BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion to Adopt New Safety and Reliability Regulations for Natural Gas Transmission and Distribution Pipelines and Related Ratemaking Mechanisms.	Rulemaking 11-02-019 (Filed February 24, 2011)

REPLY BRIEF OF THE UTILITY REFORM NETWORK ON THE PROPOSED PHASE 1 PIPELINE SAFETY ENHANCEMENT PLAN OF PACIFIC GAS AND ELECTRIC COMPANY

Thomas J. Long, Legal Director
Marcel Hawiger, Energy Attorney

THE UTILITY REFORM NETWORK
115 Sansome Street, Suite 900
San Francisco, CA 94104
(415) 929-8876 (office)
(415) 929-1132 (fax)
TLong@turn.org
Marcel@turn.org

May 31, 2012

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CPUC Decisions

Court Decisions

Public Utilities Code Sections

Federal Regulations

REPLY BRIEF OF THE UTILITY REFORM NETWORK

1 Introduction and Summary

The Utility Reform Network ("TURN") submits this Reply Brief regarding the Phase One Pipeline Safety Enhancement Plan ("PSEP") of Pacific Gas and Electric Company ("PG&E"). For the most part, this Reply will focus on the opening brief of PG&E and, to a lesser extent, the briefs of the Northern California Indicated Producers ("NCIP"), Southern California Edison Company ("SCE"), and the City of San Bruno ("CSB").

To read PG&E's opening brief is to enter an alternative reality in which the tragic San Bruno explosion and the resulting revelations of PG&E's serious mismanagement of its gas operations have had absolutely no impact on PG&E's PSEP. In PG&E's fictional world, the activities in PG&E's PSEP are needed solely because of new regulatory requirements imposed by the Commission and have nothing to do with correcting the serious problems in PG&E's gas operations identified by the National Transportation Safety Board ("NTSB") after an exhaustive investigation. The NTSB's findings include:

- PG&E had inaccurate pipeline records
- PG&E exercised inadequate quality control
- PG&E's Integrity Management Program was "deficient and ineffective"
- PG&E's deficiencies are indicative of "an organizational accident"
- The "multiple and recurring deficiencies in PG&E operational practices" indicate "a systemic problem."[1]

[1] NTSB Accident Report, adopted August 30, 2011, pp. 124-125.

Despite these findings and similar findings by the Independent Review Panel in its June 24, 2011 Report, PG&E argues that the Commission has no legal responsibility in this docket to determine the extent to which PG&E's undeniable past imprudence has contributed to the PSEP costs that PG&E now seeks to impose on its ratepayers. As shown in TURN's Opening Brief and as will be further demonstrated in this Reply, PG&E's position is unequivocally wrong. Public Utilities Code Sections 451 and 463[2] and the Commission's longstanding prudence principles require the Commission to disallow from rate recovery costs that are the result of a utility's imprudence. PG&E's past practices are thus highly relevant to the Commission's apportionment of cost responsibility for PSEP costs. And it does not take much examination of PG&E's poor record-keeping and other managerial failures to realize that the primary reason PG&E's PSEP activities are needed is to remedy its past imprudence.

PG&E further asserts that the best way to promote pipeline safety in the future is to allow virtually full recovery of PSEP costs and to afford it a full return on its investment. This business as usual approach has been tried for thirty years and has demonstrably created exactly the wrong incentives for PG&E. The best way to prevent a recurrence of a major pipeline explosion is to hold PG&E fully accountable for its failures through penalties in the enforcement dockets and appropriate disallowances in this case. In addition to documenting the need for disallowances for imprudence, TURN has presented several ratemaking options to assist the Commission in arriving at a PSEP cost responsibility determination that – unlike PG&E's wholly inadequate shareholder funding proposal -- is commensurate with PG&E's past inattention to safety.

[2] Statutory references are to the California Public Utilities Code, unless otherwise indicated.

With respect to PG&E's pipeline and valve programs, PG&E wrongly accuses TURN of focusing on cost to the exclusion of safety. In fact, as discussed below, TURN's analysis and recommendations have had a dual focus of promoting safety and cost effective outcomes. When necessary to foster safety, TURN has not hesitated to recommend work that would lead to higher costs. And when work can be done differently without jeopardizing safety, TURN has advocated for the more cost effective approach.

TURN's Opening Brief has already rebutted most of the positions and arguments presented in PG&E's brief. The remainder of this Reply will focus on issues that TURN has not yet fully addressed.

2 Applicable Law Does Not Allow PG&E to Make Ratepayers Pay For the Consequences of Its Imprudence

PG&E claims that the Commission has no legal obligation to determine the extent to which PSEP activities arise from PG&E's past imprudence. According to PG&E, the CPUC's duty extends no further than to assessing the reasonableness of the PSEP activities themselves, without examining whether those activities are a consequence of unreasonable errors or omissions by PG&E.[3] PG&E's arguments fail in the face of Sections 463 and 451, fundamental prudence principles, and PG&E's own acknowledgement that it may not recover PSEP costs that are remedial in nature.

[3] PG&E Op. Br., pp. 85-86 ("The Commission will fully discharge its legal obligations under Sections 451 and 463 by reviewing the reasonableness of PG&E's testimony, workpapers and ratemaking proposals and determining if this would result in a just and reasonable rate.")

2.1 PG&E Misinterprets Public Utilities Code Section 463

Central to PG&E's position is a complete misreading of Section 463. PG&E contends that Section 463 only requires a review of the PSEP costs themselves and does not contemplate any consideration of past imprudence that may have given rise to those costs. The plain language of Section 463 rejects such a narrow and contrived interpretation. Section 463(a) states, in relevant part:

> For purposes of establishing rates for any electrical or gas corporation, the Commission shall disallow expenses reflecting the direct or indirect costs resulting from any unreasonable error or omission relating to the planning, construction, or operation of any portion of the corporation's plant which cost, or is estimated to have cost, more than fifty million dollars . . . , including any expenses resulting from delays caused by any unreasonable error or omission.

The statute requires the Commission ("shall disallow") to disallow any direct or indirect costs resulting from any unreasonable error or omission "relating to" the planning, construction, or operation of the PSEP.[4] Past errors or omissions that necessitate PSEP activities clearly "relate to" the PSEP; in fact, they cause the PSEP. Moreover, the directive to disallow costs "resulting from" unreasonable errors or omissions necessarily requires a determination of whether imprudent <u>past</u> actions (or inactions) caused PSEP costs that PG&E now seeks to impose on ratepayers.

Contrary to PG&E's assertion, Section 463.5(a) does not help PG&E. That section applies only to "recorded costs" and is thus inapplicable to the PSEP costs, which have yet to be incurred for the most part. Moreover, the point of Section 463.5 is only to clarify that the Commission is not obligated to perform an after-the-fact reasonableness review after it has adopted an estimate of reasonable costs. Under Section 463(a), the Commission remains

[4] There can be no dispute that the $2.2 billion PSEP would cost more than $50 million.

obligated in the first instance to disallow costs exceeding $50 million that result from imprudence.

2.2 The Commission Has Repeatedly Held that Ratepayers Should Not Pay for the Consequences of a Utility's Imprudence

PG&E's argument that the Commission should blind itself to PG&E's past imprudence flies in the face of common sense and numerous Commission decisions. Under PG&E's logic, the Commission should not even ask whether Line 132 replacement costs result from PG&E's imprudence. Instead, PG&E would have the Commission confine its review to whether the replacement costs were reasonably budgeted and then pass those costs along to ratepayers. This would be an absurd result – making ratepayers pay to replace pipeline that failed due to PG&E's admitted imprudence.

