STATE OF CALIFORNIA GAVIN NEWSOM, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

June 30, 2020

Carla Peterman
Southern California Edison
8631 Rush Street
Rosemead, CA 91770

SUBJECT: Wildfire Safety Division Action Approving Southern California Edison Company's 2020 Executive Compensation Program Pursuant to Public Utilities Code §§ 8389(e)(4) and 8389(e)(6)

Dear Ms. Peterman:

This action approves Southern California Edison Company's (SCE) current executive compensation program as one component of the process for qualifying the utility for a 2020 Safety Certification. The Wildfire Safety Division (WSD) finds that SCE's executive compensation program minimally and conditionally satisfies the requirements of Pub. Util. Code §8389(e)(4) and §8389(e)(6). The WSD will initiate a stakeholder process to further develop its executive compensation review criteria for use in 2021 executive compensation evaluations shortly after the issuance of this action.[1]

On January 17, 2020, the WSD notified SCE that Public Utilities Code (Pub. Util. Code) §8389 (e)(4) requires that each electrical corporation demonstrates that its executive compensation structure promotes safety as a priority and ensures 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 Pub. Util. Code §451.5. The WSD directed SCE to submit a formal request for approval of its executive compensation program to the WSD by January 27, 2020.

Pub. Util. Code §8389(e)(6)(A) further requires the following:

The electrical corporation has established a compensation structure for any new or amended contracts for executive officers, as defined in Section 451.5, that is based on the following principles:

[1] Because of the accelerated timing of Pacific Gas & Electric's (PG&E) Chapter 11 bankruptcy reorganization, the consideration of PG&E's executive compensation structures was addressed in Order Instituting Investigation 19-09-016. In Decision (D) 20-05-053, the Commission similarly found that PG&E's executive compensation plan minimally and conditionally satisfied the requirements but that further proceedings are necessary to refine future submittals.

1. Strict limits on guaranteed cash compensation, with the primary portion of the executive officers' compensation based on achievement of objective performance metrics;
2. No guaranteed monetary incentives in the compensation structure;
3. It satisfies the compensation principles identified in §8389(e)(4);
4. 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.
5. Minimization or elimination of indirect or ancillary compensation that is not aligned with shareholder and taxpayer interest in the electrical corporation.

In addition to complying with all portions of the relevant Pub. Util. Code, the WSD required SCE to submit the following information:

- 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 safety whether 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; and,
- Examples of incentive compensation reduced or withheld in the last 5 years as a result of failure to meet safety metrics.

On January 14, 2020, SCE submitted an overview of its executive compensation structure for approval and explained how its structure complies with Pub. Util. Code §8389(e).
On February 5, 2020, the California Environmental Justice Alliance (CEJA) and The Utility Reform Network (TURN) submitted comments to the WSD on SCE's program. SCE, on February 11, 2020, responded to CEJA and TURN's comments and provided additional information and details of aspects of its executive compensation structure. On June 18, 2020, SCE responded to a data request from the WSD seeking information on the relative weighting of elements of safety metrics used in its executive compensation structure.

Pursuant to its authority under Pub. Util. Code § 8389(e)(6)(B), the WSD has taken all of these submittals into consideration for its review of SCE's program, with particular regard to

adherence to §8389(e)(4) and §8389(e)(6) and the safety implications and financial stability of the compensation structure.

Discussion:

In its submittal, SCE explained that its executive compensation structure consists of base salary, annual incentive awards, and 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, operating, financial, and strategic objectives that benefit customers and stakeholders. Long-term incentive compensation is largely tied to underlying stock performance and focuses on the company's long-term goals and financial health. SCE explained 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 those goals results in the potential reduction or elimination of annual incentive award payouts. SCE explained that its Compensation Committee provides independent oversight of compensation, relies on third-party data, and has discretion to reduce, or eliminate, annual incentive awards if circumstances warrant.

Criticisms by CEJA and TURN of the utility submittal offered an overarching critique that metrics used in the executive compensation program insufficiently weigh safety outcomes in the awards calculation. Further, metrics used are not "measurable and enforceable" as required by law.

The WSD finds that these comments have merit, in particular the SCE's reliance on program targets and variance across all utilities in the weighting of safety criteria versus financial performance as components of executive compensation structures. In the future, the WSD expects there to be a greater emphasis on compensation awards criteria directly tied to safety, based on enforceable metrics that measure safety outcomes.

The WSD further expects that utility executive compensation structures more closely align with measurable outcomes for safety improvements that are required for Wildfire Mitigation Plans (WMPs). Components of SCE's compensation awards evaluation rely on program targets rather than safety outcome targets. For example, SCE lists replacement of overhead lines with covered conductor as a performance metric, without a clear nexus to actual wildfire safety mitigation outcomes.

The Commission has previously found that the effectiveness of wildfire mitigation activities contained in electrical corporations' WMPs could not be determined solely through the use of program targets.[2] The WSD refined 2020 WMP submission requirements to emphasize *progress metrics* that track impacts on drivers of ignition probability and *outcome metrics* that measure leading and lagging indicators of wildfire risk and consequences of wildfire mitigation work.[3]

The requirements set forth in the statute for the structure of an executive compensation program are detailed and complex, and more work needs to be undertaken on aligning utility executive compensation metrics to those required in WMPs. Developing a robust executive compensation structure necessitates a more thorough public process than is currently achievable given the time constraints for approving the 2020 executive compensation programs. To establish these metrics, the WSD will engage in a stakeholder process to develop robust executive compensation criteria for 2021 and beyond to which the utilities will need to conform.

Therefore, the WSD finds that SCE's executive compensation program minimally and conditionally satisfies the requirements of Pub. Util. Code §8389(e)(4) and §8389(e)(6). The WSD will provide additional guidance in the form of a Staff Proposal and a schedule for a public input and review of the Staff Proposal to guide SCE's, and all other utilities', 2021 executive compensation structures. SCE will be expected to conform future executive compensation structures to the metrics and structure ultimately adopted by the WSD through the stakeholder process.

Sincerely,

Caroline Thomas Jacobs
Director, Wildfire Safety Division
California Public Utilities Commission

[2] In D.19-05-036, Findings of Fact and Conclusions of Law 4 & 5, pg. 40.
[3] See WSD-002 Guidance Resolution on 2020 Wildfire Mitigation Plans, Pg. 12. Approved June 11, 2020.