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)

NOTICE OF EX PARTE COMMUNICATION

TURN
THE UTILITY REFORM NETWORK
Lower bills. Livable planet.

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June 29, 2012

Pursuant to Rule 8.4 of the Commission's Rules of Practice and Procedure, The Utility Reform Network (TURN) gives notice of the following ex parte communication.

On June 26, 2012, TURN's Legal Director, Thomas Long, TURN Energy Attorney, Marcel Hawiger, met with Commissioner Florio and his advisor Sepideh Khosrowjah. The meeting took place at the Commission's office in San Francisco from approximately 4:15 p.m. to 4:45 p.m. The communication consisted of an oral presentation accompanied by a written handout, a copy of which is attached.

In the meeting, Mr. Long and Mr. Hawiger discussed the attached handout, which summarizes TURN's view of the main issues that should be addressed in the decision on the Phase 1 Pipeline Safety Enhancement Plan (PSEP) proposed by Pacific Gas & Electric Company (PG&E), and TURN's recommendations on those issue

June 29, 2012

Respectfully submitted,

_____/s/_________________
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ATTACHMENT TO EX PARTE NOTICE

HANDOUT AT TURN MEETING WITH COMMISSIONER FLORIO
JUNE 26, 2009
R.11-02-019

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Ex Parte Meeting
R.11-02-019: PG&E PSEP
June 26, 2012

Overview of the Case

<u>Why are we here?</u>

ϕϕι San Bruno 9/9/10 explosion: 8 dead, 58 injured, 38 homes destroyed, another 70 homes damaged

ϕϕι Key NTSB findings:
- PG&E had inaccurate pipeline records
- PG&E exercised inadequate quality control
- PG&E's Integrity Management Program was deficient and ineffective
- The multiple and recurring deficiencies in PG&E operational practices indicate a systemic problem; this was an "organizational accident"
- "The NTSB is concerned that the PG&E GIS still has a large percentage of assumed, unknown, or erroneous information for Line 132 and likely its other transmission pipelines as well." (p. 110)

ϕϕι Key Independent Review Panel findings:
- PG&E's top management was focused on financial performance and corporate image and insufficiently attentive to public safety.
- PG&E had erroneous pipeline records because of the lack of: robust data and document management systems, and processes to capture emerging information about the system.
- PG&E's record-keeping problems hindered PG&E's ability to identify threats and to assess the risks posed by those threats.

ϕϕι Decision 11-06-017
- MAOP validation project was set in motion by NTSB's "justifiable alarm" at PG&E's inaccurate pipeline records (p. 17)
- Curing PG&E's unreliable pipeline records was the "obvious goal" of the NTSB's recommendation to obtain traceable, verifiable and complete records and with reliably accurate data, create a dependable MAOP (p. 17)

Key Issues in the Case

- How should the costs of the PSEP be apportioned between shareholders and ratepayers?
    - To what extent is the PSEP remedying PG&E's serious mismanagement of its pipeline records and overall transmission system (i.e, the result of PG&E's imprudence)
    - In light of PG&E management's excessive focus on profits and insufficient attention to safety, what other ratemaking adjustments are appropriate (e.g., rate of return reductions, use of other sources of funding)
    - In light of the pending enforcement investigations that are likely to further illuminate the scope of PG&E's past mismanagement, when should the Commission make a final cost responsibility determination?
- How should the proposed scope of the PSEP be modified to achieve the necessary safety improvements in the most cost effective manner?
- Are PG&E's cost estimates reliable? (DRA)
- What ratemaking accounting mechanisms (e.g., memorandum accounts, balancing accounts, after-the-fact reasonableness review) should be used to ensure that, for any of the costs apportioned to ratepayers, only reasonably incurred costs are recovered in rates?
- For any costs apportioned to ratepayers, what cost allocation methodology should be used?

Cost Responsibility Issues

What cost responsibility principles should the Commission use?