Not surprisingly, the CPUC has not followed such as a straitjacketed approach. For example, in D. 94-03-048, after finding that Southern California Edison's ("SCE") negligence was responsible for the deadly Mojave Coal Plant accident in 1985, the Commission concluded that "it is not reasonable to pass on to SCE's ratepayers the costs resulting from the accident."[5] Likewise, in D.85-08-102, the Commission put PG&E on notice that it would not be able to recoup from ratepayers various costs arising from a failed pipeline in the Helms pumped storage project, including $240 million of reconstruction capital costs. The Commission further warned PG&E that it was potentially responsible for other costs to ratepayers such as a revenue offset to "reflect the lost or deferred capacity benefits" resulting from the delay of commercial operations. Summarizing the operative principle, the Commission made clear that ratepayers are not

[5] *Investigation on the Commission's Own Motion of the Maintenance and Operating Practices, Safety Standards and the Reasonableness of Costs Incurred from the Mohave Coal Plant Accident, Southern California Edison Company, Respondent* ("Mojave"), D.94-03-048, 53 CPUC 2d 452, 456.

responsible for "bearing the consequences of" PG&E's imprudence.[6] In these and other cases, the Commission has recognized that its obligation under Section 451 to establish just and reasonable rates requires it to ensure that utilities are not burdening ratepayers with the costs of their imprudence. As the Commission explained in D.84-09-120, "it would be unconscionable from a regulatory perspective to reward such imprudent activity by passing the resultant costs through to ratepayers."[7]

2.3 PG&E's Other Legal Arguments Against a Retrospective Prudence Review Are Incorrect

PG&E asserts that disallowing PSEP costs resulting from PG&E's past imprudence would violate the rule against retroactive ratemaking.[8] This is a specious argument. Contrary to PG&E's contortion of TURN's position, TURN is not proposing to change past rates. Rather, consistent with longstanding Commission precedent, TURN seeks to disallow from future rates PSEP costs that result from PG&E's past imprudence. As the Commission has stated, "historical information can be used as a basis for prospective Commission orders."[9] The disallowances TURN seeks affect prospective rates, not past rates, and thus do not implicate in any way the prohibition against retroactive ratemaking.[10]

---

[6] *Re Pacific Gas & Electric Co.* (Helms Pumped Storage Project), D.85-08-102, 18 CPUC 2d 700, 715-716.
[7] *Re Southern California Edison Co.*, D.84-09-120, 16 CPUC 2d 249, 283.
[8] PG&E Op. Br., p. 88.
[9] *Re Southern California Edison Co.*, D.97-04-069, 72 CPUC 2d 104, 107.
[10] For the same reason, TURN's recommended disallowances of PSEP costs under "deferred maintenance" principles constitute prospective ratemaking. The Commission has "repeatedly held" that making ratepayers pay a second time for activities authorized by the CPUC in the past would be unjust and unreasonable. (D.07-03-044, p. 94).

PG&E also claims that a retrospective prudence review "opens the door" to PG&E being "penalized" multiple times for the same conduct.[11] By this, PG&E apparently means that the Commission is not permitted to impose separate disallowances and penalties related to the same conduct. PG&E is wrong. The Commission has explicitly held that "separate penalties and disallowances are possible in response to the same utility behavior."[12] The Commission has explained that, even though disallowances may cause may cause adverse consequences for utility shareholders, disallowances are not the same as penalties.[13]

2.4 PG&E Itself Recognizes that Retrospective Review Is Necessary

PG&E's professed legal objections to a retrospective prudence review are puzzling in light of PG&E's own proposed cost responsibility principles. Under PG&E's second "eligibility" principle, the Commission needs to ask whether preexisting regulatory requirements required PG&E to carry out work now proposed for the PSEP.[14] Although TURN believes that PG&E has applied this principle too narrowly, even under PG&E's approach, the Commission needs to look back at least 50 years – to the adoption of GO 112 in 1961 – to determine that PG&E should have hydrotested any pipe segments installed after that date and should disallow any proposed PSEP costs to hydrotest post-1961 pipe.[15]

Thus, PG&E's testimony recognizes that it would be wrong to impose on ratepayers PSEP costs that result from PG&E's past failure to meet its obligations. Indeed, as noted in

---

[11] PG&E Op. Br., p. 89.
[12] *Re Southern California Edison Co.*, D.93-05-013, 49 CPUC 2d 218, 220; see also *Re California Water Service Co.*, D.04-07-033, 2004 Cal PUC Lexis 329 (imposing a fine and an ROE reduction for the same conduct – failure to obtain required CPUC authorization for acquisition of water systems).
[13] *Re Southern California Edison Co.*, D.91-12-076, 42 CPUC 2d 645, 754 (FOF 346).
[14] PG&E Op. Br., p. 63.
[15] PG&E Op. Br., p. 64.

TURN's opening brief, PG&E has acknowledged that PG&E's past obligations include its prudence obligations under Section 451.[16] In short, even PG&E does not seem to accept its own legal arguments against a retrospective prudence review.

3 The Commission Has Made Clear That the Final Determination Regarding PSEP Cost Responsibility Will Be Made In This Proceeding

PG&E complains that reviewing the prudence of PG&E's past actions would be duplicative of the pending enforcement proceedings and argues that the Commission should confine its review of PG&E's past practices to those cases.[17] This argument is a rehash of PG&E's unsuccessful February 3, 2012 *Motion to Amend Scoping Memo and Reassign Testimony About PG&E's Past Practices to I.11-02-016* ("Motion to Reassign Testimony") and should be rejected.

In the Motion to Reassign Testimony, PG&E contended that: (1) testimony in this case submitted by TURN, DRA, NCIP, and CCSF related to PG&E's past practices was outside the scope of this case and belonged in the pending OIIs; and (2) in any event, the Commission should amend the Scoping Memo to reassign such testimony to I.11-02-016. TURN and other parties vigorously opposed PG&E's motion.[18] The Commission has effectively denied PG&E's time-sensitive motion by not ruling upon it. Moreover, by not granting PG&E's request to reassign to another case the testimony of TURN and other intervenors regarding PG&E's past conduct, the Commission has made clear (as it has since the outset of this case) that issues

[16] TURN Op. Br., p. 68.
[17] PG&E Op. Br., pp. 85-88.
[18] *Response of TURN to the Motion to Amend Scoping Memo and Reassign Testimony About PG&E's Past Practices*, February 10, 2012. To avoid repetition, TURN hereby incorporates this Response by reference.

concerning the prudence and propriety of PG&E's past practices, *as they relate to the recovery of PSEP costs*, will be resolved in this case.

PG&E's effort to renew its motion in its post-hearing brief is an improper *post hoc* attempt to change the longstanding rules of the game. From the outset, the Commission clearly anticipated and signaled to the parties that the three OIIs and this proceeding would all examine facts related to PG&E's past practices. In the Amended Scoping Memo in this case, the Commission stated that "[t]he issues in this proceeding require an in-depth analysis of historical safety practices and ratemaking treatment . . . ." and emphasized that "the testimony that will be most useful to the Commission" will include "an assessment of past practices."[19] Likewise, in D.11-06-017, the CPUC reaffirmed the statement in the OIR opening this docket that the Commission intended to take official notice of the record of other proceedings, including I.11-02-016 (the record-keeping OII), in making its cost sharing and ratemaking determinations regarding the PSEP.[20] Since February 2011, the Commission has been clear that, notwithstanding the factual overlap between the enforcement cases and this rulemaking, this is the docket where the Commission will decide whether shareholders or ratepayers will be responsible for PSEP costs.[21]

For PG&E to argue at this late date that prudence and other issues related to PG&E's past practices should only be considered in the OIIs is to invite serious procedural error. TURN and other parties have relied on the Commission's clear and consistent statements that past practices, as they relate to PSEP cost recovery and ratemaking, are highly relevant to this case and will be addressed here. In this regard, although TURN has served limited testimony on prudence issues

[19] Amended Scoping Memo, Nov. 2, 2011, p. 2.
[20] D.11-06-017, p. 23 (citing OIR 11-02-019 at pp. 11-12).
[21] OII 11-02-016, p. 15.

in I.11-02-016 and I.12-01-007, TURN has reserved its comprehensive showing regarding the impact of PG&E's imprudence on PSEP cost responsibility for this case. Had the Commission indicated that PSEP cost responsibility issues would be addressed in one or more of the enforcement dockets, TURN would have conducted far more discovery and submitted far more extensive testimony in those cases.

Without citing to any TURN pleading, PG&E attributes to TURN positions that TURN does not hold. For instance, according to PG&E, TURN has supposedly argued that the CPUC cannot, as a matter of law: (1) review past "errors or omissions" in the OIIs or (2) order any remedies other than fines or penalties in the OIIs.[22] In fact, TURN has not made such legal arguments. Rather, TURN has highlighted the difference between, on the one hand, penalties for violations and, on the other hand, PSEP disallowances based on imprudence and other ratemaking adjustments. By distinguishing penalties and disallowances, TURN's key point has been that a finding that certain PG&E conduct does not constitute a violation does not necessarily resolve the issue of whether such conduct was imprudent.[23] As the foregoing discussion has shown and as TURN explained in its opening brief,[24] TURN has no objection to (indeed welcomes) further development of the record regarding PG&E's past practices in the OIIs. However, in accordance with the announced scope of the cases and as a matter of due process, the final decision regarding PSEP cost responsibility and ratemaking adjustments must be made in this docket.

