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 COMMENTS OF THE UTILITY REFORM NETWORK ON THE PROPOSED DECISION OF ADMINSTRATIVE LAW JUDGE BUSHEY

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

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I. INTRODUCTION

The Utility Reform Network ("TURN") submits these reply comments on the Proposed Decision of Administrative Law Judge Bushey ("PD") regarding the proposed Phase One Pipeline Safety Enhancement Plan ("PSEP") of Pacific Gas and Electric Company ("PG&E").

II. PG&E ACKNOWLEDGES THAT THE APPROVED SCOPE OF PHASE 1 IS EXCESSIVE

PG&E acknowledges that, in Phase 1, it will test and replace fewer than the 783 and 186 pipeline miles that the PD would approve for testing and replacement, respectively.[1] PG&E gives precisely the same reasons identified by TURN in its opening comments: (1) since the PSEP was prepared, PG&E has located records of an adequate pressure test for many segments; and (2) under the PD, non-adjacent Class 2 segments must be deferred to Phase 2.[2] Accordingly, there is no reason for the PD to approve any cost recovery to test or replace these segments, and the PD should be modified, as recommended by TURN, to require PG&E to file an advice letter 30 days after the final decision to remove these ineligible segments from Phase 1 and to reduce the cost cap accordingly.[3]

Rather than reduce its cost recovery by the cost of these ineligible projects, which TURN calculated to exceed $300 million,[4] PG&E asks the Commission to let it pocket this money to cover cost overruns. The Commission should soundly reject this brazen request for the persuasive reasons given at pages 101-102 of the PD, including the need to give PG&E "powerful incentives" to manage the PSEP efficiently. That PG&E even makes this request underscores TURN's concern[5] that, unless the approved cost cap is reduced at the outset, PG&E will attempt to find a way to avoid returning to ratepayers the money they are owed for projects that are not performed.

III. THE PD PROPERLY EXCLUDES THE CONTINGECY ALLOWANCE BASED ON VALID POLICY AND FORECASTING GROUNDS

PG&E alleges that the PD errs: by defining contingency as an allowance for "cost overruns" rather than as an inherent component of engineering project cost estimation; by eliminating the contingency even though no party proposed this outcome; and by finding as a matter of fact that

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[1] PG&E Comments, pp. 24-25.
[2] TURN Comments, pp. 2-5; PG&E Comments, p. 24.
[3] TURN Comments, pp. 3, 5. TURN's proposed a new ordering paragraph (OP) 12 to accomplish this result (TURN Comments, App. A, p. 15).
[4] TURN Comments, pp. 3-4, fn. 6; p. 5.
[5] TURN Comments, pp. 3, 5.

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PG&E's cost estimates are so high as to effectively include "an implicit allowance for unexpected cost overruns."[6]

PG&E's claim of errors rests on a simplistic and incomplete description of what the PD actually states. The PD does not mischaracterize the purpose of a contingency; rather, the PD concludes that "for *both cost forecasting reasons as well as policy reasons*, P&GE shareholders should bear the risk of cost overruns and we do not authorize the contingency allowance for inclusion in revenue requirement."[7]

The PD first explains that PG&E's cost forecasts greatly exceed other credible forecasts on the record, so that the request for an additional contingency is undermined. Moreover, the PD explains that eliminating the contingency is a policy choice necessary to control costs in light of the need to perform massive amounts of work on an "urgent" basis as a result of "poor management decisions," thus likely increasing the risks of high costs "caused by quickly doing work that could and should have been [done] over a much longer time period."[8]

The PD could have adopted other methods of trimming costs or imposing risks on shareholders. However, the policy choice to eliminate the contingency as a way to control costs and place cost risks on shareholders is consistent with previous Commission decisions that treat contingency costs differently from other components of the cost forecast.[9]

PG&E also claims that the PD's conclusion that its program cost forecasts are biased to the high end of the expected cost range is factually erroneous, and PG&E cites to its recorded 2011 hydrotesting costs as support for the proposition that its cost estimates were low.[10] However, this initial 2011 hydrotesting work reflects exactly the cost pressures associated with rapid performance of a large

