

**PREPARED REBUTTAL TESTIMONY OF THOMAS J. LONG
ON COST RESPONSIBILITY ISSUES**

PIPELINE SAFETY RULEMAKING

R. 11-02-019

THE UTILITY REFORM NETWORK (TURN)

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February 28, 2012

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5 **I. INTRODUCTION AND SUMMARY**

6 This rebuttal testimony is presented on behalf of The Utility Reform Network
7 (“TURN”) by Thomas J. Long, TURN’s Legal Director. A summary of Mr. Long’s
8 qualifications is attached as Appendix B to Mr. Long’s Opening Testimony served on
9 January 31, 2012. This testimony responds to the Opening Testimony of David Marcus
10 on Behalf of the Coalition of California Utility Employees (“CUE”).

11 Mr. Marcus states that “CUE and many others believe that ratepayers should not
12 have to pay twice for work it failed to do in the past.” (pp. 1-2). However, his testimony
13 goes on to express the view that the shareholders of Pacific Gas and Electric Company
14 should not have to pay for any part of the future work that will be required in this
15 proceeding. (p. 5). Although the import of CUE’s testimony is not clear, if CUE is
16 advocating that there should be no disallowance of any expenditures that are attributable
17 to PG&E’s imprudent behavior, or that there should be no other ratemaking adjustments,
18 then TURN strongly disagrees.

19
20 **II. SUMMARY OF CUE TESTIMONY**

21 Mr. Marcus summarizes CUE’s position as follows:

22 In order to get the incentives for future behavior right, the Commission should
23 distinguish between the consequences for past behavior and the desired future
24 behavior. Where money was inappropriately underspent in the past, the
25 underspending should be recouped from shareholders via some sort of penalty.
26 But that penalty should be clearly linked to the past misbehavior, and not imposed
27 on future investments. Otherwise, the Commission will be trying to use two

1 wrongs to make a right, underfunding future work to offset PG&E's
2 underspending on past work.

3
4 Underfunding future work by requiring shareholders to pay for part of
5 it is wrong because it gives PG&E an incentive to either cut corners on the future
6 work (in order to control costs) or to endeavor not to do it at all (to avoid
7 shareholder losses). The Commission doesn't want shoddy work, and it shouldn't
8 want to have to fight a recalcitrant PG&E to get PG&E to do what needs to be
9 done. The Commission can, and should, have it both ways. It should reassure
10 PG&E that it will fully fund future work that the Commission finds is needed for
11 safety, so that there is no extra incentive for PG&E to avoid doing that work, or to
12 do it on the cheap. But it should also penalize PG&E for past work that was either
13 promised and not done, or should have been done pursuant to then-existing safety
14 requirements, but was not done. And it should also make clear to PG&E, in case
15 there is any doubt, that it is prepared to impose further penalties in the future, if
16 PG&E doesn't do the right thing this time around. (pp. 4-5).

17
18 One issue that is raised by this testimony is what CUE means when it uses the
19 term "penalty." In the ordinary legal sense, the word refers to payments made to the
20 State's General Fund under Sections 2100 *et seq.* of the Public Utilities Code for
21 violations of applicable requirements. CUE's notion of penalty seems to extend beyond
22 this interpretation, since Mr. Marcus says that underspending should be "recouped from
23 shareholders via some sort of penalty." It is not clear, however, whether CUE's concept
24 of penalty extends to disallowances for imprudence. If not, then TURN takes issue with
25 CUE's position because it would invite the Commission to ignore its responsibility to
26 disallow from rate recovery any expenditures that flow from PG&E's imprudence.

27 28 **III. PENALTY VS. DISALLOWANCE FOR IMPRUDENCE**

29 In TURN's view, the concepts of "penalties" and "disallowances for imprudence"
30 are different and need to be distinguished. Although they serve different (but
31 overlapping) purposes, together they create a powerful incentive for utilities to fulfill
32 their obligations to their customers and the public in a safe and prudent manner.

1 **A. Penalties**

2 This testimony refers to penalties in the legal sense described above. Under
3 current law, penalty proceeds are paid to the State’s General Fund; no penalty moneys are
4 “returned” to ratepayers or used to offset utility revenue requirements.

5 The main purpose of penalties is to punish a utility for its violations of statute,
6 rules, orders, decisions, or other applicable requirements. Penalties are a concrete way
7 for the Commission to signal the extent of its disapproval of violative behavior.

8 Another important purpose of penalties is to deter future violations. The threat of
9 fines¹ is an important tool by which regulators can promote compliance with regulations.

10 TURN’s understanding is that penalties associated with the San Bruno accident
11 and PG&E’s management and operation of its gas pipeline system can only be levied in
12 enforcement dockets, such as I.11-02-016 (record-keeping), I.11-11-009 (high
13 consequence areas), and I.12-01-007 (San Bruno accident).