[22] PG&E Op. Br., p. 87.
[23] Ex. 122 (TURN/Long Rebuttal), pp. 3-5.
[24] TURN Op. Br., pp. 114-118.

4 A Significant Reduction to PG&E's Return on Equity for Any Approved PSEP Capital Costs Is Fully Justified

In its opening brief, TURN demonstrated that PG&E's entire PSEP is remedial in nature and that all Phase 1 costs, including all capital costs, should therefore be disallowed from rate recovery.[25] Should the Commission nevertheless allow recovery of any PSEP capital expenditures, TURN further showed that, in light of PG&E's documented systemic mismanagement of its gas operations and its attention to profit over safety,[26] PG&E's return on equity ("ROE") on such costs should be reduced 530 basis points to PG&E's current 6.05% cost of debt.[27] Northern California Indicated Producers ("NCIP") similarly made a convincing case for a 500 basis point reduction on ROE for PSEP costs.[28]

PG&E and Southern California Edison ("SCE") make a variety of arguments against an ROE reduction, most of which TURN and NCIP have already rebutted in opening briefs.[29] This reply brief will focus on arguments that TURN has not already addressed.

4.1 Fines in the Enforcement Cases and ROE Reductions In This Case Would Not Constitute 'Double Counting'

PG&E argues that ROE reductions in this case and penalties in the OIIs would "effectively double count for past conduct."[30] However, the Commission has rejected PG&E's

---

[25] TURN Op. Br., pp. 1-4, 69-74, 97-114.
[26] The NTSB and IRP Reports contain a more than sufficient record of PG&E's mismanagement and misplaced priorities to support the ROE reductions proposed by TURN and NCIP. *See, e.g.,* NTSB Report, pp. 108-110, 116-118; IRP Report, pp. 7-13, 16-17, 48, 52-53.
[27] TURN Op. Br., pp. 121-125. Alternatively, TURN recommended that the ROE on PSEP capital be reduced to at least 10.3%, a 105 basis point reduction from PG&E's current ROE.
[28] NCIP Op. Br., pp. 25-34.
[29] TURN Op. Br., pp. 122-125 (rebutting arguments that ROE reductions: violate Dr. Tierney's PG&E-centric "ratemaking principles"; reduce incentives to invest in pipeline safety; would have a worse effect than penalties or other disallowances; and create the wrong incentives for PG&E to improve pipeline safety); NCIP Op. Br., pp. 27-32.
[30] PG&E Op. Br., p. 82.

double-counting argument. As noted previously, the Commission has held that separate ratemaking disallowances and penalties can be imposed in response to the same utility behavior.[31] And in D.04-07-033, a decision directly on point, the Commission determined that California Water Service Co. ("Cal Water") should be subjected to both a fine and an ROE reduction for the same conduct – a failure to obtain the required CPUC authorization for acquisition of water systems.[32] The Commission reasoned that ratepayers were harmed by Cal Water's misconduct and that a fine, payable to the General Fund, would not mitigate the harm. The Commission concluded that an ROE reduction would provide some relief to ratepayers and also provide an incentive to the utility to improve its service and thereby encourage the Commission to restore the full ROE at a later time.[33]

The reasoning of D.04-07-033 is fully applicable here. Ratepayers have been harmed by being deprived of the system safety to which they were entitled when they paid for gas service. In addition, if the Commission decides to allow rate recovery for any PSEP capital costs, for the next 45 years, ratepayers will be burdened with significantly higher rates for pipeline replacement work that is compressed into a shorter than normal construction window in order to assure the safety of the system.[34] Penalties paid to the General Fund do nothing to mitigate these harms. However, an ROE reduction would recognize that past ratepayers have not received full value for their rates and would alleviate the elevated financial burden on future generations of

---

[31] *Re Southern California Edison Co.*, D.93-05-013, 49 CPUC 2d 218, 220.
[32] *Re California Water Service Co.*, D.04-07-033, 2004 Cal PUC Lexis 329.
[33] D.04-07-033, *mimeo* at pp. 14-15; *see also* D.06-11-020, *mimeo*, pp. 11-12 (finding that an ROE reduction ordered in response to utility mismanagement was not a penalty but rather an incentive adjustment to draw management's attention to the need to improve its management).
[34] NCIP has noted that the present value of revenue requirements for the life of replacement pipeline is significantly higher when the replacement program is concentrated into a 3-year period, as PG&E proposes, rather than a more normal 15-year period. NCIP Op. Br., p. 8.

PG&E customers. Furthermore, PG&E would be free to seek to moderate the ROE reduction in a future proceeding if the utility could demonstrate to the Commission's satisfaction that it has diligently and efficiently addressed the serious problems giving rise to the ROE reduction. In this manner, as in D.04-07-033, PG&E would have an added financial incentive to comprehensively reform its gas operations.

4.2 The Commission Should Not Be Influenced by Self-Serving Utility Claims of Adverse Financial Effects From an ROE Adjustment

PG&E and SCE make overblown claims about adverse effects from the 500-530 basis point ROE reductions proposed by TURN and NCIP. NCIP has shown that, even if the ROE reductions applied to the full $1.4 million of proposed PSEP Phase 1 capital expenditures (*i.e.*, if, contrary to TURN's recommendations, the Commission does not disallow all or most of those capital costs), the impact on PG&E's overall ROE would be a mere 20 basis point reduction.[35]

In any event, the Commission has been clear that "financial community anxiety" must take a back seat when the Commission is deciding how to respond to utility mismanagement. As the Commission stated in D.91-12-076 (when considering whether to adopt an ROE reduction recommended by DRA): "The Commission should not and will not refuse to order justified penalties because of the financial community's anxiety about adverse consequences to shareholders. The financial impacts of any Commission decision are important, but our first responsibility is to ratepayers."[36]

Similarly, the references by PG&E and SCE to takings law cases are inapposite.[37] It is axiomatic that the prohibition against regulatory takings does not apply to penalties or

---

[35] NCIP Op. Br., p. 28.
[36] *Re Southern California Edison*, D.91-12-076, 42 CPUC 2d at 739.
[37] PG&E Op. Br., pp. 55, 84; SCE Op. Br., p. 3.

disallowances a Commission may apply when a utility has engaged in imprudent conduct or otherwise violated its regulatory obligations. PG&E and SCE do not, and cannot, point to any decisions that hold that the takings doctrine insulates a utility from penalties for violations or disallowances for imprudence.[38]

5 PG&E Fails Even to Address TURN's Proposals for Other Ratemaking Adjustments

In order to give the Commission a full array of options for responding to PG&E's long-term and systemic mismanagement of its gas transmission system, TURN proposed other ratemaking adjustments in the testimony of TURN's ratemaking expert, William Marcus.[39] Those proposals included: (1) offsetting PSEP revenue requirements by an amount equal to bonus payments to PG&E's top executives; (2) offsetting PSEP costs by any earnings from gas transmission and storage (GT&S) operations above authorized levels; (3) using any available bonus depreciation funds for PSEP projects before using ratepayer money; (4) removing incentive compensation payments from PSEP costs charged to ratepayers; (5) adopting a longer, more accurate depreciation life for replacement pipeline; and (6) various adjustments for deferred maintenance.

PG&E failed to address any of these proposals in its opening brief. In the event that PG&E discusses these proposals in its reply brief, the Commission should recognize that PG&E has deprived TURN of an opportunity to respond to such discussion.

---

[38] See generally, *Market Street Railway v. Railroad Comm.*, 324 U.S. 548, 566-568 (1945) (regulatory commission has no obligation under the takings clause to insulate the regulated entity from impacts of a failed business model).

[39] These proposals are summarized in TURN's opening brief at pages 125-138.

