

CPUC Docket I.12-01-007
 Rebuttal Testimony of Gary Harpster
 Errata
 September 19, 2012

Page	Line	Change From	Change To
4	19	\$94 million	\$117 million
8	1 - 22	Current Table 3-3	Revised Table 3-3
8	24	\$93.9 million	\$116.7 million
15	1 - 22	Current Table 3-10	Revised Table 3-10
15	24	\$355 million	\$378 million
16	23	Current source note	Revised source note on Table 4-1
31	22	Current Table 4-9	Add note to Table 4-9
32	6	\$56.6 million	\$33.8 million
32	9 - 22	Current Table 5-1	Revised Table 5-1
36	25	\$56 million	\$34 million
75	31	decision	decisions
75	32	was	were
76	19 - 20	Current format	Indent and single space lines 19 and 20
80	FN 90	Adopted	Adopt (on first line of Footnote 90)
104	15	Form 1	Form 2 (In column heading)
112	32	he	The
120	6	mult-step	multi-step
121	28	muti-step	multi-step
129	9 - 10	Section 17, Actual...	Delete "Actual Return on Equity"
131	FN 151	\$87 million	\$102 million (second line of footnote)
142	1 - 5	Current Format	No indent (These lines are not a quote)

1 **Section 2**

2 **Summary**

3
4 Q. Please provide a summary of your rebuttal testimony.

5 A. Overland accepted several changes recommended in Mr. O'Loughlin's testimony. Those
6 changes did not significantly impact Overland's results or the findings and conclusions
7 stated in the Overland Report.

8
9 Overland's revised functional O&M comparison shows that PG&E underspent by \$40
10 million over the 14-year study period. Mr. O'Loughlin claims PG&E overspent on
11 functional O&M by \$19 over the same period. The difference is explained by: (1) a
12 fundamental disagreement about the correct basis for determining adopted O&M
13 expenses in 2003 and 2008 to 2010; and (2) four errors made by Mr. O'Loughlin. His
14 largest error was including \$22 million in San Bruno Incident response costs in actual
15 2010 O&M. Those costs are the direct consequence of multiple violations of CPUC safety
16 rules and should be excluded from the O&M comparison for that reason.

17
18 Overland's revised capital expenditures comparison shows that PG&E underspent by
19 \$117 million over the study period. Mr. O'Loughlin claims PG&E overspent by \$262 million
20 over the same period. Mr. O'Loughlin claims PG&E overspent by \$275 million in just
21 three years, 2008 to 2010. He claims that PG&E spent 82 percent more than its adopted
22 capital expenditures in 2008 to 2010. That claim is not credible, as demonstrated in
23 Section 10. Mr. O'Loughlin's implausible claims of massive overspending in 2008 to 2010
24 demonstrate the fundamental error in his approach during those years.

25
26 Overland's revised revenue comparison shows that actual revenues exceeded adopted
27 revenue requirements by \$244 million over the period 1999 to 2010. Mr. O'Loughlin
28 claims actual revenues exceeded adopted by \$515.5 million over the same period. Mr.
29 O'Loughlin's comparison is invalid because his adopted revenue requirements are
30 incorrect. Mr. O'Loughlin excluded \$236 million from his adopted revenue requirements
31 based on his theory that approximately half of the Line 401 revenue requirement was
32 excluded from the GA I Settlement. That theory is wrong for the reasons stated in
33 Section 4.

34

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22

Year	Actual	Adopted	Difference
1997	61,630	75,200	(13,570)
1998	39,307	75,200	(35,893)
1999	31,664	75,200	(43,536)
2000	66,431	75,200	(8,769)
2001	97,714	75,200	22,514
2002	132,566	75,200	57,366
2003	89,030	99,908	(10,878)
2004	81,199	142,100	(60,901)
2005	119,176	111,289	7,887
2006	129,365	113,392	15,973
2007	158,330	153,045	5,285
2008	216,751	221,970	(5,219)
2009	200,319	249,969	(49,650)
2010	192,993	190,260	2,733
Total	1,616,475	1,733,133	(116,658)

Source: Overland Analysis

23
24 After the revisions, PG&E's actual capital expenditures are \$116.7 million lower than
25 adopted over the study period. That compares with under-spending of \$95.4 million
26 shown on Table 4-1 in the Overland Report.