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[6] PG&E, p. 4-8.
[7] PD, p. 100.
[8] PD, p. 101-102.
[9] See, for example, D.10-04-052, p. 32 (threshold for shareholder incentive mechanism for cost reduction excludes contingency component, because "we do not believe that PG&E should be expressly rewarded for not having exhausted the approved contingency amounts"); D.10-02-032, Sec. 31.5, p. 113 (excludes entirely PG&E's requested 26.5% contingency for peak day pricing implementation, and concludes that "We are concerned that our regulatory obligation to ensure just and reasonable rates is being eroded by including such large portions of project costs in rates, without having determined the reasonableness of the costs."); D.03-12-059, p. 49 (reduces contingency for the Mountainview plant to 5% so as to "encourage Edison to bring the project in at cost, or at the lowest cost overrun.").
[10] PG&E Comments, p. 7.

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project, and even PG&E admitted that "it can drive down costs with more engineering and planning time than was available in 2011, and through competitive bidding for the hydrotest construction."[11]

IV. THE DISALLOWANCE OF 2012 COSTS IS NECESSARY AND APPROPRIATE

PG&E argues that the PD errs in denying recovery of 2012 costs because the Commission arbitrarily failed to act on PG&E's May 5, 2011 motion for a memorandum account in this docket.[12] PG&E's arguments lack merit and should be rejected.

As a threshold matter, PG&E misstates the dollar impact of this issue. On page 2, PG&E claims that the PD would disallow $342.7 million of 2012 costs. However, that number improperly includes the full $265.2 million of approved capital expenditures in 2012. (See PD Table E-3). The rule against retroactive ratemaking only precludes PG&E from recovering the relatively negligible carrying costs (return, depreciation, and taxes) on those capital expenditures for 2012. Once a final decision is issued, PG&E will still be able to recover capital costs over all the many remaining years and decades of the depreciable life of the capital assets.[13] As a result, the dollar impact of the denial of 2012 costs approximates the $77.4 million of 2012 expenses shown in Table E-2.

As the PD notes,[14] PG&E does not contest that the rule against retroactive making precludes recovery of costs incurred prior to a decision authorizing rate recovery unless the costs were recorded in a Commission authorized memorandum or balancing account.[15] Accordingly, because the 2012 costs have not been recorded in such an approved account, all 2012 costs incurred prior to the date of the final decision may not be recovered in rates.

Nevertheless, PG&E contends that it was unreasonable for the Commission not to grant its motion for a memorandum account, thereby effectively denying recovery of 2012 costs incurred to carry out PSEP activities. However, the PD provides ample justification for not approving that request. The PD explains that, while it does not accept as reasonable DRA's post-test year ratemaking argument to completely deny recovery of the PSEP costs that PG&E is incurring between rate cases, it would also

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[11] Exh. 21, PG&E Rebuttal Testimony, p. 4-2, lines 17-19, Campbell/PG&E.
[12] PG&E Comments, pp. 8-12.
[13] The PD approves a 65-year depreciable life for new pipeline installed under the PSEP.
[14] PD, p. 83, fn. 84.
[15] TURN Reply Brief, pp. 35-36. PG&E incorrectly argues that, in D.12-04-021, the Commission approved the retroactive recording of 2011and early 2012 costs in a memorandum account approved for the Sempra Utilities in April 2012. This is a misreading of that decision, as TURN demonstrated in its Reply Brief, pp. 36-37, and in the June 11, 2012 Response of TURN and DRA in Opposition to the Motion of the Sempra Utilities for Interim Recovery of Costs Recorded in Pipeline Safety and Reliability Memorandum Accounts, A.11-11-002, pp. 5-7 (attached to these comments as Attachment A).