6 PG&E's Shareholder Responsibility Proposal Is Woefully Inadequate

6.1 PG&E's Proposed Shareholder Contributions Are Minimal

PG&E's shareholder responsibility proposal has two components: (1) not seeking recovery for 2011 PSEP costs; and (2) subtracting from its request the costs for PSEP activities that, in PG&E's view, were required under pre-existing requirements. In Section 6 and 7 of its opening brief, TURN has demonstrated that PG&E's proposal falls far short of the cost responsibility mandated by prudence principles and sound policy. In this reply, TURN focuses on fallacies and shortcomings in PG&E's proposal not addressed in our opening brief.

With respect to 2011 PSEP costs, at this point, PG&E is offering "the sleeves off its vest." The prohibition against retroactive ratemaking prohibits increasing utility rates for previously incurred expenses unless those expenses have been booked into a memorandum or balancing account for possible future recovery.[40] Because the Commission has not yet approved a memorandum account for PSEP costs, PG&E has no right to recover any PSEP costs in rates until such a memorandum account is authorized. Accordingly, PG&E is proposing to have its shareholders absorb costs that they have already had to write off.[41]

In addition, the Commission should be aware that, with respect to 2011 capital costs, PG&E is not proposing that such costs be kept out of rate base, but rather that ratepayers not be required to pay the carrying costs on such capital expenditures (*i.e.,* depreciation, return and taxes). Thus, while PG&E's testimony estimated $68.9 million of capital costs for 2011,[42]

---

[40] *See, e.g.,* D.06-01-018, p. 3.
[41] TURN further discusses this issue in Section 12 below.
[42] Ex. 2 (PG&E Direct), p. 8-4, Table 8-3.

PG&E has only proposed to have shareholders pay $1.4 million in capital-related revenue requirements for 2011.[43]

With respect to costs attributable to pre-existing regulatory requirements, PG&E quantifies such costs that its shareholders will absorb at $139.5 to $155.5 million in PSEP costs "to be incurred in the 2011 to 2014 period."[44] Given the other component of PG&E's proposal under which shareholders pay all 2011 costs, TURN does not understand why this category should include any 2011 costs. TURN encourages the Commission to ensure that there is no double-counting between these two components of PG&E's proposal.

Assuming there is no double-counting, the amounts to be funded by shareholders under PG&E's proposal are: $222 million in forecast costs for 2011, $110 million for a cost overrun in 2011, and the previously mentioned $139.5 to $155.5 million -- for a total of $471.5 to $487.5 million.[45] When the potential $6.9 to $9.0 billion cost for Phase 2[46] is added to the Phase 1 total of $2.18 billion, it is clear that PG&E is proposing that shareholders fund only a sliver of total PSEP costs. As discussed in the next section, when the full impact on ratepayers of capital costs is considered, the shareholder sliver becomes even smaller.

6.2 PG&E's Proposal Would Require Ratepayers to Pay Virtually All Capital Costs for the Life of the Assets

Capital expenditures, which total $1.43 billion, comprise most of PG&E's proposed $2.18 billion budget for the Phase 1 PSEP. PG&E's opening brief makes clear that PG&E wants every single dollar of those capital expenditures to be entered into rate base, even for pipeline replacement costs that result from PG&E's admitted failure to follow pre-existing regulations.

[43] Ex. 2 (PG&E Direct), p. 8-11, Table 8-5.
[44] PG&E Op. Br., p. 62.
[45] PG&E Op. Br., pp. 62-65.
[46] Ex. 121 (TURN Direct/Long), p. 8.

PG&E's brief states that shareholders will pay for the costs of post-1970 pipeline replacement because of PG&E's failure to have the required documentation of a strength test.[47] However, footnote 270 shows that this offer is not what it seems. The footnote explains that, rather than keeping these pipeline replacement costs out of rate base, PG&E is only proposing to forego recovery of the revenue requirement associated with these replacement costs for the 2011-2014 period.[48] In other words, for the remaining 42 years of the 45-year depreciable life of the new pipeline, ratepayers will pay depreciation, taxes and return – virtually all of the capital costs. Thus, PG&E's supposed full disallowance is really, at best, 3/45 of a disallowance.

Footnote 270 underscores PG&E's failure to accept full responsibility even for its admitted mistakes. The Commission should reject PG&E's faux disallowance. Instead, as urged by TURN, for pipeline replacement that results from PG&E's failure to maintain required records or otherwise manage its operations prudently, the Commission should order a full disallowance and not allow the associated capital costs to be entered into rate base.[49]

This leads to a broader point about PG&E's cost responsibility proposal. As TURN now understands it, PG&E's proposal with respect to capital costs is to move all $1.4 billion of those costs into rate base, an outcome that makes shareholders happy but saddles ratepayers with comparatively expensive capital costs for decades to come. As DRA has pointed out, when the 45 years of revenue requirements that ratepayers will pay for rate base capital costs are considered, the Phase 1 PSEP price tag increases to $5 billion,[50] of which PG&E is proposing to absorb no more than $490 million, or less than 10%. In light of PG&E's systemic managerial

[47] PG&E Op. Br., p. 62. PG&E's testimony stated that "post-1970 segments to be replaced have been removed from the forecast . . .." (Ex. 2, p. 3-66).
[48] PG&E Op. Br., p. 62, fn. 270.
[49] TURN Op. Br., pp. 78-82.
[50] DRA Op. Br., p. 5.

failures and the remedial nature of the PSEP, shareholder funding of only 10% of the PSEP costs is grossly inadequate as a matter of law and sound regulatory policy.[51]

6.3 PG&E Has Failed to Meet Its Burden of Justifying Rate Recovery for Testing or Replacement of Post-1955 Pipeline for Which PG&E Lacks the Requisite Testing Records

PG&E acknowledges that it should have a complete strength test record for any pipeline installed after GO 112 went into effect in 1961, but does not accept responsibility for the lack of strength test records that PG&E should have retained at least as far back as 1955, when ASA B.31.8-1955 became the industry standard.

PG&E's six-page rebuttal to DRA only reinforces TURN's point that PG&E's prudence obligations required it, at a minimum, to strength test and retain testing records for all pipeline segments installed after 1955.[52] In asserting that "there was no requirement to conduct hydrostatic tests until the 1955 version of the ASA"[53] and that "requirements to keep hydrostatic test records . . . did not appear in the ASA until 1955,"[54] PG&E concedes that the ASA did impose such requirements at least as early as 1955.

Notwithstanding this concession, PG&E attempts to excuse its failure to maintain test records based on the 1970 grandfathering provision that exempted pre-1970 pipeline from the

---

[51] PG&E asserts that PG&E's shareholders are likely to spend $1.6 to $1.7 billion "more than authorized in existing rates." (PG&E Op. Br., p. 66). However, PG&E's limited breakdown of the derivation of those figures makes no effort to clarify which of those costs are for PSEP work and fails to provide any specifics about what that money is to be spent for. For example, much of that spending is likely for costs of responding to CPUC and NTSB investigations, repairing the exploded pipeline, and for the extensive litigation resulting from the blast – costs that PG&E brought upon itself and that warrant no consideration or recognition by the Commission in this case. Accordingly, PG&E's assertion has no demonstrated relevance to PG&E's PSEP and should be given no weight in the Commission's deliberations.

[52] PG&E Op. Br., pp. 74-79.

[53] PG&E Op. Br., pp. 76-77.

[54] PG&E Op. Br., p. 78.

new federal hydrotesting requirement.[55] This argument ignores the fact that the federal regulations explicitly state that they establish only "minimum safety requirements."[56] As noted, the 1955 ASA standards, which PG&E has admitted to following,[57] imposed a more rigorous requirement that PG&E's prudence obligations required it to meet.

Accordingly, for the reasons stated in Section 6.2 of TURN's opening brief,[58] the Commission should, at a minimum, disallow all PSEP pipeline testing and replacement costs for pipeline installed after 1955.

6.4 PG&E's Imprudence in Its Integrity Management of Manufacturing Defects Contributes to PSEP Costs

PG&E replies to DRA's argument that PG&E should have done more hydrostatic pressure testing as part of Transmission Integrity Management, by noting that federal regulations allowed different methods of assessment.[59] PG&E explains that it intended to rely on ILI, direct assessment and replacement for its TIMP assessment work, and that it never requested funding in GT&S rate cases for hydrotesting. PG&E concludes that there is thus no evidence of deferred maintenance due to lack of TIMP hydrotesting. PG&E further opines that it was very clear about its TIMP strategy, and that the Commission approved and funded this strategy.

