**BEFORE THE PUBLIC UTILITIES COMMISSION**

**OF THE STATE OF CALIFORNIA**

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| 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. | R.11-02-019<br>(Filed February 24, 2011) |

# REPLY COMMENTS OF SOUTHERN CALIFORNIA GAS COMPANY (U 904 G) AND SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M) ON PROPOSED DECISION MANDATING PIPELINE SAFETY IMPLEMENTATION PLAN

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Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E) submit the following Reply Comments on the Proposed Decision Mandating Pipeline Safety Implementation Plan, Disallowing Costs, Imposing Earnings Limitations, Allocating Risk of Inefficient Construction Management to Shareholders, and Requiring On-Going Improvement in Safety Engineering (Proposed Decision) pursuant to Rule 14.3 of the Commission's Rules of Practice and Procedure.

## I. INTRODUCTION AND SUMMARY

In opening comments, SoCalGas and SDG&E explain why the Proposed Decision, which denies cost recovery for pressure testing pipelines installed after 1956, is in error and would be prejudicial to SoCalGas and SDG&E, if adopted without considering the additional evidence presented in connection with SoCalGas and SDG&E's plan. To avoid such a result, SoCalGas and SDG&E asked the Commission to not pre-determine issues in this proceeding that are also before the Commission in their Triennial Cost Allocation Proceeding (TCAP) and instead make a determination with respect to the overlapping issues only after it has considered the record evidence from the TCAP.[1]

[1] These issues, as SoCalGas and SDG&E explained, all relate to intervenors' "shareholder responsibility" and "disallowance" proposals, as well as related determinations regarding the existence of pressure testing and recordkeeping requirements for pre-1970 vintage pipelines, the effect of missing records, and the policy determination of whether the Commission should allow the "grandfathering" of pre-1970 pipelines that have not been pressure tested to modern Subpart J standards.

Pacific Gas and Electric Company's (PG&E) opening comments to the Proposed Decision supports that result. There, PG&E expressly states that it does not oppose the disallowance of pressure testing costs for pipelines installed after 1955 as an "additional shareholder contribution."[2] Because of this, there is no reason for the Commission to predetermine these issues on PG&E's incomplete record and run the risk of violating SoCalGas and SDG&E's due process rights and/or rendering inconsistent judgments in parallel proceedings.

The comments that follow also respond to assertions by The Utility Reform Network (TURN) that D.11-06-017 does not require natural gas pipeline operators to test or replace older pipelines to satisfy modern safety standards, address arguments by TURN and the Division of Ratepayer Advocates (DRA) that section 463 of the Public Utilities Code requires the Commission to comprehensively disallow PG&E's recovery of any Implementation Plan costs, refute claims by DRA and the City and County of San Francisco that the Proposed Decision incorrectly applies the burden of proof, and oppose an incentive credit proposal submitted by Northern California Indicated Producers (NCIP).

## II. DISCUSSION

### A. To Preserve the Integrity of its Administrative Process, the Commission Should Refrain from Adopting Determinations on Unopposed Legal and Factual Issues.

The Proposed Decision excludes the costs of pressure testing pipelines installed between 1956 and 1961 where pressure test records are missing because "PG&E undertook or stated that it undertook to comply with industry standards but no longer possesses the records of such compliance."[3] According to the Proposed Decision:

> The evidentiary record supports the factual finding that from 1956 on, PG&E's practice was to comply with then-applicable industry standards for pre-service pressure testing, and that retaining records of such testing was part of the industry standard. As it was PG&E's practice to incur these pre-service test costs, we would expect that absent unusual circumstances such costs would be included in revenue requirement and recovered from ratepayers."[4]

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2 PG&E Opening Comments at 3.

3 Proposed Decision at 60.

4 *Id.* at 61.