27
28 Overland made four changes to its adopted capital expenditures. All four changes were
29 recommended by Mr. O'Loughlin. The four changes are listed below.

- 30
31
- 32 ■ Include Common Plant expenditures in adopted capital expenditures during 1997 to 2002;
 - 33 ■ Modify the treatment of NOx capital expenditures in Overland's GA I period capital expenditures imputation model to directly account for the capital expenditures amounts shown in the GA I Settlement workpapers.
 - 34 ■ Escalate Overland's 2004 adopted capital expenditures from 2001 dollars to 2004 dollars.
 - 35 ■ Use Mr. O'Loughlin's slightly lower escalation rate to calculate 2006 adopted capital expenditures.
- 36
37
38
39
40

41 Q. Please describe revised Table 5-3.

42 A. Revised Table 5-3 is shown below.

43

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23

Table 3-10 Comparison of Adopted Capital Expenditures Overland Revised Compared to O'Loughlin 1997 to 2010 Dollars in Thousands			
Year	Overland	O'Loughlin	Difference
1997	75,200	43,430	31,770
1998	75,200	101,056	(25,856)
1999	75,200	90,916	(15,716)
2000	75,200	84,828	(9,628)
2001	75,200	89,594	(14,394)
2002	75,200	75,200	0
2003	99,908	56,245	43,663
2004	142,100	142,146	(46)
2005	111,289	113,669	(2,380)
2006	113,392	115,731	(2,339)
2007	153,045	106,853	46,192
2008	221,970	89,673	132,297
2009	249,969	158,203	91,766
2010	190,260	87,408	102,852
Total	1,733,133	1,354,952	378,181

24
25
26
27

Source: Overland Revised Table 4-1 and MPO Workpapers 134 to 137

Mr. O'Loughlin's adopted capital expenditures are \$378 million lower than Overland's adopted amounts. The largest differences occur in 2008 to 2010.

Section 4

1997 to 2002 Adopted Functional O&M Expenses

1
2
3
4 Q. What issues account for the differences in adopted functional O&M during the GA I
5 period?

6 A. The following table shows the differences by issue.

7
8
9
10
11
12

Table 4-1 Gas Accord I Period Imputed Adopted Functional O&M Overland Compared to O'Loughlin Dollars in Thousands					
Year	Adopted O&M Per Overland	Line 401 Phase-In	1997 Escalation	Other	Adopted O&M Per O'Loughlin
1997	58,253	(1,590)	(1,358)	(57)	55,248
1998	59,732	(1,485)	(1,392)	(63)	56,792
1999	61,250	(1,371)	(1,427)	(71)	58,381
2000	62,803	(1,332)	(1,463)	(74)	59,934
2001	64,398	(1,289)	(1,499)	(79)	61,531
2002	66,034	(1,242)	(1,537)	(84)	63,171
Total	372,470	(8,309)	(8,676)	(428)	355,057

13
14
15
16
17
18
19
20
21
22
23 Sources: Overland Adopted is Revised Overland Table 3-1; O'Loughlin Adopted is MPO
24 Workpaper page 24.
25

26 **Line 401 Phase-In**

27 Q. Mr. O'Loughlin claims the revenue requirements adopted in the GA I settlement excluded
28 roughly half of the Line 401 revenue requirement. Do you agree with that
29 position?

30 A. No. The GA I Settlement unbundled backbone transmission rates by transmission path.
31 The GA I Settlement excluded a portion of the Line 401 revenue requirement from the
32 rates for one of those paths, while fully including the entire Line 401 revenue requirement
33 in the rates for three other paths. The entire Line 401 revenue requirement was used to
34 calculate several rates adopted in the GA I settlement.

35
36 Q. Does the Line 401 phase-in issue raised by Mr. O'Loughlin have any impact on the
37 comparison of adopted and actual capital expenditures?

38 A. No. The issue does not have any impact on adopted or actual capital expenditures.
39

1 Q. Would reducing adopted O&M by 2.5 percent a year, as proposed by Mr. O'Loughlin,
2 increase adopted capital expenditures?