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be unreasonable to allow PG&E to recover costs that PG&E deemed it necessary to incur without waiting for a Commission decision.[16] As the PD notes, "the events in San Bruno required that PG&E take immediate action" and the need to act before Commission approval of cost recovery "was caused at least in part by PG&E's own actions."[17] In this vein, PG&E does not argue that it was required to incur the 2012 costs at issue.[18] PG&E chose to undertake the 2012 activities, knowing that it lacked Commission authorization for rate recovery. The fact that PG&E made this choice is an implicit acknowledgement that its gas transmission system and record-keeping were in urgent need of improvement in order to ensure the level of safety required by Public Utilities Code Section 451.[19]

PG&E also argues that the PD's "reliance" on the Overland Report violates due process because this report "has been shown to be misleading and inaccurate on this topic."[20] PG&E's arguments lack merit. First, the PD does not "rely" on the Overland Report; it simply uses the Overland Report as an example of how the rule against retroactive ratemaking can function to the utility's advantage during a period of "overearning." Second, PG&E itself explained in its comments that the issue in "dispute" was whether and how much PG&E "underspent"; PG&E did not dispute in I.12-01-007 the fact that its GT&S earnings were significantly higher than authorized due to high storage revenues.[21] (PG&E Comments, p. 13)

PG&E also argues that overearning on GT&S is not relevant, since on a company-wide basis PG&E's "overall financial returns were close to the authorized amount." (PG&E Comments, p. 13) TURN is not aware of record evidence in this proceeding concerning PG&E's actual versus authorized earnings levels. However, based on data submitted in PG&E's ongoing cost of capital proceeding (A.12-04-018), its actual returns during 1999-2008 (except 2000) were always higher than authorized.

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[16] PD, p. 84.
[17] *Id.*
[18] Contrary to PG&E's intimation (p. 11), D.11-06-017 did not specifically order PG&E to accelerate safety improvement work. Instead, the Commission directed *all utilities* to present Plans that would complete the required work "as soon as practicable." (D.11-06-017 at 20).
[19] In addition, if PG&E felt that the CPUC's failure to grant its motion was contrary to law, it could have pursued its legal remedies, such as a writ of mandate to compel CPUC action on its request under Code of Civil Procedure 1085.
[20] PG&E Comments, p. 12.
[21] Indeed, PG&E did not substantially disagree with the $430 million calculation, and presented data showing that GT&S actual average annual ROE for 1999-2010 was 14.6%, versus an average authorized ROE of 11.2%. See, I.12-01-007, Exh. 2, p. 7, O'Laughlin/PG&E.

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With each 10 basis points worth millions of dollars, "close" translates into significant shareholder earnings above authorized levels.[22]

Finally, PG&E contends that Section 957(c)[23] compels rate recovery of any valve costs it incurred in 2012. To the contrary, Section 957(c) only allows recovery of "reasonably incurred" valve costs and does not create an exception to Section 728's longstanding prohibition against retroactive ratemaking. As explained above, expenditures that PG&E voluntarily undertook without any reasonable expectation of recovery under the rule against retroactive ratemaking are not costs PG&E is entitled to recover.

V. THE ROE REDUCTION IS WELL JUSTIFIED AND SHOULD BE EXTENDED FOR THE LIFE OF THE ASSETS

PG&E and the Sempra Utilities present various objections to the PD's five-year reduction to PG&E's return on equity (ROE) on PSEP Phase 1 capital expenditures. With the exception of one legal argument by the Sempra Utilities, the objections amount to nothing more than a policy disagreement with the PD about the appropriate objectives of ratemaking. None have any merit.

Taking the legal argument first, the Sempra Utilities contend that the reduction of PG&E's ROE on PSEP assets to the utility's cost of debt constitutes a taking.[24] However, this argument ignores the point that the prohibition against takings does not apply when a utility has engaged in imprudent conduct or otherwise acted contrary to its regulatory obligations.[25] Even if takings law did apply, in light of the fact that PG&E's PSEP investments are a small part of its overall gas business investments and that its gas operations are, in turn, smaller than PG&E's electric operations, the overall impact of the ROE reduction on PG&E's overall return is minimal and hardly reaches takings levels.[26]

PG&E and the Sempra Utilities assert, without citation to any authority, that it is improper for the Commission to use ratemaking as a tool to penalize deficient utility behavior. However, as TURN pointed out in its Reply Brief, the Commission has previously found it appropriate to impose separate

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[22] See, A.12-04-018, Exh. 23, PG&E Rebuttal Testimony, ch. 2, Attachment 5, Smith/PG&E (PG&E actual versus authorized ROE graph, 1961-2010); Exh. 22, PG&E Supplemental Testimony, p. 7 (PG&E actual versus authorized earnings data, 2006-2010).