In Opening Comments, PG&E affirms that although it does not necessarily agree with this outcome, it does not oppose the disallowance of recovery of costs for pressure testing pipelines installed after 1955, and that it accepts them as an "additional shareholder contribution."[5]

As explained in our Opening Comments, the Commission elected to consider SoCalGas and SDG&E's proposed pipeline safety plan in a separate proceeding, after considering PG&E's plan in this proceeding. While this process enables the Commission to analyze the plans of each utility on their own separate merits, it is not without risks. If findings and conclusions that the Commission makes with respect to PG&E's proposed plan, and the requirements and rate treatment that the Commission establishes for PG&E, are treated as precedent for SoCalGas and SDG&E, then SoCalGas and SDG&E's due process rights will have been violated. On the other hand, if findings and conclusions the Commission makes with respect to PG&E's proposed plan are not treated as precedent for SoCalGas and SDG&E, then the Commission runs the risk of rendering inconsistent judgments.

The risk of violating SoCalGas and SDG&E's due process rights and/or rendering inconsistent judgments in parallel Commission proceedings is even greater where, as here, the Proposed Decision incorporates factual and legal determinations of issues that are no longer disputed by PG&E in this proceeding, but are disputed by SoCalGas and SDG&E in the TCAP. As described in our Opening Comments, SoCalGas and SDG&E do dispute the validity of the Proposed Decision's findings with respect to recovery of pressure testing costs for pipelines installed after 1955. Indeed, unlike PG&E, SoCalGas and SDG&E submitted extensive evidence from both in-house and outside experts regarding historic pressure testing requirements, historic recordkeeping requirements and other related factual issues in the TCAP. That evidence in the record of the TCAP refutes the factual and legal determinations of these issues rendered in the Proposed Decision, without the benefit of that detailed record.

Where a matter is not opposed or in dispute, it makes little sense for the Commission to risk violating the due process rights of a party or to risk rendering inconsistent judgments in parallel Commission proceedings. Accordingly, SoCalGas and SDG&E urge the Commission to revise the Proposed Decision to refrain from articulating broad factual and legal conclusions with respect to overlapping issues, such as pipelines installed after 1955, that may arguably pre-determine issues

5 PG&E Opening Comments at 2.

that are in dispute in the TCAP. These issues should only be determined after the evidence in the TCAP has been considered.

### B. Decision 11-06-017 Directs Natural Gas Pipeline Operators to Test or Replace Pipelines Segments not Previously Tested to Modern Standards.

In opening comments, TURN erroneously states that "it is undisputed that any post-1955 pipeline segments would not be in the PSEP unless PG&E had imprudently failed to retain the pressure test records required by industry standards and applicable regulations."[6] TURN's argument is based on a misreading of D.11-06-017. According to TURN, D.11-06-017 required natural gas pipeline operators to "document test pressures," and that if PG&E could produce "the requisite pressure test record, there would be no need to replace any pipe in the PSEP."[7] Based on its misreading of D.11-06-017, TURN asks the Commission to delete language in the Proposed Decision stating that "[n]otwithstanding compliance with historic standards, PG&E should evaluate these pipeline segments in later Phases of the Implementation Plan."[8]

As discussed in our Opening Comments, the Commission ordered in D.11-06-017 that *all* transmission pipelines must now be tested to modern standards, and that "[h]istoric exemptions must come to an end . . ."[9] The Commission was not ambiguous or ambivalent with respect to this directive. Ordering Paragraph 4 of D.11-06-017 specifically directs all California natural gas pipeline operators to file proposed plans "to comply with the requirement that all in-service natural gas transmission pipeline in California has been pressure tested in accord with 49 CFR 192.619, excluding subsection 49 CFR 192.619 (c)," a regulation that did not exist prior to 1970.[10] Thus, D.11-06-017 expressly requires that all pipelines installed prior to 1970 be either pressure tested or replaced in order to satisfy modern regulatory requirements.

Ordering Paragraph 3, which states that "[a] pressure test record must include all elements required by the regulations in effect when the test was conducted," does not negate the Commission's express directive in Ordering Paragraph 4, as suggested by TURN. Rather, Ordering Paragraph 3 provides guidance to the utilities for carrying out the Commission's directives in

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6 TURN Opening Comments at 11.
7 *Id.* at 12.
8 *Id.* at 19 (quoting D.11-06-017 at 61, n. 48).
9 D.11-06-017. at 18.
10 D.11-06-017 at 31, Ordering ¶ 4.