3 A. Yes. The rates adopted in the GA I Settlement recover all of the underlying adopted
4 elements of the cost of service. Reducing adopted O&M, as proposed by Mr. O'Loughlin,
5 increases the amount of the revenues available to support capital expenditures. Adopting
6 Mr. O'Loughlin's position on O&M escalation increases adopted capital expenditures by
7 \$21 million over the GA I period, as shown below.³⁶

8

9

10

11

12

13

14

Table 4-9 Impact of 1997 O&M Escalation On Adopted GA I Capital Expenditures Dollars in Thousands			
Year	Adopted Capex Without 1997 O&M Escalation	Adopted Capex With 1997 O&M Escalation	Increase in Adopted Capex
1997	76,800	73,300	3,500
1998	76,800	73,300	3,500
1999	76,800	73,300	3,500
2000	76,800	73,300	3,500
2001	76,800	73,300	3,500
2002	76,800	73,300	3,500
Total	460,800	439,800	21,000
Sources: Overland Report Table 4-1 and Overland Rebuttal Workpapers. Note: Amounts are shown for illustration purposes and do not reflect the revisions for common plant and NOx plant additions described on page 8.			

15

16

17

18

19

20

21

22

23

24

25

26 Adopting an O&M escalation rate of zero percent in 1997 would reduce adopted O&M by
27 \$8.7 million and increase adopted capital expenditures by \$21 million over the GA I rate
28 period.

29

30

31

³⁶ Overland's methodology for imputing adopted GA I capital expenditures is described in Section 5. The adopted capex amounts without 1997 escalation were calculated by preparing an alternative case using Overland's GA I period capital expenditures imputation model. Overland workpapers 4-1 to 4-4 show the model (without the revisions adopted in Section 3).

Section 5

1997 to 2002 Adopted Capital Expenditures

Q. Are Mr. O’Loughlin’s recommended GA I adopted capital expenditures higher than the amounts recommended by Overland?

A. Yes. Mr. O’Loughlin’s GA I adopted capital expenditures are \$33.8 million higher than the amount recommended by Overland, as shown on the following table.

Table 5-1 Comparison of Adopted Capital Expenditures Overland Revised Compared to O’Loughlin 1997 to 2002 Dollars in Thousands			
Year	Overland	O’Loughlin	Difference
1997	75,200	43,430	31,770
1998	75,200	101,056	(25,856)
1999	75,200	90,916	(15,716)
2000	75,200	84,828	(9,628)
2001	75,200	89,594	(14,394)
2002	75,200	75,200	0
Total	451,200	485,024	(33,824)

Source: Overland Revised Table 4-1 and MPO Workpapers 134 to 137

Q. What issues caused the differences?

A. Overland and Mr. O’Loughlin used different methodologies to impute GA I Capital expenditures. As a result, a detailed reconciliation of the differences by issue is not meaningful.

Q. Please describe the methodology used by Overland.

A. Overland imputed capital expenditures using a standard revenue requirements model to solve for the plant additions that produce the authorized rate of return for each year given revenues equal to the non-Line 401 revenue requirements adopted in the GA I settlement.³⁷

The analysis excludes Line 401 because Line 401 was addressed separately in the GA I Settlement workpapers. Line 401 capital expenditures were assumed to be zero

³⁷ Overland Report page 29. Overland imputed adopted operating expense and other rate base investments for each year in the study period and solved the model for the annual capital expenditure amounts that produced PG&E’s authorized return-on-equity. The calculations are shown on Overland workpapers 4-1 to 4-4.

1 Q. Mr. O'Loughlin cites the GA I Settlement rate design workpapers as support for
2 escalating net plant and depreciation expense at the same rate as the adopted GT&S
3 rates. Do those workpapers justify Mr. O'Loughlin's position?

4 A. No. The rate design workpapers cited by Mr. O'Loughlin do not show net plant or rate
5 base values. All of the cost of service elements shown on those schedules, including
6 depreciation and return on rate base, escalate at the same rate as the overall revenue
7 requirement, with the exception of Line 401 costs and NOx capital additions.⁴⁵ The cost
8 elements that largely reflect sunk costs, such as depreciation and return on rate base,
9 increase at the same rate as the cost elements for current expenditures.

