BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

Order Instituting Investigation on the Commission's Own Motion into the Operations and Practices of Pacific Gas and Electric Company with Respect to Facilities Records for its Natural Gas Transmission System Pipelines.	**I.11-02-016** **(Filed February 24, 2011)**

PREPARED DIRECT TESTIMONY OF PETER A. BRADFORD ON BEHALF OF THE UNITED ASSOCIATION OF PLUMBERS, PIPE FITTERS AND STEAMFITTERS LOCAL UNION NOS. 246 AND 342, AND THEIR INDIVIDUAL MEMBERS

(from R. 11-02-019)

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TESTIMONY OF PETER A. BRADFORD

QUALIFICATIONS OF PETER A. BRADFORD

I chaired the New York Public Service Commission (1987-95) and the Maine Public Utilities Commission (1974-75 and 1982-87). I also served as a commissioner on the Maine PUC from 1971-1977. Both commissions had jurisdiction over the safety of natural gas systems. Both commissions had occasion to revisit their gas safety rules in the wake of significant fatal explosions.

I was also a member of the U.S. Nuclear Regulatory Commission (1977-82). The NRC has exclusive responsibility for the safety of U.S. nuclear power plants. My term included the accident at Three Mile Island (1979). After that accident, the NRC revised its regulatory framework in many areas, including offsite emergency preparedness, control room design, staffing, and instrumentation, analysis of operating experience and operator training. The NRC had no ratesetting responsibility.

My full CV is Appendix A to this testimony.

PURPOSE OF TESTIMONY

I am testifying on behalf of the United Association of the Plumbing and Pipe Fitting Industry, Locals 246 and 342. I am urging that the California Public Utilities Commission (PUC) defer consideration of the ratemaking implications of this rule making until either a later phase of this docket or until a separate docket altogether. To the extent that the PUC decides to set forth general ratemaking principles in this proceeding, I offer some suggested principles for the Commission's consideration.

REASONS TO DEFER RATEMAKING ISSUES

Setting safety standards in the aftermath of a catastrophic accident is among the most challenging tasks confronting utility regulators. Such events are fortunately rare, but this lack of frequency means that the full range of needed expertise is not part of the commission's repertoire. This is especially true when – as here – the accident reveals "multiple and recurring deficiencies" in the regulated operations and therefore necessarily implicates many aspects of the regulations themselves.

Such a regulatory proceeding will inevitably consist in part of developing new standards and in part of developing new ways to insure that existing standards and regulatory requirements are

followed and enforced. Issues ranging from technical to institutional (corporate culture) to financial (economic disincentives to safety) will have to be reviewed. Decisions as to whether to proceed under a rate of return or a performance based framework will be necessary.

Such a proceeding will have as inputs several complex reviews of the triggering event, each containing a detailed record of its own.

The current proceeding is forward-looking. Its fundamental purpose includes restoring to Californians the level of safety and security in their homes that they thought they had attained before the San Bruno explosion.

A rate case is fundamentally different. By its nature, it looks backward at the prudence and proper accounting and allocation of costs already incurred. Even a rate case dealing with expenditures that haven't yet been made takes substantial categories of cost as given and seeks to estimate and allocate reasonable magnitudes. It not primarily concerned with establishing basic standards.

Indeed, it is only by chance that the basic standards in this proceeding are within the control of the PUC. Many standards fundamental to utility operation are not. Nuclear safety is determined by the NRC. Environmental standards are usually set by other state and federal agencies. Even when the PUC sets standards – such a service quality – my experience suggests that such activity is rarely if ever undertaken in the context of a rate proceeding.

CONSIDERATION OF ECONOMIC ASPECTS OF PROPOSED REGULATIONS

My recommendation that the California PUC defer ratemaking until a later proceeding is not at all a recommendation that the Commission should not consider some economic issues in this proceeding. For one thing, the Commission will certainly want to assure that its regulations are cost effective, both in the sense that the options chosen are the most efficient means to attain the desired safety result and in the sense that particular measures produce safety improvements commensurate with the costs that they impose. Furthermore, the Overland Consulting Report ("Focused Audit of Pacific Gas and Electric Gas Transmission Pipeline Safety-Related Expenditures") makes clear that economic considerations played an important part in the PG&E operational shortcomings that

contributed to the accident.[1] The NTSB report reached similar conclusions.[2] This proceeding is a sensible venue in which to address in principle the regulatory modifications necessary to mitigate any existing financial incentives to such behavior.

Detailed tariff setting is another matter. If this rulemaking is to consider and evaluate costs (including cost of equity), ratemaking, cost allocation and rate design, it should provide adequate time for separate testimony development and evidentiary hearings for each step of the cost evaluation and ratemaking process. Such a ratemaking proceeding normally takes months (at least) of evidentiary development and testing before a commission can compile and evaluate an adequate evidentiary record. Achieving the ratemaking and rate design functions listed in the Amended Scoping Memo of November 2, 2011, in a compacted time frame in the current rulemaking risks the quality of both the standard setting and the ratemaking.

This situation is exacerbated because the nature of past Gas Accord settlements leaves the Commission without sufficient historical information relating to PG&E's actual and projected costs to be able to undertake ratemaking, cost allocation and rate -design work at this juncture.[3]

Conflating ratemaking into this rulemaking also places an expensive and time-constrained burden on the parties. Requiring the parties in this rulemaking to develop accurate cost analyses and ratemaking proposals within three months from the date of the November 2, 2011 Assigned Commissioner Ruling places the parties in an untenable and unprecedented position. Normally, the Commission would examine such analyses and proposals within the context of a multi-year ratemaking proceeding.

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[1] Overland Consulting for the CPUC Consumer Protection & Safety Division, *Focused Audit of Pacific Gas & Electric Company's Gas Transmission Pipeline Safety-Related Expenditures for the Period 1996 to 2010*, submitted December 30, 2011.