There are at least two major flaws in PG&E's argument. First, the fact that PG&E did not request money for hydrotesting in its rate cases, and that no party objected to this, does not indicate Commission "approval" of its TIMP strategy, and does not make such a strategy

[55] PG&E Op. Br., pp. 72-73. PG&E's brief wisely did not even attempt to advance the discredited claim by Mr. Howe that the grandfathering provision somehow reflected DOT acceptance of poor record-keeping by pipeline operators. TURN demonstrated the fallacy of Mr. Howe's assertion at pages 105 and 107-109 of its Opening Brief.
[56] 49 C.F.R. Section 192.1(a).
[57] Ex. 143 (DRA Direct/Pocta), p. 23.
[58] TURN Op. Br., pp. 75-83.
[59] PG&E Opening Brief, pp. 80-81.

prudent. The federal regulations do authorize four different assessment methods; however, the regulations (and attendant ASME B31.8S) specify the use of hydrotesting for assessing unstable seam welds. It was PG&E's chosen method of spiking certain lines with identified manufacturing threats in order to preserve a high MAOP that created the potential for unstable seam defects, and thereby warranted hydrotesting as the proper assessment method. This issue was discussed in Section 6.2.2.4 of TURN's opening brief.

More importantly, as detailed in Section 6.2.2 of TURN's Opening Brief, there is substantial evidence showing that PG&E did not pursue its own chosen assessment method – ILI – to assess pipelines with manufacturing threats.[60] Thus, separate from any arguments about deferred maintenance, PG&E should pay for the costs of replacing or testing 300 miles of pipeline due to imprudence in its integrity management work.

PG&E identified 457 miles of pipeline as having manufacturing threats in its 2004 BAP.[61] PG&E scheduled pipelines with manufacturing threats to be assessed using ECDA, even though ECDA is inappropriate to evaluate manufacturing threats.[62] TURN has submitted data in I.12-01-007 indicating that PG&E in-line inspected only 34 miles of pipeline with manufacturing threats as part of its integrity management work. A comparison of the PSEP with the 2009 BAP shows that 300 out of 400 miles with identified manufacturing threats are now included in the PSEP. TURN thus recommends, based on the imprudence of PG&E's integrity management work, that shareholders pay for the testing or replacement of the 300 miles of pipeline now

[60] The facts in this reply brief are presented and cited in Sections 6.2.2.1 to 6.2.2.3 of TURN's Opening Brief.
[61] A link to the hard copy of the 2004 BAP is included with the CCSF Testimony as Attachment 6 to Exhibit 137.
[62] 49 CFR 192.921(a)(3). See, Sections 6.2.2.1 and 6.2.2.2 of TURN's Opening Brief for a discussion of appropriate assessment methods for integrity management.

included in the PSEP, as explained fully in Section 6.2.2.3 of our Opening Brief. The Overland Report provides additional documentation of how PG&E reduced planned ILI in favor of ECDA as a cost cutting measure.

At the same time that it failed to perform in-line inspections as part of its integrity management, PG&E also reduced its transmission pipeline replacements, as detailed in 6.2.4 of TURN's Opening Brief. The reduction in planned pipeline replacements is a separate reason to disallow pipeline replacement costs due to deferred maintenance.

7 TURN's Recommendations In This Proceeding Reflect Concerns About Both Safety and Cost Effectiveness

PG&E claims that TURN is "focused on program cost reductions, not safety."[63] This accusation thoroughly misrepresents TURN's analyses and recommendations in this proceeding. TURN's dual focus has been to promote safe policies, even if they increase costs, and also to promote cost effective work. If some work can be done differently or can even be avoided, without jeopardizing safety, then TURN will advocate for this rational solution.

Some of TURN's primary recommendations could increase costs, but TURN believes they are essential to safe operations. Thus, TURN advocates for higher pressure hydrotesting, even though PG&E claims that segmenting its pipelines will dramatically increase costs.[64] Likewise, TURN advocates for much greater use of ASVs with complex signaling, even though PG&E claims that such valve automation would require monitoring equipment, thus also potentially increasing costs.

---

[63] PG&E Opening Brief, p. 12.

[64] TURN appreciates that there will be some cost increase. However, we believe PG&E exaggerates the cost escalation, in part due to their refusal to hydrotest any portion of the line at above 100% SMYS.

TURN does not deny that we have proposed one major change that reduces costs – a default to hydrotest rather than replace pipelines with manufacturing threats. But we believe this recommendation ensures an equally safe outcome at lower costs, as discussed in Section 8.2 below.

In a similar vein, the City of San Bruno ("CSB") emphasizes that the PSEP should not be delayed due to a focus on ratemaking issues, and CSB references the testimony of TURN's witness, Mr. Kuprewicz, who cautioned against rushing decisions without adequate information.[65] CSB has apparently misinterpreted TURN's position. TURN does not recommend postponing PSEP work due to cost uncertainties. Rather, we have recommended against adopting any forecast costs as reasonable based on this uncertainty, suggesting that instead the Commission could authorize a memorandum account with subsequent reasonableness reviews.[66] Mr. Kuprewicz's remark was not at all related to "ratemaking issues." Rather, Mr. Kuprewicz was concerned that certain substantive program design issues not be decided without adequate information, in a rush to "get things done." Doing things quickly to create the appearance of safety is not a safe strategy.

8 Reply Regarding Pipeline Modernization Program

TURN has already addressed all the major arguments advanced by PG&E in their opening brief. We reply to highlight certain key factual issues.

[65] CSB Opening Brief, p. 13.
[66] Similarly, TURN recommended that if the Commission cannot resolve cost responsibility issues at this point, it should authorize remedial work to commence and resolve cost responsibility issues in a later phase.

8.1 The Jacobs Report Is Entitled to Little Evidentiary Weight

PG&E commences its discussion of the Pipeline Modernization Program by citing to the supportive conclusions of the Jacobs Consultancy report, and claiming that this stamp of approval was "based on a thorough review of the PSEP." This characterization of the Jacobs Consultancy report is inaccurate. The Jacobs report was almost exclusively a summary of PG&E's program, oftentimes copying *verbatim* PG&E's own testimony, and provided no independent analysis or support for PG&E's decision tree process or outcomes.[67] Indeed, buried deep in Appendix B of PG&E's comments on the Jacobs Consultancy report is the fact that Jacobs fundamentally misunderstood the role of outside experts, who did not "develop" any processes or models but simply provided "subject matter expert review" for PG&E's consideration.[68]

8.2 PG&E Relies Excessively on Replacement for Manufacturing Threats

One of the major issues with a significant impact on program costs is the decision to test versus replace pipelines with identified manufacturing threats. PG&E's position on this issue is troubling. First, PG&E claims that it has identified pipelines that are "good candidates for replacement" due to "archaic manufacturing techniques."[69] PG&E explains that these pipelines are less likely to pass a strength test and more likely to result in test failures. PG&E implies that

[67] See, "Comments of TURN on the CPSD and Jacobs Consultancy Reports Regarding PG&E's Pipeline Safety Enhancement Plan," R.11-02-019, January 13, 2012, which TURN incorporates by reference.
[68] See, "PG&E's Response to Technical Report of the CPSD Regarding PG&E's Pipeline Safety Enhancement Plan," R.11-02-019, January 13, 2012, Appendix B, p. 2-3.
[69] PG&E Opening Brief, p. 8.

all of the pipe with the characteristics identified in Decision Tree Steps 1E, 1F and 1G should be replaced.[70]

However, PG&E also explains that the decision to test or replace will be driven by the operating pressure (whether greater than 30% SMYS) and HCA location.[71]

As TURN highlighted in our Opening Brief, PG&E also significantly hedged its position with the caveat that it may test, instead of replace, some of those pipelines based on engineering judgment applied "on a case-by-base basis."[72]

The problem with PG&E's position is that it has over-defined "problem" pipe to include *all* low frequency ERW pipe, and *all* pipe with joint efficiency of less than one. The available evidence does not demonstrate that all such pipeline is inherently flawed and cannot be strength tested, even if operating at above 30% SMYS. For example, in the technical section discussing the manufacturing decision tree, PG&E describes in detail the history of pipeline manufacturing processes.[73] In that discussion, the primary document that PG&E cites as justifying replacement of all low frequency ERW pipe is the 1988 Pipeline Safety Alert Notice from the DOT.[74] But that three-page document concludes that if pre-1970 ERW pipe has not been hydrostatically tested to 1.25 times the MAOP, an operator "should consider hydrostatic testing to assure the integrity of the pipeline."[75] The DOT did not recommend replacement of such pipe.