10

11 As explained in Section 4, the rates of increase in the individual non-Line 401 cost
12 elements shown on the rate design workpapers did not have any impact on the interests
13 of the Commission or the parties because they did not have any impact on rates or
14 services.

15

16 Escalating depreciation and return-on-rate base at the same rate as O&M is contrary to
17 sound cost-of-service principles. The year-to-year rates of increase in the individual non-
18 Line 401 cost elements shown on the rate design workpapers were superfluous and
19 contrary to sound cost-of-service principles. The annual rates of change for each
20 individual cost element should not be construed as adopting a specific escalation factor
21 for that cost element.

22

23 Q. Did the escalation rates used by Mr. O'Loughlin cause his adopted capital expenditure
24 amounts to be overstated?

25 A. No. Overland's adopted capital expenditure amounts for 1997 to 2002 are \$34 million
26 lower than Mr. O'Loughlin's adopted amounts. That difference is consistent with the fact
27 that net plant consists largely of sunk costs that are not subject to inflation.

28

29 **O'Loughlin Criticisms of Overland Approach**

30 Q. Does Mr. O'Loughlin dispute the validity of Overland's basic approach?

31 A. Not entirely. Page 49 of Exhibit__(MPO-1) indicates:
32

⁴⁵ The rate design workpapers are reproduced on Exhibit__(MPO-14). See pages 18-3, 18-15, 18-27, 18-27 and 18-39, 18-51 and 18-63.

Table 10-5
GA IV Adopted Capital Expenditures
Per O'Loughlin
2008 to 2010
Dollars in Thousands

Description	2008	2009	2010
Year End Net Plant	1,716,655	1,717,794	1,719,652
Net Plant - Beginning	1,712,371	1,716,655	1,717,794
Increase in Net Plant	4,284	1,139	1,858
Depreciation Expense	85,388	85,465	85,550
Total Before LT Plant Adders	89,672	86,604	87,408
Local Transmission Plant Adders	0	71,600	0
Rounding	1	(1)	0
Total Capex per MPO	89,673	158,203	87,408

Source: MPO workpapers, page 137

17 Q. Is Mr. O'Loughlin's approach valid?

18 A. No. The starting point for Mr. O'Loughlin's calculations are his adopted net plant and
19 depreciation expense amounts for 2007. Those amounts were determined, in turn, by
20 escalating his adopted 2005 net plant and depreciation expense values using the same
21 approach.

22
23 Mr. O'Loughlin's adopted capital expenditure values for 2006 through 2010 are all based
24 on the 2005 net plant and depreciation expense values adopted in the GA III Settlement.

25 Those values reflected PG&E's plans for a single year, calendar year 2005. Mr.

26 O'Loughlin's approach cannot, and does not, reflect PG&E's capital expenditure plans for
27 2008, 2009 and 2010, as they existed in March 2007 when the Settlement Agreement
28 was signed.

29
30 The rate commitments made in the GA III Settlement Agreement expired on December
31 31, 2007. The decisions to propose, agree upon and approve the rates adopted in the GA
32 IV Settlement were based on the decision makers perceptions of the current cost of
33 providing service when those decisions were made, not the cost of providing service in
34 2005.

35
36 Q. Are Mr. O'Loughlin's adopted depreciation expense values consistent with the GA IV
37 Settlement Agreement?

38 A. No. The following table shows the average depreciation rates produced by Mr.
39 O'Loughlin's adopted depreciation expenses and mid-year gross plant values.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15

Year	Mid-Year Gross Plant	Depreciation Expense	Depreciation Rate
2005	2,918,339	81,732	2.80
2006	3,003,200	83,277	2.77
2007	3,090,540	84,852	2.75
2008	3,162,921	85,388	2.70
2009	3,228,558	85,465	2.65
2010	3,294,374	85,550	2.60

Source: MPO workpapers, pages 136 and 137

16 Mr. O'Loughlin's average adopted depreciation rate decreases each year from 2005 to
17 2010. Section 8.7 of the GA IV Settlement Agreement states:

18
19 During the term of this agreement, PG&E will continue to use the depreciation
20 parameters used in the Gas Accord III Settlement and approved in D.04-12-050.⁸⁶
21