[2] National Transportation Safety Board, *Pipeline Accident Report, Pacific Gas and Electric Company, Natural Gas Transmission Pipeline Rupture and Fire, San Bruno, California, September 9, 2010,* adopted Aug. 30, 2011.

[3] Overland's *Focused Audit* details the history of PG&E's gas pipeline ratemaking, including the procedural history that four of the five PG&E gas transmission and storage rate cases were adopted by settlements since the Gas Accord mechanism was first used in 1998. Overland Report at p. 2-7 – 2-12 and Table 2-2.

RATEMAKING PRINCIPLES

That customers pay the just, reasonable and prudent costs of gas supplied reliably and safely is a basic principal of utility regulation. For PG&E's Gas Transmission and Storage system, this basic understanding has since 1998 been embodied in a more specific compact, namely the Gas Accord.[4] By paying the rates resulting from the Gas Accord, the customers fulfilled their part of a bargain in which PG&E was obligated, among other things, to transport gas safely. Ample evidence now demonstrates that PG&E failed to live up to its obligation under the Accord. That penalties are in order is beyond dispute. The challenge is to develop ratemaking principles that assure that disincentives will not thwart the safety investments and expenditures required in the future while also assuring that customers do not pay again for measures and results which PG&E has already been compensated for and should have achieved.

Determining whether the ratepayer should pay for the work listed in PG&E's Implementation Plan and other work that the U.A. Local Unions and other parties demonstrate is necessary for safety is made difficult by two facts. First, PG&E did not perform (or inadequately performed) work that industry standards and federal regulations required it to perform. Second, the Gas Accord settlement makes it hard to figure out whether PG&E has already been compensated for required work that was not performed.

In facing the difficulties involved in assuring a safe system while treating customers fairly, generally-accepted utility ratemaking practices are a useful guide. To this end I recommend that the Commission apply the following ratemaking principles:

1. **The Commission should undertake a prudence review of PG&E gas transmission and storage safety-related expenditures affecting the present system sufficient to assure that these expenditures were prudent before it allocates costs between ratepayers and shareholders.**

The CPUC has made a good start with Overland Consulting's focused audit, but it needs to go farther back in time and also audit PG&E's gas transmission and storage books more comprehensively.

[4] The Commission recently reaffirmed this obligation in the parallel investigation of PG&E's record-keeping. In I.11-02-16 at page 9, the Commission stated "PG&E's obligations to public safety are informed by federal standards, but they do not depend on federal safety rules alone."

A two-step evaluation of whether the money was spent, and if spent, was it spent prudently, is time- and resource-intensive,[5] but if the Commission wants to comprehensively determine what the ratepayers should properly pay for, the Commission must first determine whether the work that customers have already paid for was prudently accomplished. (Nov. 2, 2011 ACR, Questions 5, 6, 7, 9, at P. A1).

2. Ratepayers should not be made to pay twice for the same work.

The Commission should rigorously recover for customers the value of money collected in the past for projects whose objectives were not accomplished and that are now reflected in Implementation Plan costs.[6] As stated above, the Commission should not implement this principle by disallowing or reducing the return on future expenditures because such ratemaking will create incentives to cut corners on necessary safety improvements. (Nov. 2, 2011 ACR Question 9, at p. A1-2)

3. Customers should also not pay for any other work performed imprudently (or omitted through imprudence and now found to be necessary).

Again, the customers had a right pursuant to the Gas Accord to expect that safety and compliance with applicable state and federal regulations would be fully looked after.

4. Where new requirements impose costs necessary for the safety of PG&E's gas transmission pipeline system, such costs should normally be reflected in rates.

Disallowing costs unrelated to past imprudence is unlikely to contribute to safety, to customer well-being or to the availability of investment capital.

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[5] In all likelihood, the Commission would need to employ independent technical consultants to determine whether the work was properly performed, a multi-year endeavor that could be informed by the technical failure analyses undertaken by PG&E as part of its ongoing pressure testing and pipeline replacement work.

[6] CPUC General Order 112-E requires PG&E to maintain pipeline integrity and safety, and P.U. Code § 461 requires PG&E to maintain specific records necessary to establish that the testing, evaluation and repair work has been properly performed. Customers should not be made to pay for work that PG&E was required to do, was paid for, but failed to do prudently. (Nov. 2, 2011 ACR, Questions 3, 5, at p. A1)

5. It seems inevitable that there will be categories of future expenditure that will mix the remediation of past imprudence in with work that customers had no reasonable expectation would be performed under the gas accords. No general principle set forth here is likely to be adequate to the resolution of all such categories.

Among the considerations necessary to a fair resolution of such situations is the possibility that customers realized savings if revenue requirements were reduced by PG&E's failure to perform necessary work. To determine the appropriate division between the shareholders and ratepayers, the PUC must scrutinize more thoroughly the full costs and benefits that the ratepayers experienced over time. The Commission should delve into the proper calculation of these incremental cost elements in a later phase of this ratemaking, after the Commission determines exactly what work needs to be performed and how it should be accomplished.

6. Any penalties or disallowances applied to PG&E should not vary with future investments in the gas supply and storage system. Prudent future investment should be reflected in rates, to the extent that original cost rate of return ratemaking is applied.

Ample measures exist to protect customers by applying ratemaking disallowances or penalties based on past investments and expenditures that were not made or that were done inadequately.

7. The allowed rate of return on future investments should be calculated in the proceeding appropriate for developing the cost of capital for PG&E.

It is difficult to see any justification for applying a different rate of return gas on system investments. Using the cost of capital calculation for future investments as a vehicle for penalizing past imprudence is likely to have a perverse effect on system improvements.

PETER A. BRADFORD