Ordering Paragraphs 1 and 2, which directed PG&E to complete its MAOP validation effort and SoCalGas and SDG&E to complete their review of records in response to the National Transportation Safety Board's safety recommendations, respectively. Consistent with this plain reading of the Commission decision, SoCalGas and SDG&E, in their plan, prioritized pipelines segments for further action based on the review of pressure test documentation conducted in response to the NTSB's safety recommendations, and did not assume that the Commission would allow natural gas pipeline operators to continue to exempt older "grandfathered" pipelines segments from satisfying modern safety standards and the requirements of Ordering Paragraph 4.

### C. Section 463 Does Not Require Shareholders to Shoulder the Costs of Complying with the Commission's New Safety Regulations.

TURN and DRA both argue that section 463 of the Public Utilities Code requires the Commission to disallow PG&E's recovery of any costs of implementing the Commission's directives in D.11-06-017. TURN claims, "Section 463(a) is clear that the Commission 'shall disallow' 'direct or indirect' costs resulting from a utility's errors or omissions."[11] DRA argues that "[t]here should be no question that pursuant to § 463 (which, as noted above, merely clarified § 451), the Commission must disallow all PSEP costs, direct or indirect, associated with PG&E's errors or omissions in the operation of its gas system."[12] The Proposed Decision correctly determines that both TURN and DRA are wrong.

In considering the arguments raised by TURN and DRA that section 463 prohibits PG&E from recovering any costs related to its Implementation Plan, the Proposed Decision determines that "[t]he public utility code standards for rate recovery, i.e. just and reasonable, and the disallowance concept reflected in § 463 do not combine to provide an analytical basis for disallowing reasonable costs on the basis that the utility should have made the expenditures at an earlier date."[13] The Proposed Decision further explains that:

> section 451 of the public utility code requires that public utility rates be just and reasonable, and section 463 states that costs associated with an 'unreasonable error or omission related to planning, construction, or operation' of utility plant be excluded from revenue requirement.

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11 TURN Opening Comments at 9.

12 DRA Opening Comments at 16-17.

13 Proposed Decision at 55 (quoted in DRA Opening Comments at 17.)

The Proposed Decision is correct. Where, as here, the costs result from a Commission decision directing the State's natural gas utilities to submit proposed plans for bringing aged pipelines up to modern standards of safety, those costs are not the result of unreasonable errors or omissions. In fact, Section 463 (added to the Public Utilities Code in 1985) only applies to additions of capital plant in excess of $50 million[14] and requires the Commission to review the reasonableness of a utility's management of and expenditures on the project and disallow, if applicable, project expenditures that result from "unreasonable error or omission related to the planning, construction, or operation" of the project "including any expense resulting from delays caused by any unreasonable error or omission." The definitions of key terms, such as "error" and "omission," found in the statutes make clear that Section 463's focus is on *new* construction, not construction that occurred at least 15 years before the statute was even adopted. Thus, the Proposed Decision correctly concludes that the Commission should not comprehensively disallow PG&E from recovering the reasonable costs of enhancing its natural gas transmission system to achieve the Commission's heightened safety objectives.

**D. The Proposed Decision Correctly Applies the Burden of Proof.**

The Proposed Decision correctly states that "PG&E must meet the burden of proving that it is entitled to the relief sought in this proceeding, and PG&E has the burden of affirmatively establishing the reasonableness of all aspects of the application."[15] No parties dispute the validity of this determination. Instead, DRA in its Opening Comments argues that the Proposed Decision "commits legal error by adopting the less stringent preponderance of the evidence standard" rather than the "more stringent" clear and convincing standard.[16] In addition, CCSF and DRA each contend that the Proposed Decision improperly shifts that burden of proof from PG&E to intervenors.[17] Both arguments lack merit.

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14 The statute – a result of PG&E's "mirror image" problem at Diablo Canyon – does not apply to related projects that together total more than $50 million if the individual projects themselves are each less than $50 million. *See* D.87-12-066 at 434, Conclusion of Law ¶ 61.