22 PG&E's Application and Request for Approval of the GA IV Settlement indicates "Section
23 8.7 states that PG&E will not change its depreciation parameters during the settlement
24 period." Mr. O'Loughlin's assumption that depreciation rates will decline in every year of
25 the settlement period is inconsistent with the Settlement Agreement.
26

27 Q. Does reducing depreciation rates between rate cases harm ratepayers?

28 A. Yes. As explained in Section 5, reducing depreciation rates between rate cases harms
29 ratepayers.
30

31 **Local Transmission Adder Projects**

32 Q. Mr. O'Loughlin accounted for the local transmission adder projects separately. Please
33 explain how the local transmission adder projects were addressed in the GA IV
34 Settlement.

35 A. Section 8.4 of the Settlement Agreement adopts contingent rate surcharges for five local
36 transmission projects. The amount of the surcharge for each project was fixed in the
37 Settlement. The settlement authorizes PG&E to implement the surcharges for each of the
38 projects on January 1 of the year following the year in which the individual projects
39
40

⁸⁶ D.04-12-050 is the decision that approved the Gas Accord III Settlement.

1 Section 7.2.11 is titled Capital Projects with Post-2014 In-Service Dates. That section
2 states:

3
4 Various projects in PG&E's capital expenditures plan have in-service dates after
5 2014 (e.g, the Burney K-2 replacement project). Those projects have no impact
6 on the Settlement revenue requirement and nothing in this Settlement shall be
7 construed as endorsement of the reasonableness and/or approval of any such
8 project.
9

10 The projects with post-2014 completion dates, including the Burney K-2 replacement
11 project, are included in the adopted capital expenditures plan shown in Section 7.2 of the
12 Settlement Agreement.⁸⁹ The expenditures for those projects are shown in the year in
13 which the expenditures are expected to occur, not the year in which the project is
14 expected to be completed. That demonstrates: (1) adopted capital expenditures are
15 recognized in the year that they are incurred; and (2) the recognition of adopted capital
16 expenditures does not depend on their inclusion in rates during the settlement period.
17

18 Q. Is Mr. O'Loughlin's approach inconsistent with the approach he took for other multi-year
19 projects?

20 A. Yes. For 2004, Mr. O'Loughlin's adopted capital expenditures reflect the 2004 capital
21 expenditures adopted in the 2004 Test Year GT&S rate case. Those adopted capital
22 expenditures include several projects that began in 2003 and were expected to be
23 completed in 2004.⁹⁰ Mr. O'Loughlin did not include the entire completion cost of those
24 projects in his adopted 2004 capital expenditures. Instead, he only included the amounts
25 that were expected to be expended during calendar year 2004 in his adopted 2004
26 capital expenditures.
27

⁸⁹ The Burney K-2 Gas Turbine Replacement Project is shown on PG&E capital expenditures workpaper 6-5. PG&E expected the project to have \$15.5 million in capital expenditures in 2014. PG&E's forecasted completion date for the project was December 31, 2015. The project is included in MWC 76 Station Reliability. Section 7.2 of the Settlement Agreement lists the adjustments that were made to PG&E's capital expenditures forecast to derive the adopted capital expenditures plan shown in that section. Section 7.2 does not make any adjustments to PG&E's capital expenditures forecast to exclude the Burney K-2 replacement project from the adopted capital expenditures.

⁹⁰ For example, the 2004 Test Year Decision did not adopt any adjustments to PG&E's 2004 capital expenditures forecast for MWC 12, Environmental Projects (See Overland workpaper 4-8). Page 2 of PG&E's capital expenditures workpapers for that case show the details of its MWC 12 forecast. The forecasted capital expenditures for MWC 12 include two projects with the title "Frame 3 Unit Replacement, Delevan Comp. Willows." Those projects are described on page 12 of PG&E's capital expenditure workpapers. The combined forecasted expenditures for the two projects are \$5 million in 2003 and \$23 million in 2004. Mr. O'Loughlin's 2004 adopted capital expenditures only include the \$23 million that was forecasted for 2004.