[23] Citations are to the Public Utilities Code, unless otherwise indicated.

[24] Sempra Utilities Opening Comments, pp. 19-21.

[25] TURN Reply Brief, pp. 13-14; NCIP Opening Brief, p. 28 (a 500 basis point reduction in PG&E's ROE would lower its overall ROE by a mere 20 basis points).

[26] TURN Opening Brief, p. 124. See *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1988) ("total effect" of a rate order must be examined in takings analysis).

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ratemaking disallowances and penalties on the same utility related to the same behavior.[27] Moreover, the Commission has ample discretion under the "just and reasonable" rate requirement of Section 451 to use ratemaking both to promote efficient and safety-conscious utility behavior and to discourage behavior that undermines these important Commission objectives.

PG&E and the Sempra Utilities further speculate that the ROE reduction will reduce returns to shareholders and make it more difficult and costly to raise capital.[28] In so arguing, the utilities' appear to confuse their shareholders' interest with the public interest.[29] The Commission has made clear that the public interest must trump any anxiety about adverse consequences to shareholders.[30] The utilities completely ignore the vital public interest in deterring PG&E and other utilities from placing financial concerns ahead of safety responsibilities. As TURN and others explained in their opening comments, the public interest compels extending the ROE reduction to the full depreciable life of the PSEP assets.[31]

VI. THE PD'S DISALLOWANCE OF GAS TRANSMISSION ASSET MANAGEMENT (GTAM) COSTS IS WELL SUPPORTED IN THE RECORD

PG&E contends that the record does not support the PD's conclusion that the GTAM project is a remedial effort.[32] To the contrary, there is substantial evidence, summarized in TURN's opening brief,[33] showing that the purpose of the GTAM is to remedy the serious record-keeping deficiencies identified by the National Transportation Safety Board and the CPUC's own Independent Review Panel. Much of this evidence came from PG&E's own testimony and witnesses. PG&E failed to satisfy its burden of demonstrating that the GTAM project is designed to meet new requirements rather than remedying PG&E's record management failings.

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[27] TURN Reply Brief, pp. 11-13.
[28] PG&E incorrectly contends (p. 15) that the "cost of equity is as much a cost as the cost of debt." From an accounting standpoint, the ROE is quite different from the cost of debt in that ROE is what allows a utility to book accounting profits.
[29] Contrary to the utility's assertions, there is no credible testimony in the record to support the counter-intuitive claim that the ROE reduction will lead to increased rates. The Sempra Utilities (not PG&E) cite PG&E's witness, Dr. Tierney, for this point, but TURN demonstrated that Dr. Tierney's assignment failed to consider PG&E's ineffective management and that Dr. Tierney had a financial interest in minimizing adverse financial impacts on PG&E. (TURN Opening Brief, pp. 123-125). In addition, the Sempra Utilities (p. 17) improperly cite testimony outside the record from their expert witness in A.11-11-002, testimony that TURN thoroughly discredited in its Reply Brief in A.11-11-002, pp. 21-22 (attached to these Reply Comments as Attachment B).
[30] TURN Reply Brief, p. 13, citing D.91-12-076, 42 CPUC 2d at 739.
[31] TURN Opening Comments, pp. 13-14. San Bruno Opening Comments, pp. 13-14.
[32] PG&E Opening Comments, pp. 16-18.
[33] TURN Opening Brief, pp. 111-113.