---

[70] PG&E Opening Brief, p. 13.
[71] PG&E Opening Brief, p. 6.
[72] Exh. 21, p. 3-22, A 45, Hogenson.
[73] Exh. 2, p. 3B-9 to 3B-11, Hogenson, PGE.
[74] Exh. 2, p. 3B-10, footnotes 9 and 10, and p. 3B-12, footnote 15, Hogenson, PG&E.
[75] U.S. Department of Transportation, Research and Special Programs Administration, "Pipeline Safety Alert Notice ALN-88-01," January 28, 1988, available at http://www.phmsa.dot.gov/portal/site/PHMSA/menuitem.ebdc7a8a7e39f2e55cf2031050248a0c/?vgnextoid=cb7b7511292f7210VgnVCM1000001ecb7898RCRD&vgnextchannel=8590d95c4d037110VgnVCM1000009ed07898RCRD&vgnextfmt=print . The other document to which

TURN's witness Kuprewicz explained that "old pipe by itself is not necessarily worse than new pipe,"[76] but rather that one needs to consider specific batch numbers and specific "mill certifications" to determine whether vintage pipe has such particular seam concerns as to warrant replacement.[77]

TURN fully agrees that all low frequency ERW pipeline should be tested. And pipeline that exhibits multiple test failures may need to be replaced. But there is simply no valid rationale for defaulting to replacement. PG&E can cite to no technical documents that indicate pipelines with these manufacturing characteristics cannot be safely hydrotested to evaluate seam integrity.

8.3 Corrosion and Mechanical Damage Tree – TURN Recommends Adopting an Alternative Method for Validating MAOP in Specific Situations Where Hydrotesting Does Not Help Prevent Ruptures

PG&E claims that TURN's proposed Corrosion and Mechanical Damage decision tree results in "no action on some untested pipeline segments."[78] This is incorrect. TURN's decision tree always results in a proper assessment action; however, it does not always result in testing or replacement.

A hydrotest can assess the threat from corrosion or mechanical damage only if it serendipitously occurs just when a potential corrosion defect has progressed to near failure or after mechanical damage has been done. In most situations, the potential for failure due to these threats is better assessed by close interval surveys, leak surveys and ROW monitoring.

PG&E cites, a 2004 Report from the Office of Pipeline Safety (DTRS56-02-D-70036) likewise discusses hydrotesting and ILI as the methods for assessing seam integrity in low frequency ERW pipe.

[76] 15 RT 2160:1-5, Kuprewicz, TURN.

[77] 15 RT 2154-55, Kuprewicz, TURN. Of course, if PG&E is missing all mill certification records, identifying problem pipe may be difficult.

[78] PG&E Opening Brief, p. 12.

TURN understands that the Commission's order presented a binary choice for pipelines with no prior strength test records – test or replace. The underlying issue, however, is whether it makes sense to use a hydrotest, rather than other methods that are better suited to assessing corrosion threats, to validate MAOP for pipeline that does not have a potential manufacturing or construction threat.

This Commission has jurisdiction and latitude to determine whether other information could be used to set a safe MAOP without conducting a hydrotest for pipelines lacking potential manufacturing or construction threats. PHMSA indicated in its recent Advisory Bulletin that it "is supportive of the use of alternative technologies to verify pipe characteristics," and that operators "seeking to use alternative or non-traditional technologies in the determination of MAOP or MOP, or to meet other regulatory requirements, should first discuss the proposed approach with the appropriate state or Federal regulatory agencies to determine its acceptability under regulatory requirements."[79]

TURN suggests that the Commission reconsider its June 2011 decision and pursue more effective approaches for setting and validating MAOP for pipeline segments without a potential manufacturing or construction threat.

8.4 PG&E's Arguments Concerning High Pressure Hydrotesting to a Minimum of 90% SMYS Ignore the Actual Record of PG&E and Industry Standards for Hydrotesting

PG&E claims that TURN's proposal to test pipelines at 90% SMYS only reflects the fact that TURN's witness Kuprewicz "does not believe that federal requirements are adequate," and

[79] Federal Register, p. 26823-26824.

that an industry-leading expert testified that testing to the ratios prescribed for MAOP validation is adequate also to detect pipe flaws.[80]

TURN addressed this issue extensively in Section 3.8 of our Opening Brief, and we highlight only a few key points in this reply brief.

First, PG&E's attempt to cast the 90% recommendation as purely the opinion of Mr. Kuprewicz flies in the face of industry standards and PG&E's own policies. As detailed in Section 3.8.2 of TURN's opening brief, PG&E's standard operating procedures for hydrotesting – Gas Standard A 34[81] – require pressure testing to a minimum of 90% SMYS. The primary industry guideline for hydrotesting – Section 841.3 of ASME B31.8[82] – likewise requires hydrotesting for integrity assessment to "a hoop stress of at least 90% of the SMYS."

TURN does not disagree that Mr. Kuprewicz views the requirements of Subpart J as incomplete. However, the regulations in Subpart J are minimums,[83] as this Commission well knows, since one purpose of D.11-06-017 was to adopt a more rigorous standard for MAOP validation. More importantly, the underlying dilemma, which was discussed in Section 3.8.4 of our Opening Brief, is that the test pressure ratios established in Section 192.619 are designed to validate a maximum MAOP, most likely established pursuant to the design pressure formula of Section 192.105. This does not necessarily mean that the proper way to determine the optimum hydrotest pressure is to work backwards, by starting with an MAOP of unknown origin and multiplying it by the given ratios.

---

[80] PG&E, p. 20-21.
[81] Exh. 103.
[82] Exh. 102.
[83] 49 C.F.R. Section 192.1(a), which applies to all subparts of Part 192.

In order to evaluate the integrity of seam weld defects it is more appropriate to use a hydrotest that comports with industry and PG&E operating standards. For pipeline with such potential defects, testing should not just be used to validate a (potentially ill-supported) MAOP number, but also to ensure the integrity of the pipeline against seam defects. TURN suggests that using low pressure hydrotesting does not provide adequate assurance of seam threat stability. This is especially true given that PG&E has not adequately analyzed the effects of over-pressurizations, cyclic fatigue or interactive threats, as discussed in the opening brief of the City and County of San Francisco.[84]

9 Use of Potential Impact Radius for Prioritizing Valve Automation Is Not Optimal

PG&E explains that the potential impact radius ("PIR") is a function of both pipe diameter and pressure and thus takes into account the impact of pressure on heat flux intensity. PG&E is technically correct, but fails to mention that the PIR is proportional to the pressure times the diameter squared, meaning that the impact of the pipeline diameter is doubled.[85] Thus, the pipe diameter is the major parameter controlling heat flux release, and is a more effective criterion for prioritizing valve automation. Indeed, the Sempra Utilities use the 20-inch pipeline diameter as their criterion for prioritizing valve automation.[86]

TURN already addressed in Section 4.3.1 of our Opening Brief PG&E's continuing use of one counter example, which relies on two very unusual pipelines, including a 20-inch pipeline operating at an extraordinarily high pressure of 2160 psig MAOP. The appropriate transient rupture release calculation for this pipeline would not be captured by the PIR formula. For a gas

[84] CCSF Opening Brief, p. 19-20.
[85] 49 CFR Section 192.903.
[86] See, Sempra Amended Testimony, December 2, 2011, pp. 78-79, Rivera, Sempra.

transmission pipeline operating at such an extremely high pressure of 2160 psig, the automated valve spacing would need to be significantly less than eight miles to meet the 30-minute triage goal.

10 PG&E Should Not Recover Any Costs for Its Pipeline Records Projects From Ratepayers

In Sections 6.3 and 6.4 of its Opening Brief, TURN has already rebutted all of PG&E's main arguments that the MAOP Validation project and the Gas Transmission Asset Management Project ("GTAM") are the result of new requirements and not remedial in nature. TURN replies to one new, minor point in PG&E's opening brief.