Section 14

Actual Functional O&M Expenses

- 1
2
3
4 Q. Have you prepared a table that compares Overland's actual functional O&M expenses to
5 Mr. O'Loughlin's values?
6 A. Yes. Functional O&M consists of production, transmission and storage O&M. The
7 following table compares Overland's actual (recorded) functional O&M amounts to Mr.
8 O'Loughlin's amounts.¹¹¹
9

Table 14-1
Actual Functional O&M Expenses
Comparison of Overland and O'Loughlin Amounts - 1997 to 2010
Excludes Customer Accounts and Sales Expenses
Dollars In Thousands

Year	Actual O&M Per Overland	Account 819 Storage - Fuel	Account 855 Trans - Fuel	San Bruno Incident	Form 2 And Rounding	Actual O&M Per MPO
1997	56,936	(129)	0	0	(26)	56,781
1998	64,160	(723)	0	0	1	63,438
1999	56,348	(808)	0	0	1	55,541
2000	59,378	(1,404)	0	0	0	57,974
2001	66,815	(3,713)	0	0	1	63,103
2002	64,189	(2,370)	0	0	(1)	61,818
2003	65,245	(1,561)	0	0	0	63,684
2004	70,749	(1,398)	0	0	0	69,351
2005	74,819	0	0	0	0	74,819
2006	75,615	0	0	0	(198)	75,417
2007	77,854	0	0	0	0	77,854
2008	81,991	0	286	0	1	82,278
2009	86,902	0	303	0	0	87,205
2010	80,103	0	1,388	21,775	0	103,266
Total	981,104	(12,106)	1,977	21,775	(221)	992,529

Sources: Revised Overland Table 3-1, Overland Workpaper 3-7 and MPO Workpapers, page 39

33
34 **Account 819 - Storage Compressor Fuel**

- 35 Q. Why did Mr. O'Loughlin exclude a portion of Account 819 from his actual O&M expenses
36 in 1997 to 2004?
37 A. Account 819 is Storage Compressor Station Fuel and Power. Account 819 includes two
38 types of costs, electricity for electric compressor units and gas for gas-fueled units. Mr.
39 O'Loughlin excluded the gas cost portion of Account 819 from his actual O&M expenses
40 in 1997 to 2004. He excluded account 819 gas costs from actual O&M "because

¹¹¹ The Form 2 and Rounding column includes two types of differences. First, the amounts for some FERC O&M accounts reported in PG&E's 1997 and 2006 FERC Form 2 reports did not agree with the amounts PG&E reported in the response to OC-296 for those accounts. The starting points for Overland's actual O&M expenses in those years agree with the FERC Form 2, Mr. O'Loughlin's do not. The differences shown for the other years are rounding differences.

Table 15-3
Actual Customer Accounts and Sales Expenses Difference
By Account
1999 to 2003
Dollars in Thousands

Description	Account 903	Account 912	Total
Per Overland	6,962	5,605	12,567
Per O'Loughlin	0	32,958	32,958
Difference	6,962	(27,353)	(20,391)

Source: Overland Revised ROE Analysis and MPO Workpaper Page 38

11

12 Q. Why did Mr. O'Loughlin exclude Account 903 from his actual costs during 1999 to 2003?

13 A. Customer Accounts expenses are recovered through the Customer Access Charge. As
14 discussed in Section 13, Mr. O'Loughlin's theory is that CAC costs were excluded from
15 the revenue requirements and O&M costs adopted in the GA I Settlement. He excluded
16 Customer Accounts expenses from his actual expenses for 1999 to 2003 to match the
17 scope of his adopted amounts.¹²²

18

19 Q. Should Customer Accounts expenses be excluded from actual O&M during the GA I
20 Period?

21 A. No. As explained in Section 13, Mr. O'Loughlin's theory about the treatment of CAC costs
22 in the GA I Settlement is incorrect. Customer Accounts expenses were included in the
23 CAC revenue requirement adopted in the GA I Settlement and were recovered through
24 GT&S rates. Accordingly, Customer Accounts expenses should be included in GA I
25 Period actual costs.

26

27 Q. Why did Overland exclude Sales expenses from actual O&M during 1999 to 2002?

28 A. The rates adopted in the GA I Settlement were based on the gas department revenue
29 requirements approved in PG&E's 1996 General Rate Case (GRC). The Commission
30 denied PG&E's request to include Sales expenses in rates in the 1996 GRC.