- TURN: Under PU Code Sections 451, 463 and general prudence principles, the Commission must disallow costs resulting from PG&E's imprudence.
- PG&E's "incremental" principle: If D.11-06-007 had never been issued, would PG&E have been obligated to do the work?
  - Applied too narrowly by PG&E, which ignores Section 451 and prudence principles in assessing what it was "obligated" to do. (However, PG&E's SVP Bottorf acknowledged at hearing that its obligations for this purpose should include Section 451 requirements – PG&E retracted this position in its <u>reply</u> brief.)
  - Federal regulations and GO 112 established minimum requirements; as the operator of pipelines transporting highly combustible gas, PG&E was entrusted with exercising its informed judgment to go beyond those regulations as necessary to ensure safety of the system.
- PG&E bears the burden of proof to demonstrate that PSEP costs are not the result of its imprudence.
- The Commission has made clear that fines and disallowances for the same behavior are appropriate – fines are paid to the general fund and do not mitigate the harm to ratepayers.
- Other principles:
  - Ratepayers should not be made to pay twice for the same work (deferred maintenance)
  - As a matter of basic fairness and in light of PG&E's past emphasis on profits over safety, the PSEP should not become a profit center for PG&E

Application of Prudence Principles to PG&E's PSEP

- A <u>full disallowance</u> is warranted: because the PSEP is the result of PG&E's imprudence -- or, put another way, remedial in nature.
  - The NTSB's January 2011 urgent recommendations and the Commission's follow-on directives in D.11-06-017 were necessitated by PG&E's inaccurate pipeline records and the grave doubts created by those records about whether PG&E's MAOPs and its integrity management practices were reliable.
  - The record shows that, if D.11-06-017 had not been issued, to remedy its pipeline system, PG&E would have moved ahead with its "Pipeline 2020" program, a program that is virtually identical to the Pipeline Modernization and Valve Automation programs proposed in the PSEP.
  - When asked at hearing what steps PG&E would have taken if D.11-06-017 had never been issued, PG&E's Stavropoulos evaded the question, claiming PG&E had never given any thought to that question.

- Issue-by-issue disallowances supported by the incomplete record to date
    - The costs of the MAOP validation project should be disallowed in full ($162 million expense)
        - As D.11-06-017 states, this project is the result of NTSB's alarm at PG&E's incorrect records and the need to ensure that PG&E's MAOPs are based on accurate information
        - Contrary to PG&E's contention, the obligation to have "traceable, verifiable, and complete" records is not a new standard but rather a more precise articulation of the requirement to maintain accurate and reliable records
    - Pipeline testing or replacement costs for pipeline installed from 1955 on should be disallowed ($241 million capital, $94 million expense)
        - Industry standards (later adopted by GO 112 and federal regulations) required pre-service pressure testing of all pipeline installed from 1955 on, and retention of test records for the life of the pipeline. PG&E helped formulate the 1955 standard and voluntarily followed the standard.
        - PG&E's failure to retain records of such pressure tests is imprudent and ratepayers should not be required to pay to remedy such imprudence
    - Pipeline testing or replacement costs for PSEP pipeline that PG&E improperly inspected under integrity management requirements should be disallowed ($89-$279 million capital, $16-$120 million expense)
        - PG&E used the wrong -- and less costly -- method (external corrosion direct assessment, instead of in-line inspection or pressure testing) to assess manufacturing threats
        - PG&E should have conducted a pressure test on segments with manufacturing threats where PG&E spiked the pressure
    - Pipeline testing or replacement costs for PSEP pipeline that was negligently constructed or installed should be disallowed (unknown $ amount at this time)
        - NTSB found PG&E's inadequate quality control allowed defective Segment 180 to be installed.
        - It is likely that other PSEP pipeline was defective and should never have been installed. Ratepayers should not pay to remedy such imprudence.
        - The Commission should direct PG&E to have independent inspectors at excavation sites to assess whether pipe segments were defective.
    - The costs of the Gas Transmission Asset Management (GTAM) project should be disallowed in full ($95 million capital, $21 million expense)
        - The record shows that the GTAM is needed to remedy PG&E's serious record-keeping deficiencies, as identified by the outside PwC report commissioned by PG&E, as well as the NTSB and the Independent Review Panel.