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As a fallback, PG&E asks the Commission to allow it to recover its GTAM capital costs, based on the theory (used by the PD to allow near-total recovery of replacement costs) that ratepayers should not receive an ongoing benefit at no cost.[34] The Commission should reject this request. First, ratepayers have already paid for effective PG&E gas record-keeping systems and should not have to pay again to remedy the deficiencies in those systems. Second, the PD principle PG&E invokes is itself erroneous, as shown in the opening comments of TURN and others, in that the PD ignores the legal requirement to disallow any costs, including capital costs, that are necessary to remedy a utility's imprudence.[35]

VII. THE INCREASE IN DEPRECIABLE LIFE FOR TRANSMISSION MAINS IS WELL SUPPORTED IN THE RECORD

PG&E claims that the PD lacks record evidence to support changing the depreciable life of transmission mains from 45 to 65 years. PG&E admits that the PD relied on data, but then claims that "the average age of PG&E's pipelines and speculation regarding the expected lives of new transmission pipelines (for which there was no evidence submitted)" is not sufficient evidence.[36]

The calculation of depreciable life is typically performed by analyzing accounting records and using professional judgment to determine the expected life of an asset.[37] PG&E last established the asset life of transmission mains in 1996. The PD appropriately relies on average age data to adjust the depreciable life in this proceeding, since the simple math illustrates that the average age of PG&E's transmission mains is now more than 50 years.

PG&E's contention that there is no evidence about the expected lives of new transmission mains contradicts the fundamental premise of PG&E's manufacturing threat decision tree. PG&E chose to replace *all* pre-1970 pipelines that are not DSAW or seamless (approximately 100 out of the 185 miles of replacement) precisely because it argues that post-1970 regulations and the improvements in steel manufacturing, welding processes and quality assurance procedures resulted in a fundamental

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[34] PG&E Opening Comments, p. 19.
[35] TURN Opening Comments, pp. 9-11, DRA Opening Comments, pp. 16-19.
[36] PG&E Comments, p. 19.
[37] The Commission's Standard Practice U-4 for Determination of Straight-Line Remaining Life Depreciation Accruals provides the accepted methodology. See, for example, D.06-05-016, Sec. 16.1; D.09-03-026, Sec. 7, p. 175. If the expected asset life changes based on new data, the undepreciated cost is amortized over the new "remaining life" of the asset.

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change with respect to manufacturing defects.[38] PG&E cannot in good faith now argue that these changes will not result in an increase in expected asset life of new pipe.

VIII. THE COMMISSION SHOULD DISREGARD THE SEMPRA UTILITIES' EFFORT TO LITIGATE ITS PSEP IN THIS CASE

With the luxury of 25 pages of comments and fresh from the conclusion of briefing in A.11-11-002, the Sempra Utilities belatedly attempt to inject into this case their one-sided and misleading portrayal of the record in their PSEP docket. The Commission must decide this case based on the record here and disregard the Sempra Utilities' extra-record evidence and argument.

The Commission should also reject the Sempra Utilities' extraordinary request to: (1) delay this decision to await a decision in A.11-11-002; or alternatively (2) to declare that this decision will not be precedential with respect to their PSEP. It is common at the Commission for cases involving one utility to potentially have a precedential effect on other utilities' proceeding. Often the utilities attempt to exploit this fact to their advantage. Just because the Sempra Utilities are concerned about adverse precedential impacts is not a reason for any special rules in this particular instance.

The Sempra Utilities are at their most misleading in their revisionist view that the text of D.11-06-017 requires all post-1970 segments to be re-tested or replaced, regardless of whether the utility has a qualifying pressure test for these segments. The Sempra Utilities fail even to mention Conclusion of Law (COL) and OP 3 of that decision, which specifically state that pressure tests are valid for PSEP purposes if they include all the elements required at the time of the test and, for pre-1961 segments, if the test was at least one hour long. This issue was fully briefed in A.11-11-002. For the Commission's convenience, TURN attaches (Attachment B) its Reply Brief in that docket, which demonstrates that the Sempra Utilities' interpretation is both contrary to the words of the decision and contrary to the Sempra Utilities' own testimony.[39]

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[38] Exh. 1, p. 3B-9 to 3B-11. TURN does not agree with PG&E that all pre-1970 pipelines (irrespective of seam weld processes) warrant replacement, but TURN has agreed that post-1970 pipelines present fewer problems and are thus likely to have a longer expected life.

