs are aligned with shareholder and taxpayer interest in the electrical corporation.

RECOMMENDATIONS FOR 2023 EXECUTIVE COMPENSATION STRUCTURE SUBMISSIONS AND EVALUATIONS AND 2024 GUIDELINE DEVELOPMENT

The Draft 2023 Guidelines do not set a submission deadline for requests for approval of 2023 executive compensation structures. SCE respectfully recommends that the final 2023 guidelines set a mid-to-late March 2023 submission deadline. This timing would be consistent with the submission deadline for 2022 executive compensation structures (March 14, 2022) and would allow SCE a reasonable amount of time to prepare its 2023 submission after the Compensation Committee meets on February 22, 2023 to determine compensation for individual executive officers and set final success measures for 2023 corporate goals. The executive compensation structure requests for approval are extensive (SCE's submission for 2022 was 82 pages), so it would be helpful to have at least three weeks after February 22, 2023 to thoughtfully prepare the submission for 2023.

The Draft 2023 Guidelines provide that "Energy Safety may at its discretion hold one or more public workshops during the Executive Compensation evaluation period." The Draft 2023 Guidelines also set forth processes for data requests by Energy Safety or designated stakeholders.

SCE suggests that instead of holding workshops during the evaluation period of 2023 executive compensation structures, it would be preferable for Energy Safety to allow comments on submissions through mid-April and to provide two weeks for responses to comments, consistent with the process Energy Safety used for 2022 executive compensation submissions. Unless the comments or Energy Safety's evaluation identify severe deficiencies that clearly violate fundamental aspects of Energy Safety's final guidance for 2023, Energy Safety should then approve the 2023 executive compensation structures and turn its attention to evaluating updates

[12] Draft 2023 Guidelines, p. A-37.

to its guidance for 2024 executive compensation structures. As SCE has previously explained, it is too late to make sensible changes to the executive compensation structure for a particular year after the annual long-term incentive grant date, which is generally toward the beginning of March. After that point, irrevocable long-term incentive grants have been made and annual goal success measures have been communicated to all employees to set expectations and incent the intended performance for the year.

Instead of holding workshops in the first half of 2023 to evaluate 2023 executive compensation structures, SCE recommends that Energy Safety hold a public workshop regarding the 2024 guidelines in May 2023, followed by a comment period, the issuance of draft 2024 guidelines, and another comment period. Starting in May 2023 is advisable to allow enough time for a constructive public process that concludes with appropriate final guidance for 2024 issued in the summer or early fall of 2023. Such timing would provide SCE and other electrical corporations sufficient time to thoughtfully structure their executive compensation structures for 2024.

As Energy Safety considers how to proceed, SCE urges Energy Safety to keep in mind that it has approved SCE's executive compensation structures for 2021 and 2022 as complying with the requirements of Pub. Util. Code 8389(e). SCE values continuous improvement and welcomes input from Energy Safety on how to continue driving desired performance. However, Energy Safety's future evaluations of SCE's executive compensation structure and any updates to Energy Safety's executive compensation guidelines must align with the intent and statutory language of AB 1054, including avoiding unintended outcomes and affording utilities the flexibility necessary to manage the complex operations of the utility.

SCE's executive compensation structure is a product of executive compensation expertise. It is established by an independent Compensation Committee comprised of non-employee Directors who have significant experience and qualifications in driving performance and setting compensation. The Compensation Committee's decisions are based on market data and expert advice provided by an independent compensation consultant retained by the Compensation Committee. The Compensation Committee's objective in designing SCE's executive compensation structure is to attract and retain qualified executives while meeting company goals, particularly with regards to safety and financial stability, that the Compensation Committee establishes with the input of the independent Safety and Operations Committee. The former enables the latter – consistent, qualified executive leadership is crucial for meeting safety and financial stability goals.

CONCLUSION

SCE appreciates the opportunity to submit these comments on the Draft 2023 Guidelines and urges Energy Safety to adopt these recommendations for modifications and clarifications to the Draft 2023 Guidelines, including the recommended timeline. If you have any questions, or require additional information, please contact me at michael.backstrom@sce.com.

Sincerely,

//s//

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Regulatory Affairs
Southern California Edison