15 Proposed Decision at 42 (*citing* D.08-12-058).

16 DRA Opening Comments at 21.

17 *See* DRA Opening Comments at 22; CCSF Opening Comments at 6.

### 1. The Proposed Decision Applies the Correct Evidentiary Standard in Assessing Whether PG&E Met its Burden of Proof.

DRA strains to find Commission precedent to support its contention that the Commission must apply a clear and convincing evidentiary standard in this case. DRA quotes dicta from a decision reached in an investigation launched by the Commission in 1984 into "the Maintenance and Operating Practices, Safety Standards and the Reasonableness of Costs Incurred from the Mohave Coal Plant Accident."[18] In that decision, the Commission refused to adopt Southern California Edison Company's (SCE) proposed "professional negligence standard" instead of a "reasonableness standard," when reviewing SCE's conduct. The issue of the applicable *evidentiary* standard was not before the Commission at that time, as illustrated by a more complete quote from that decision:

> SCE relies on Osborn v. Irwin Memorial Blood Bank for its argument that the professional negligence standard should apply here. This reliance on Osborn is misplaced. Osborn is a civil case determining tort liability for personal injuries resulting from a blood transfusion. The case before us examines whether SCE may be reimbursed through rates for expenses incurred as a result of the Mohave accident. That the facts of the incident at Mohave could have given rise to tort litigation does not transform this review of the reasonableness of utility expenditures into a tort case. Commission cases reviewing utility conduct for purposes of reimbursement consistently require that conduct meet a standard of reasonableness. Utility expenses, whether from contracts, accidents, or other sources, are reviewed under this standard. The standard was clarified in an earlier review of SCE's expenditures and has been reaffirmed many times. In D.83-05-036, we explained:
>
> > "the fundamental principle involving public utilities and their regulation by governmental authority is that the burden rests heavily upon a utility to prove it is entitled to rate relief and not upon the Commission, its staff or any interested party . . . to prove the contrary. Unless SCE meets the burden of proving, with clear and convincing evidence, the reasonableness of all the expenses it seeks to have reflected in rate adjustments, those costs will be disallowed."[19]

DRA goes on to cite decisions from PG&E's 1999 General Rate Case, where the Commission applied a clear and convincing evidentiary standard, but acknowledges that "the Commission has recently deviated from the clear and convincing standard in at least two rate cases."[20] Although DRA repeatedly refers to "longstanding [Commission] precedent of applying a higher standard for rate cases," PG&E's 1999 General Rate Case is the only ratemaking case cited to

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[18] I.86-04-002.

[19] D.94-03-048 at 34-35.

[20] DRA Opening Comments at 21.

support its contention. DRA acknowledges that the most recent decisional authority on this topic applies the preponderance of the evidence standard, but nevertheless argues [i]t is legal error for the Commission to change the long-standing standard of proof for rate cases without any rationale" and that "[i]t is also legal error to continually move the ball on the standard of proof issue."[21]

The California Evidence Code provides that "except as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence."[22] This is the correct standard applied in the Proposed Decision, and is consistent with more recent Commission precedent. Indeed, the Commission has previously explained why older precedent may appear inconsistent on this issue. In rejecting a challenge of its application of the preponderance of the evidence standard in SDG&E's Sunrise Powerlink Case, the Commission "decline[d] to adopt the clear and convincing evidence standard for SDG&E's application, adopting the more common preponderance standard," and distinguished prior precedent that purportedly applied the clear and convincing standard, explaining that in those older cases it was "unclear whether the Commission means 'clear and convincing' in a lay sense, or is actually adopting the more technical 'clear and convincing' standard."[23]

### 2. The Proposed Decision Correctly Determines that Once PG&E Met the Burden of Proving the Reasonableness of its Plan and Related Costs, Intervenors Bore the Burden of Proving a Basis for Disallowing Recovery of those Costs.

DRA and CCSF each argue that the Proposed Decision inappropriately shifts the burden of proof from PG&E to intervenors.[24] These contentions are without merit.

