



PRELIMINARY STATEMENT

Sheet 1

VII. COST OF CAPITAL MECHANISM (CCM)

A. OVERVIEW

Pursuant to Decision D.08-05-035, The Cost of Capital mechanism provides for an adjustment to SDG&E's authorized Return on Common Equity (ROE) if the twelve month average of the A rated utility bond yield changes by more than plus/minus 100 basis points from the benchmark.

B. EFFECTIVE DATE / DURATION

The Cost of Capital Mechanism is established effective May 29, 2008 by the Commission and shall be effective until modified or terminated by further action of the Commission.

C. DESCRIPTION OF MECHANISM

The automatic ROE adjustment mechanism is triggered when the October through September twelve month average of Moody's A rated utility bond yield is more than 100 basis points higher or lower than the benchmark, which is either the October through September average of A utility bond yields from the year of SDG&E's most recent cost of capital proceeding or the most recent year thereafter where the October through September average utility bond yield triggers an automatic adjustment.

Pursuant to Decision D.08-05-035 Conclusion of Law 11, Moody's Aa utility bond interest rates should be used for those utilities under the CCM having an AA credit rating or higher, Moody's A utility bond interest rates should be used for those utilities having an A credit rating, and Moody's Baa utility bond interest rates for utilities having a BBB credit rating or lower. SDG&E has an A credit rating. The Moody's October 2006 - September 2007 average of the A-rated utility bond yield is 6.02%. Should SDG&E's credit rating change during the three-year interval between full cost of capital applications, SDG&E may file a capital structure adjustment application.

When an automatic adjustment is triggered, the costs of capital components are updated and a new rate of return is computed as follows:

- a. The return on common equity is adjusted by one-half of the difference between the A utility bond average and the benchmark.
- b. Costs of long-term debt and preferred stock are updated to reflect actual August month-end embedded costs in the trigger year, forecasted interest rates for variable long-term debt, and new long-term debt and preferred stock scheduled to be issued.
- c. The currently authorized capital structure is used to calculate an updated rate of return, which is filed by advice letter on October 15 of the trigger year to be effective January 1 of the following year.

(Continued)

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Decision No. D.08-05-035

Issued by
Lee Schavrien
Senior Vice President
Regulatory Affairs

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Resolution No. _____

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