ϕϕι It is premature to make any final decision that costs should be assigned to ratepayers. If any cost recovery is approved based on this limited record, rate increases should be interim and subject to refund.

- The three pending enforcement dockets will further develop the record regarding deficient past practices of PG&E, particularly record-keeping and integrity management, and are likely to demonstrate other ways in which the PSEP is remedying PG&E's imprudence. The OII records should be particularly relevant to determining disallowances related to the GTAM, improper integrity management, and installing defective pipe segments.
- Remedial measures ordered in the OIIs at shareholder expense are likely to include PSEP activities or affect PSEP cost recovery.
- The OIIs specifically contemplated taking notice of the records of those cases in this docket. Once those cases are concluded, this docket should re-visit the extent to which PSEP activities are remedying PG&E's imprudence.
- The same cost responsibility issues will also need to be addressed for PG&E's Phase 2 PSEP, which PG&E estimates will cost between $6.9 and $9 billion.

Recommendations Concerning Scope of Work

Pipeline Modernization Program

- Prioritization: Delay work in Class 2 non-HCA areas until later phase. Impacts about 500 miles of pipeline.
- Test or Replace: PG&E should hydrotest rather than replace most pipelines with manufacturing threats operating above 30% of SMYS, rather than defaulting to replacement. Contrary to D.11-06-017, PG&E has failed to provide the criteria it will use to decide between testing and replacement. Impacts up to 124 miles of pipeline with manufacturing threats, reducing total costs by about $450 million.
- Hydrotesting Protocols: Hydrotest pressures should be at least 90% of SMYS on main lines. Low pressure strength testing just to validate the MAOP does not sufficiently assess pipeline integrity and may require duplicative future work.
- The Commission should allow an exception from the "test or replace" requirement for pipelines operating below 30% of SMYS. Experts agree that defects on such pipelines would fail as a leak, not a rupture. Impacts over 300 miles of pipeline scheduled for hydrotesting, saving $150 million in expenses.

Valve Automation Program

- Type of Valves: PG&E should install Automated Shut-off Valves ("ASVs") rather than Remote Control Valves on large diameter (above 24-inch) pipelines. Concerns about "false closure" ignore complex monitoring and programming options.
- Prioritization: PG&E should prioritize valve automation by targeting pipelines greater than 24-inches in diameter, rather than by using the Potential Impact Radius.
- Prioritization: PG&E should closely consider automating valves in Class 1 and 2 HCA areas containing identified sites.

Gas Transmission Asset Management

- Independent Audit: The Commission should independently audit the GTAM project to ensure that it is meeting all objectives and requirements before allowing any rate recovery.

Recommendations Regarding Ratemaking Adjustments and Accounting Mechanisms

- The Commission should reduce the ROE on PSEP capital investments to prevent PG&E from turning the PSEP into a profit center.
    - A full ROE is unwarranted in light of the IRP Report conclusion that PG&E top management was focused on financial performance and not operational safety, and the Overland Report findings that PG&E's shareholders benefitted from this insufficient regard for safety. (PG&E's average actual annual ROE for GT&S was over 3.00% higher than authorized in 1999-2010).
    - PG&E's large capital investments are necessary to fix problems of its own making and reflect decades of ineffective corporate management. The CPUC can consider these factors in reducing ROE for PSEP investments.
    - The Commission should set the authorized PSEP ROE at PG&E's cost of debt, currently 6.05%, which would reduce the present value of PG&E's revenue requirements for capital costs by 26%.
    - Alternatively, at a minimum, the Commission should reduce the ROE to 10.3%, the low end of the range of reasonable ROEs found in the last Cost of Capital proceeding.