PG&E suggests that PHMSA's recently issued Advisory, which gives further definition to the terms "traceable, verifiable, and complete," supports PG&E's argument that that phrase imposes a new regulatory requirement.[87] However, nothing in that Advisory indicates that PHMSA is imposing any new requirements. To the contrary, the Advisory provides guidance regarding record-keeping standards that pipeline operators should have been meeting all along in order to "establish confidence in the validity of the records."[88] In any event, as shown in Section 6.3 of TURN's Opening Brief, even if federal regulations did not heretofore require traceable, verifiable, and complete records, California prudence requirements surely did.

[87] PG&E Op. Br., p. 41.
[88] 77 Fed. Reg. at 26823 (issued May 1, 2012).

11 The NCIP Cost Allocation Proposal Is Contrary to Accepted Ratemaking Principles for Gas Transmission Cost Allocation, Lacks Factual Basis, and Is Based on the False Premise that the Purpose of the PSEP is Simply to Protect Building Structures

NCIP proposes a cost allocation that shifts approximately $120 million of the first 2012-2014 revenue requirement to core customers.[89] NCIP alleges that the Gas Accord V cost allocation is not consistent with "cost causation" because the actual structures close to transmission pipelines likely belong to core customers, so that large industrial users of the transmission system should not pay to make the system safe. NCIP also argues that PG&E's proposed allocation may cause negative impacts due to customer bypass and increased electric rates.[90]

NCIP's cost causation argument lacks factual basis, conflicts with historical ratemaking and is based on the false premise that the purpose of the PSEP is to protect building structures, rather than save people's lives.

11.1 The NCIP EPAM Proposal Is Contrary to Historical Ratemaking for Gas Transmission Costs

NCIP proposes to use the equal percent of base margin (EPAM) from the gas and electric distribution rate case as the cost allocation method. NCIP correctly explains that this method "bundles together distribution and local transmission costs."[91] The EPAM allocates a much larger percentage of the PSEP costs to core customers – 76.5% versus 60.4% under PG&E's proposal[92] – precisely because EPAM includes the cost of distribution pipelines and, even more egregiously, distribution service lines, meters, and regulators, as well as customer service and

[89] Exh. 123, p. 12 and 19, Beach, NCIP. The shift is calculated as: (0.765-0.600)*744=122.76.
[90] NCIP Opening Brief, p. 39-45.
[91] NCIP Opening Brief, p. 40.
[92] The NCIP Opening Brief, at p. 41, cites to different numbers. However, we presume that was an inadvertent error based on a reference to Table 2 of Mr. Beach's testimony, which referenced the numbers for Sempra utilities.

billing expenses that are totally unrelated to any pipelines. When allocating costs for distribution pipelines, residential core customers appropriately pay much more of the costs precisely because residential customers are more numerous and thus require the installation of more distribution pipelines and end-use customer equipment. But the same is not true of transmission pipelines. It is fundamentally unfair to allocate the costs of transmission pipelines based on those distribution allocators.

TURN's witness William Marcus has participated in nearly all of PG&E's rate cases since the early 1980's, including all the GT&S rate cases after unbundling of the backbone system in the late 1990's. Mr. Marcus succinctly concluded that "any attempt to assign these costs using a metric like EPAM that includes distribution is contrary to the unbundling of transmission that has been in place since Gas Accord I."[93]

Mr. Marcus further explained that, if PG&E had included any of these costs in prior rate case requests, these costs would have been allocated similarly to PG&E's proposed allocation:

> If PG&E had kept proper records and done proper tests in the first place and done the work on system replacement that was forecast under previous Gas Accord cases, any capitalized costs of these activities would clearly be part of PG&E's transmission rates today and any expensed costs since Gas Accord I would have been part of PG&E's past transmission rates. There could have been no complaining by non-core customers that it is somehow unfair to have the original costs of a proper past maintenance program included in Gas Accord transmission rates.[94]

The Commission should also keep in mind that there are likely to be additional costs for distribution work in coming years. The utilities are now implementing new federal Distribution

[93] Exh. 100, p. 3, Marcus, TURN.
[94] Exh. 100, p 1, Marcus, TURN.

Integrity Management Program rules, and PG&E may have to do work to fix problems associated with its old Aldyl-A plastic distribution pipe.[95] As noted by Mr. Marcus:

> I also expect that the non-core customers served at transmission who want core customers to pay disproportionately for transmission pipeline safety costs would be the first to be incensed if the shoe were on the other foot, and they were asked to pay for additional programs to fix leaks on the distribution system based on an equal percentage of all costs – transmission and distribution.[96]

11.2 The NCIP Argument Regarding the Gas Accord V Settlement Lacks Factual Support

NCIP alleges, without support, that the Gas Accord V cost allocation may not reflect cost causation principles since "allocation factors included in the GA V settlement may have been intended by parties to counterbalance other settlement concessions." (p. 39) NCIP provides no evidence to indicate that, indeed, those allocators do not reflect cost causation. While it is impossible to know the exact basis of a settled outcome, the Commission can accept that all parties considered the allocation under GA V to be reasonable and equitable. The *only* costs addressed by the GA V settlement involved backbone transmission, local transmission and storage costs. The PSEP involves exactly those same costs.

11.3 The False Premise of the NCIP Proposal Is that the Goal of the PSEP is to Protect Building Structures

The only factual evidence offered by NCIP in support of its proposal relates to the proximity of structures near Phase 1 transmission lines. NCIP argues that Phase 1 prioritizes HCA pipelines, and that most of the structures in HCA areas are residential and commercial structures, meaning that "customers who live or work within the PIR of a gas transmission line

[95] The Commission can take official notice of public reports of problems with PG&E's Aldyl-A pipe, without accepting any specific facts as evidence in this proceeding.
[96] Exh. 100, p. 2, Marcus, TURN.

will receive the direct benefits of enhanced safety, in terms of reducing their own risk of harm from a pipeline incident."[97]

Whether or not there are more residential and commercial structures than industrial buildings and power plants near HCA pipelines is irrelevant. As explained by Mr. Marcus, "the reason that the prioritization of pipeline work is driven by High Consequence Area and Class locations is due to concern about the safety of human beings," not property destruction.[98] Moreover, the relevant issue for cost allocation is not who benefits from safety, but who uses the assets that are being upgraded in the PSEP.

11.4 The Threat of Customer Bypass Does Not Help To Define a Proper Allocation Methodology

NCIP argues that higher noncore rates will promote bypass of the utility system, and will disproportionately raise electric rates. NCIP's argument does not provide an appropriate basis for determining cost allocation. Under NCIP's logic, electric generation ("EG") customers should never pay a dime for access to the PG&E transmission system because other customers would allegedly be better off if EG customers were excused for paying for not just some of PSEP costs that they cause, but for all the costs that they cause. The Commission should reject such unbounded reasoning.

[97] NCIP Opening Brief, p. 41.
[98] Exh. 100, p. 2, Marcus, TURN.

11.5 GTAM Costs Represent a Special Category of Costs and Are Properly Allocated Using Total Mileage

NCIP and PG&E both oppose TURN's proposal to allocate GTAM costs based on total pipeline mileage. NCIP makes a cost causation argument and claims that this proposal "fails to reflect how the PSEP funds will be used."[99] NCIP's argument is without merit.

NCIP bundles *all* PSEP costs together and ignores the fact that the PSEP includes four separate components. The GTAM is a separate and distinct project that is not related to the pipeline modernization, valve automation or MAOP validation projects. Under standard ratemaking principles used by all the utilities in their rate cases, cost causation is implemented by *first* functionalizing different costs into appropriate categories.[100] Those categories of costs are then allocated to customer classes by using appropriate marginal or embedded cost allocators that approximate cost causation. Mr. Marcus's recommendation simply reflects the fact that GTAM costs are a separate category, and should thus be appropriately functionalized to backbone and local transmission and storage using a different method than the other PSEP programs. No party, including NCIP and PG&E, rebutted his analysis that GTAM costs, which are primarily IT costs for collecting and storing all pipeline data, are caused by all pipeline mileage, not just the segments or mileage included for work in Phase 1 of the pipeline modernization or valve automation components.