DRA claims that the Proposed Decision errs by evaluating the weight of the evidence and concluding that PG&E's cost estimates are reasonable, despite evidence of lower costs presented by DRA. However, DRA's argument ignores the facts presented by PG&E on this issue, and set forth in the Proposed Decision, that the assigned hearing officer found persuasive:

- PG&E's cost estimates were based on actual data from pressure tests of its gas system analyzed by experienced engineers.

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21 DRA Opening Comments at 22.

22 California Evidence Code Section 115; *see also* D.09-07-024 at 3 *citing* California Administrative Hearing Practice, 2d Edition (2005), 365 (the "preponderance standard is the default standard in administrative proceedings").

23 D.08-12-058 at 3.

24 *See* DRA Opening Comments at 22-23; CCSF Opening Comments at 6-8.

- DRA's estimates relied on pressure test cost estimates in sets of industry data that showed very broad cost ranges and lacked detail on important pipeline attributes.
- DRA's cost estimates did not include costs for pre-cleaning the pipeline.[25]

Based on the weight of the evidence in the record, the Proposed Decision finds "DRA's analysis is insufficient to overcome PG&E's actual cost experience of pressure testing natural gas pipeline in its natural gas system."[26] Thus, the Proposed Decision did not improperly shift the burden of proof to DRA, as contended by DRA. Rather, the Proposed Decision weighed the evidence and determined that the evidence presented by PG&E was more persuasive.

CCSF contends that while "the Proposed Decision correctly states that PG&E has the burden of affirmatively establishing the reasonableness of all aspects of the application,"[27] it errs by shifting that burden to intervenors in assessing whether to impose a disallowance of reasonable costs.[28]

CCSF's argument fails because, as previously explained by the Commission, "where other parties challenge the utility's showing, such parties have the burden of producing evidence in support of such challenge and in support of adoption of their recommended ratemaking disallowance or adjustment."[29] Moreover, where an intervenor "allege[s] that the utility has violated a statute, rule, general order, or tariff, the ultimate burden of proof regarding existence of the violation and the appropriate penalty to be imposed rests with the party alleging the violation and seeking the penalty."[30] Therefore, the Proposed Decision applies the appropriate burden of proof in assessing intervenor disallowance proposals.

### E. The Commission Should Not Adopt NCIP's Interruption Credit Proposal.

NCIP asserts that the Commission should adopt a service disruption credit of 25¢ per therm of gas curtailed or diverted for customers with qualifying service interruptions, not noticed by at least 30 days prior notice.[31] The Commission should not adopt this proposal.

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25 Proposed Decision at 64-65.
26 *Id.* at 65.
27 CCSF Opening Comments at 6.
28 *Id.*
29 D.87-12-067 at 297.
30 D.87-12-067 at 297-98; D.96-08-033 at 19.
31 NCIP Opening Comments at 7.

The Southern California Indicated Producers (SCIP) introduced a similar proposal in Phase 1 of our TCAP, and SoCalGas, SDG&E, and other parties submitted testimony demonstrating that this proposal would be unfair and potentially counterproductive to the safety-related objectives of the utilities, the Commission, and the State.[32] If a pipeline-related safety issue arises that needs to be dealt with more quickly than 30 days hence, utilities should be permitted to do the work without financial penalty.[33] Additionally, because pressure testing requires a line to be taken out of service for a much longer time than replacing it, the NCIP proposal could incentivize PG&E to replace pipe that might otherwise be pressure tested. The Commission should not determine the merits of NCIP's proposal without first considering the relevant evidence presented by SoCalGas, SDG&E, and other parties in A.11-11-002.

## III. CONCLUSION

For the reasons set forth above, and the facts established in the record of this proceeding, as well as in A.11-11-002, SoCalGas and SDG&E request that the Commission approve the Proposed Decision, with the few revisions set forth in our Opening Comments, to ensure that SoCalGas and SDG&E are provided with a full and fair opportunity to present their case with respect to the reasonableness of their proposed Pipeline Safety Enhancement Plan.

Respectfully submitted,

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32 *See* A.11-11-002, SoCalGas/SDG&E Opening Brief at 174-177.

33 As the Legislature recently explained in Public Utilities Code Section 963(b)(3), "It is the policy of the state that the commission and each gas corporation place safety of the public and gas corporation employees as the top priority."