31

32 The rates adopted in the 1996 GRC were approved in D.95-12-055. Table 8 of Appendix
33 C to that decision is titled Gas Department Marketing Expenses Summary. That table
34 shows PG&E's requested amount of \$5.6 million for Account 912 and an adopted amount
35 of zero for that account. Account 912 is shown under the heading "Market
36 Building/Market Retention Exp."

37

¹²² Exhibit ___(MPO-3), pages 13 to 15.

Section 17

Actual Return On Equity - Income Tax Normalization Policy

Q. Please walk me through the methodology that Mr. O’Loughlin used to calculate the actual return on equity earned by GT&S operations?

A. Mr. O’Loughlin used a multi-step process to calculate the actual return on equity. The steps are shown in the following table.¹³⁴

Table 17-1 O’Loughlin Process for Calculating Actual Return On Equity	
Step	Description
1	Calculate the “Actual Revenue Requirement” using the authorized rate-of-return.
2	Calculate surplus revenues by subtracting the actual revenue requirement from actual revenues.
3	Calculate the income tax liability associated with the surplus revenues by applying statutory income tax rates to the surplus revenues.
4	Calculate surplus operating income by subtracting the income tax liability from the surplus revenues.
5	Calculate surplus rate of return by dividing the surplus operating income by the actual rate base.
6	Calculate the surplus return on equity by dividing the surplus rate of return by the authorized equity ratio.
7	Calculate the actual return on equity by adding the surplus return on equity to the authorized return on equity

Q. Have you prepared a table that illustrates Mr. O’Loughlin’s calculations?

A. Yes. The following table summarizes Mr. O’Loughlin’s calculations for 2008, 2009 and 2010.

¹³⁴ The steps reflect Overland’s distillation of the process shown on pages 13 and 16 of Exhibit__(MPO-7).

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19

Table 17-2 Actual Return On Equity Calculations Per O'Loughlin 2008 to 2010 Dollars in Thousands			
Description	2008	2009	2010
Actual Revenues	498,851	514,934	508,524
Actual Revenue Requirement	449,367	469,066	498,486
Surplus Revenues	49,484	45,868	10,038
Statutory Tax Rates (combined)	0.407460	0.407460	0.407460
Income Tax on Surplus Revenue	20,163	18,689	4,090
Surplus Operating Income	29,321	27,179	5,948
Actual Rate Base	1,502,153	1,533,564	1,605,476
Surplus Rate of Return	1.9520	1.7723	0.3705
Authorized Equity Ratio	0.520	0.520	0.520
Surplus Return on Equity	3.7538	3.4082	0.7125
Authorized Return On Equity	11.350	11.350	11.350
Actual Return on Equity per MPO	15.1	14.8	12.1
Source: Exhibit__(MPO-7), page 16 and MPO Workpapers, page 173			

20
21 Q. Are the mechanics of Mr. O'Loughlin's multi-step process sound?

22 A. Yes. However, the accuracy of the results depends on the accuracy of the actual
23 revenues and actual revenue requirement used in the calculations. Mr. O'Loughlin's
24 actual revenue requirements amounts are the product of a defective methodology.
25 Consequently, his results are not accurate.

26
27 Q. How did Mr. O'Loughlin calculate his "actual revenue requirements"?

28 A. Mr. O'Loughlin used the following multi-step process to calculate the actual revenue
29 requirement.¹³⁵

30
31
32
33
34
35
36

¹³⁵ The steps shown below reflect Overland's distillation of the calculations shown on Exhibit__(MPO-7),
page 16.

Section 18
Surplus Revenues

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27

Q. On page 7 of his testimony, Mr. O'Loughlin indicates that the actual ROE for PG&E's GT&S operations averaged 14.6% during 1999 to 2010. Is that similar to what you found?