A different cost allocation method for this component is thus entirely appropriate and consistent with fundamental ratemaking principles. GTAM is different from the other PSEP programs, as it relates to the whole PG&E transmission pipeline system, not just those segments where work is being done. It therefore needs to be functionalized differently to reflect the whole

[99] NCIP Opening Brief, p. 46-47.
[100] For example, transmission, distribution, generation, customer services, etc. Some costs may be direct assigned to particular customer classes rather than functionalized and allocated.

system – with more to backbone and less to local transmission. The end result of this different functionalization is that GTAM costs are appropriately allocated differently to customer classes to reflect the difference in functions for which GTAM costs are incurred.

12 Contrary to PG&E's Assertion, the Commission May Not Allow PG&E to Increase Rates to Recover Costs Incurred Prior to the Authorization of a Memorandum Account

PG&E asserts that, even though the Commission has not authorized a memorandum account for any PSEP costs incurred to date, there is no legal barrier to establishing a retroactive January 1, 2012, effective date for such a memorandum account.[101] This assertion runs directly contrary to the rule against retroactive ratemaking and longstanding Commission doctrine and finds absolutely no support in the authorities cited by PG&E.

If any principle is firmly established at the CPUC, it is that costs incurred prior to the decision authorizing a rate increase may only be recovered if they were recorded in a Commission authorized memorandum or balancing account. Otherwise, the rate increase would violate the rule against retroactive ratemaking enunciated by the California Supreme Court.[102] Typical of the numerous Commission decisions on this subject is D.06-01-018, in which the Commission explained:

> A memorandum account allows a utility to isolate and list costs related to a particular activity, and later to seek to recover those costs in rates. We require such recovery from pre-approved memorandum accounts to avoid unlawful retroactive ratemaking:
>
> > It is a well established tenet of the Commission that ratemaking is done on a prospective basis. The Commission's practice is not to authorize increased utility rates to account for previously incurred expenses, unless, before the utility incurs those expenses, the Commission has authorized

[101] PG&E Op. Br., pp. 95-97.
[102] *Pacific Telephone and Telegraph Co. v. PUC*, 62 Cal. 2d 634, 650 (1965).

> the utility to book those expenses into a memorandum or balancing account for possible future recovery in rates. This practice is consistent with the rule against retroactive ratemaking.[103]

Despite this "well established tenet," PG&E cites two authorities for the proposition that the Commission can circumvent the rule against retroactive ratemaking merely by fixing a retroactive date for the establishment of a memorandum account. Neither come close to supporting PG&E's position.

The first is *Southern Calif. Edison Co. v. Pub. Util. Comm.*, 85 Cal. App. 4th 1086, 1100 (2000), which PG&E only cites in a footnote, but does not discuss. Contrary to PG&E's unexplained citation, the decision only reinforces the Commission's longstanding interpretation. There, the court held that, under then-applicable provisions of Section 455 and GO 96-A, a non-suspended advice letter seeking a memorandum account became effective 40 days after submission and did not require a Commission decision to go into effect. In no respect can the decision be construed to hold that the Commission may set a retroactive effective date for a memorandum account. To the contrary, the court notes the CPUC's position that establishing such a retroactive date would violate the rule against retroactive ratemaking.[104]

Second, PG&E claims that, in the recently issued D.12-04-021 in this docket, the Commission authorized the Sempra utilities to retroactively record in memorandum accounts costs incurred prior to the April 20, 2012 decision, including costs incurred in 2011.[105] PG&E offers no page reference or quotation to support its interpretation of D.12-04-021. TURN has scoured D.12-04-021, and the Sempra utilities' January 13, 2012 filing referenced in Ordering Paragraph 3 that describes the costs to be tracked. Nowhere in either document is there any

---

[103] D.06-01-018, p. 3 (citing D.92-03-094, 43 CPUC 2d 596 (1992), 1992 Cal PUC LEXIS 236, at *7).
[104] *Id.*, 85 Cal. App. 4th at 1104, fn. 8.
[105] PG&E Op. Br., p. 96.

indication whatsoever that the Commission was authorizing a retroactive effective date or the inclusion of pre-April 20, 2012 costs in the memorandum account. Given the Commission's longstanding position that costs incurred prior to authorization of a memorandum account cannot be recovered in rates, it would be highly surprising – indeed legally improper – for the Commission to depart from its well-established practice without discussing it in the decision. Accordingly, TURN can only conclude that PG&E's reading of D.12-04-021 is flat out wrong.

13 PG&E's Contingency Request Conflicts with its Advice Letter Proposal

PG&E's request for a 21% contingency[106] is in conflict with its advice letter proposal to submit an advice letter seeking rate increases in case of cost overruns. A contingency increases cost forecasts in order to cover unanticipated cost increases. In essence, the contingency reduces the risk that actual costs will exceed forecast costs, based on the assumption that the total forecast cost (including the contingency) will be the maximum required from ratepayers to perform the full scope of work.

PG&E's advice letter proposal would ensure that, if actual costs are higher than forecast, PG&E will simply not do the work unless the Commission authorizes additional rate increases. The advice letter request thus completely eliminates the risk that the contingency amount is supposed to mitigate. It represents another variant of the 'heads I win, tails you lose' ratemaking approach.

TURN supports PG&E's proposal to true-up any costs to actuals at the end of the PSEP. However, TURN does not support a conclusion that, if actual costs were below PG&E's present forecast, they would be deemed *per se* reasonable. TURN's primary recommendation is for the

[106] PG&E Op. Br., pp. 50-52.

Commission to reject any such attempt to establish cost reasonableness based on PG&E's forecasts. Nevertheless, we additionally point out that if the Commission authorizes any funding that includes a contingency amount, then it should require PG&E to complete the work without more rate increases. Otherwise, PG&E would be insulating itself from absolutely any cost increases or any errors in its forecast.

14 Conclusion

For the reasons set forth in its Opening Brief and this Reply Brief, TURN urges the Commission to adopt the recommendations described in the Summary of Recommendations in TURN's Opening Brief. A corrected version of TURN's Summary Table of Proposed Disallowances and Reductions that was appended to the Summary of Recommendations is attached to this Reply Brief as Appendix A.

Date: May 31, 2012

Respectfully submitted,

By: _____/s/_____

Marcel Hawiger, Staff Attorney
Thomas J. Long, Legal Director

THE UTILITY REFORM NETWORK
115 Sansome Street, Suite 900
San Francisco, CA 94104
Phone: (415) 929-8876
Fax: (415) 929-1132
Email: Marcel@turn.org
Email: TLong@turn.org

APPENDIX A
Summary Table of Proposed Disallowances and Reductions (corrected)[107]

Basis for Disallowance or Reduction	Mileage (if applicable)	Capital (1)	Expense (2)
Non-Overlapping Reductions			
Pipeline Replacement for pipe installed post 1970	8.6	$38,700,000	
Hydrotesting Pipeline Installed 1961-70 with records missing	98		$49,000,000
Pipeline Replacement for pipe installed 1961-70	27	$121,500,000	
Hydrotesting pipeline installed 1956-1960	90		$45,000,000
Pipeline Replacement for pipe installed 1956-1960	18	$81,000,000	
Deferred Maintenance - Ineffective ECDA (2004-2010)			$70,000,000
Imprudent Integrity Management - failure to test pipe for MT installed pre-1956	177		$88,500,000
Imprudent Integrity Management - failure to test pipe for MT installed pre-1956	42	$189,000,000	
Disallow MAOP Validation costs*			$162,000,000
Disallow GTAM costs		$95,200,000	$20,500,000
ROE reduction to 6.05% or 10.3% (3)			
TOTAL		**$525,400,000**	**$435,000,000**
Potentially Overlapping Reductions			
Deferred Maintenance due to termination of GPRP (30% of 160 miles)	160	$216,000,000	
Pressure Spiking (subset of IM)	31.9		$15,950,000
Pressure Spiking (subset of IM)	19.8	$89,100,000	
Imprudent IM - Failure to Test pipe with MT (includes all pipe)	239		$119,500,000
Imprudent IM - Failure to Test pipe with MT (includes all pipe)	62	$279,000,000	
GPRP Imprudence	160	$720,000,000	
Notes:			
1 - Use average capital cost of $4.5 million/mile			
2 - Use average hydrotest cost of $0.5 million/mile			
3 - Impact depends on amount of total approved PSEP capital costs			
* Corrected			

[107] This table corrects the disallowance for MAOP Validation costs, to reflect the full value of costs that should be funded by shareholders, including amounts that PG&E has previously committed to remove from rate recovery. The correction will facilitate a like-to-like comparison with PG&E's proposals.