- The Commission should require PG&E to use existing internal funding sources before using any ratepayer funding for PSEP as a matter of fairness and equity.
    - Bonus depreciation funds collected in authorized memorandum account pursuant to Resolution L-411 are appropriate to use on PSEP projects.
    - Any future over-earnings from PG&E's gas transmission and storage (GT&S) operations in this GT&S rate case cycle should be used to offset PSEP costs, instead of being allocated to shareholders pursuant to revenue sharing mechanism.
    - PG&E shareholders should match, via PSEP offsets, the approximately $23 million per year included in GRC rates to fund bonuses for top managers and executives.

- The Commission should adopt a longer depreciable life of 60 years for PSEP pipeline replacements.
    - The current 45-year service life was adopted in 1996 and does not reflect new testing standards or newer data.
    - A longer service life reduces first-year capital-related revenue requirements by 4.2%, thus reducing near term rate shock without impacting total cost recovery.

- PG&E should not fund performance incentives through PSEP rates. Thus, any recorded PSEP costs should *not* include costs for the Short-Term Incentive Program. The Commission should remove any STIP costs included in forecast capital expenditures (included in standard labor and corporate overheads) and expenses (included in labor loaders).

ϕϕι The Commission should disallow costs in recognition of deferred or ineffective maintenance.

- The Overland Report documents PG&E underspent by about $135 million in 1997-2010 as compared to GT&S rate case authorized revenues, indicating a strong probability of deferred maintenance. PG&E also delayed and postponed planned integrity management ILI projects in 2007-2010.
- PG&E spent approximately $30 million in 2008-2010 on ECDA, an integrity assessment method that is of very limited value.
- PG&E canceled previously planned pipeline replacement work (160 miles) in 2000-2010 by terminating the Gas Pipeline Replacement Program.
- Because the record of the OIIs will further illuminate these issues, no final determinations about deferred maintenance should be made on this record.

ϕϕι If the Commission authorizes any rate recovery based on PG&E's cost forecasts, it should reduce the forecast and adopt safeguards to ensure ratepayers do not overpay.

- PG&E's forecast of AFUDC for expenses should be removed and its forecast of AFUDC for capital costs should be reduced, as TURN's unrebutted testimony demonstrated these forecasts are erroneous.
- The Commission should reject PG&E's proposal to allow it to defer work based on cost overruns. If PG&E is allowed to request additional rate recovery because of cost overruns, PG&E should be required to make such request by a petition for modification of the relevant Commission decision, and such petition proceeding should allow for discovery and evidentiary hearings as necessary.

ϕϕι The Commission should reserve the option of conducting a future reasonableness review of PG&E's recorded costs for PSEP work. Such a reasonableness review would be in addition to the retrospective prudence review (for a different purpose) that has already begun in this proceeding. The review should specifically analyze potential impacts on contractor costs of the need to conduct an expedited "crash program."

Recommendations Regarding Cost Allocation

- The Commission should reject attempts by large noncore customers to allocate costs using the Equal Percent of Base Margin.
  - This method includes costs for distribution lines, service lines and customer services which are wholly unconnected to the work being done in the PSEP and thus have no basis in cost causation.
  - This method results in an unfair and arbitrary shift to core customers of $120 million in just the first three years of revenue requirements.
  - The proposal is based on the false premise that the goal of the PSEP is preventing property destruction rather than saving lives.

- However, any costs for the GTAM project should be allocated separately based on total pipeline mileage.
  - The GTAM is a separate project wholly unrelated to the Pipeline Modernization, Valve Automation or MAOP Validation projects.
  - The GTAM adds IT capabilities to store data on all pipelines, not just the HCA pipelines addressed in Phase 1 of the PSEP. Its costs should thus be functionalized differently to reflect the scope of the work performed.