14 **B. Disallowances for Imprudence**

15 Disallowances for imprudence serve a different purpose than penalties in that they
16 focus on rates and are a key part of the Commission’s obligation to ensure that rates are
17 just and reasonable. It is a bedrock notion of public utility law and policy that ratepayers
18 should not be required to pay for expenditures that are a consequence of imprudent utility
19 behavior; rates that impose on customers the costs of a utility’s imprudence are not
20 reasonable. As noted in my opening testimony, Public Utilities Code Section 463 is a
21 statutory articulation of the Commission’s duty not to allow cost recovery of expenditures
22 that are attributable to utility imprudence. As Section 463(a) states, it is a clarification of

¹ I use the word “fines” to be synonymous with “penalties.”

1 previously existing law – namely the well-established law under the “just and reasonable”
2 principle embodied in Section 451.

3 Disallowances for imprudence also differ from penalties in that they use different
4 standards. As noted, penalties require a determination of a violation of a statute, order,
5 rule or other specified requirement. In contrast, prudence is assessed by whether a utility
6 has met a requisite standard of care – here, the care that one would expect from a prudent
7 pipeline operator -- which need not be specified in a particular rule or regulation. For
8 example, even if no federal or state rules specifically required California gas utilities to
9 retain records of pressure tests prior to the effective date of General Order (GO) 112 in
10 1961, TURN has taken the position that a prudent operator would and should have kept
11 such records and that any expenditures attributable to the failure to keep such records
12 should be disallowed from recovery.² Put another way, violations are always imprudent,
13 but behavior can be imprudent even if it does not constitute a violation.

14 Although the focus of disallowances is on ensuring reasonable rates,
15 disallowances, like penalties, also serve an important deterrent role. Utilities know that,
16 even if they do not violate a particular requirement, they face the threat of a disallowance
17 if they engage in imprudent behavior. In this respect, the threat of penalties and
18 disallowance both provide strong and mutually reinforcing incentives to the utility to not
19 only comply with applicable requirements, but to operate their facilities in a safe and
20 prudent manner.

21 TURN’s understanding is that the scope of the three open enforcement dockets
22 relating to PG&E’s operation of its gas pipeline system do not include the issue of

² Prepared Testimony of Richard Kuprewicz Evaluating PG&E’s Pipeline Safety Enhancement Plan on behalf of TURN, January 31, 2012, pp. 72-73.

1 disallowances for imprudent behavior or any other issue related to ratemaking and rate
2 recovery for safety measures ordered in this rulemaking. In fact, the orders instituting
3 investigations (“OII”) for those dockets make clear that the issue of the apportionment of
4 costs between shareholders and ratepayers for such safety measures will be addressed in
5 this docket.³ This is an important point, because it demonstrates the fallacy of the notion
6 that the enforcement dockets are the only ones in which PG&E’s past practices need to be
7 evaluated.

8 In sum, disallowances for imprudence are both legally required -- in order to
9 ensure just and reasonable rates – and sound policy, in that they provide an important
10 incentive for utilities to provide safe, well-managed service. Determining the scope and
11 extent of PG&E’s imprudence and the disallowances that flow from such imprudence is a
12 crucial issue in this proceeding for which billions of dollars are at stake. For these
13 reasons, if CUE is suggesting that there should be no disallowances for pipeline safety
14 expenditures in PG&E’s Implementation Plan that are attributable to PG&E’s
15 imprudence, then TURN strongly disagrees.

16

17 **IV. CONCLUSION**

18 In conclusion, a broader point about incentives needs to be made. CUE expresses
19 a general concern that underfunding of the costs of PG&E’s Implementation Plan will not
20 give PG&E sufficient incentive to do the work necessary to ensure a safe pipeline system.
21 However, PG&E failed to manage and operate a safe gas transmission pipeline system
22 even with authorized funding that, according to the Overland Consulting Audit Report,

³ OII.11-02-016, p. 15; OII 12-01-007, p. 11.

1 PG&E found more than adequate. For the period 1997 to 2010, the Overland Report
2 finds that PG&E's actual spending on gas transmission and storage O&M and capital was
3 lower than amounts adopted in rate cases.⁴ Past experience shows that meeting PG&E's
4 perceived gas funding needs and authorizing a healthy rate of return does not provide the
5 necessary incentive. TURN submits that the incentives that will best promote the goal of
6 safety are the incentives created by: (1) a credible threat that safety violations will be
7 detected and appropriately penalized; and (2) an equally credible threat that imprudent
8 behavior will lead to disallowances and other ratemaking adjustments.

⁴ Overland Consulting, Focused Audit of Pacific Gas & Electric Gas Transmission Pipeline Safety-Related Expenditures for the Period 1996 to 2010, December 30, 2011, p. 3-1 (finding that, from 1997 to 2010, actual GT&S O&M was 3.8% lower than adopted); p. 4-1 (finding that, from 1997 to 2010, actual GT&S capital expenditures were 5.6% lower than adopted).