A. Yes. As shown on Overland Revised Table 5-1, the actual ROE for PG&E's GT&S operations averaged 14.3% during the same period.¹⁴⁵ The difference between the two ROE figures is due to the income tax normalization issue discussed in Section 17, and all of the other errors Mr. O'Loughlin made when determining actual revenues and expenses. The largest of those errors were: (1) excluding \$29.7 million in customer access charge revenues from actual revenue in 1999 to 2002; (2) including \$27.4 million of disallowed Sales expenses in actual O&M during 1999 to 2002; and (3) including \$21.8 million in non-recoverable SBI expenses in his actual O&M for 2010.¹⁴⁶

Q. On page 60 of his testimony, Mr. O'Loughlin indicates that GT&S's high ROEs are entirely the result of actual revenues exceeding adopted revenues. Do you agree with that conclusion?

A. No. Mr. O'Loughlin determined that actual GT&S revenues exceeded the amount needed to earn the authorized ROE by \$479.5 million during the period 1999 to 2010.¹⁴⁷ He also claims that actual revenues exceeded adopted revenue requirements by \$515.5 million during the same period.¹⁴⁸ Based largely on that comparison, Mr. O'Loughlin concludes that all of PG&E's excess earnings were the result of actual revenues exceeding adopted revenues. That conclusion is invalid because his comparison of actual and adopted revenues is invalid.

¹⁴⁵ Section 3, Overland Revised Table 5-1. The tables in Section 3 show both the original table number from the Overland Report and a new table number the corresponds with the sequence of tables in Section 3. Overland Revised Table 5-1 is also Table 3-5 in Section 3. Overland acknowledges that having two different table numbers on the same table is somewhat confusing.

¹⁴⁶ Sections 13, 14 and 15.

¹⁴⁷ Exhibit__ (MPO-1), page 66.

¹⁴⁸ Exhibit__ (MPO-1), page 64.

- 1 Q. Page 5-3 of Overland's report cites four factors that contributed to the high ROE earned
2 by GT&S operations during the study period. Do those factors remain valid?
- 3 A. Yes. Overland's revised tables changed the amounts cited in the first and third factors
4 shown on Page 5-3 of the Overland Report by relatively modest amounts.¹⁵¹ Those
5 changes do not change the substance of Overland's findings.
6

¹⁵¹ The revenue difference cited in the first factor changes from \$224 million to \$244 million. The 1997 to 2000 capex difference cited in the second factor changes from \$94 million to \$102 million.

1 In other words, PG&E was allowed to retain excess storage profits as compensation for
 2 transmission cost recovery risks assigned to PG&E in the Gas Accord Settlements. The
 3 Joint Testimony is another clear indication of the linkage between the treatment of
 4 storage profits and transmission cost recovery.

5
 6
 7 Q. Has the Commission shared storage profits with core and other firm transmission
 8 customers in cases involving other utilities?

9 A. Yes. SoCalGas has shared the net revenues produced by its “unbundled storage
 10 program” with on-system (core and non-core) transmission customers for many years.¹⁷²
 11 SoCalGas’s unbundled storage program services are comparable to PG&E’s “at-risk”
 12 storage services. Net revenues are the difference between gross revenues and the cost
 13 of providing service. The SoCalGas sharing mechanism is consistent with the linkage
 14 between storage profits and transmission cost recovery.

15
 16 Q. Is assigning excess storage profits to transmission customers fair?

17 A. Yes. PG&E’s “at-risk” storage business is essentially a parking and lending business
 18 that makes extensive use of PG&E’s transmission and storage facilities. Parking and
 19 lending services are short-term opportunity transactions. The park and lend
 20 transactions are typically short-term in duration and depend on the spread between
 21 expected gas prices in different seasons of the year.¹⁷³

22
 23 The customer groups that pay for a system should be credited with the benefits
 24 produced by that system, including margins made on short-term opportunity
 25 transactions. Crediting parking and lending margins to firm transmission (and core)
 26 customers is fair because the rates they pay recover almost all of the fixed costs of
 27 PG&E’s transmission and storage system.¹⁷⁴

¹⁷² OCHP-38.

¹⁷³ OCHP-5 and 6.

¹⁷⁴ The purpose of a sharing margins made on short-term opportunity transactions with shareholders is to provide the utility with an incentive to actively market those services. The sharing mechanism benefits ratepayers if the increase in total net margins produced by the incentive exceeds the amount of the profits retained by shareholders. Sharing can also benefit consumers by stimulating active market participation by the utility.