[39] Attachment B, TURN Reply Brief in A.11-11-002, pp. 3-23. Brief perusal of TURN's Reply Brief in that docket will show that the Sempra Utilities are also highly misleading in their assertion that the testimony of their expert witnesses was "uncontroverted." (Sempra Comments, p. 5).

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IX. PARTIES OPPOSING PG&E'S COST ALLOCATION PROPOSAL MISREPRESENT THE BASIS FOR THE EXISTING COST ALLOCATION OF TRANSMISSION COSTS

Parties representing large noncore customers allege that the existing Gas Accord V cost allocation is based on a non-precedential settlement which adopted an 'equitable' outcome resulting from horse-trading rather than proper cost causation.[40]

This argument completely misrepresents the basis of the cost allocation of backbone and local transmission costs adopted in D.11-04-031. The Gas Accord V Settlement Agreement makes clear that it is simply continuing the "traditional" Gas Accord cost allocation methodologies:

> Sec. 9.1.2 [Backbone] Cost Allocation
>
> *Costs are allocated similar to the traditional Gas Accord methodology*. This allocation is modified by imposition of the negotiated path rate differentials discussed in Section 9.1.3 below.
>
> Sec. 9.1.1 [Local Transmission] General
>
> *Local transmission rates are designed in the same manner as in previous Gas Accords*. The local transmission rates in this Settlement, shown in Appendix B, Table B-11, reflect the Settlement revenue requirement described in Section 7, the Settlement on-system demand forecast described in Section 8, and Cold-Year-January-Demand allocators (for core versus noncore cost allocation) consistent with the on-system demand forecast.
>
> Sec. 9.3 Storage Rates
>
> *Storage rates are designed in the same manner as in previous Gas Accords*. These rates, shown in Appendix B, Table B-10, reflect the revenue requirement described in Section 7 and the updated firm storage capacities and cost allocators shown in Appendix A, Tables A-2 and A-6, respectively. Gill Ranch storage costs are assigned solely to PG&E's Market Storage services.[41]

Contrary to the assertions of these noncore parties, the "traditional" Gas Accord cost allocation methodologies were grounded in cost causation, as reflected first in proper functionalization of costs to the relevant storage, local transmission, and backbone transmission function, and then followed by the allocation of those costs based on demand-based cost allocators.[42] This functionalization and allocation

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[40] Dynegy, p. 2-3; NCGC, p. 2-5; NCIP, p. 8-9.
[41] D.11-04-031, Appendix A, pp. 12, 14 (emphasis added).
[42] The Gas Accord Settlement specified that it would "establish transmission, distribution, and storage rates based on cost of service." 73 CPUC2d, 754, 818.

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of transmission and storage costs has continued, with some modifications, ever since the Gas Accord I settlement.[43]

As explained by TURN's witness Marcus, what these noncore parties are really proposing is tantamount to allocating all of the local and backbone transmission costs similarly to the allocation of distribution costs, in total contravention of fundamental principles of cost functionalization and allocation.[44]

X. TURN AGREES THAT ERRORS IDENTIFIED BY DRA AND CCSF MUST BE CORRECTED

DRA has identified significant errors in the calculation of disallowed testing and replacement costs that need to be corrected in the final decision.[45]

CCSF notes that the PD fails to address any safety or cost concerns raised by PG&E's cyclic fatigue analysis of lines 101, 109 and 132.[46] CCSF appropriately explains that this report, which represents the type of analysis that PG&E should be doing for certain lines with identified manufacturing threats, has implications both for prioritizing work scope as well as for disallowing work that PG&E should have performed previously as part of integrity management. The failure to consider this evidence constitutes legal error.

Date: November 29, 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 x303
Fax: (415) 929-1132
Email: Marcel@turn.org
Email: TLong@turn.org

[43] See, for example, D.03-12-061, p. 210-211 (Sec. XIII).
[44] Exh. 100, p. 3, Marcus/TURN.
[45] DRA Comments, pp. 3-10 and App. B.
[46] CCSF Comments, p. 3-4. The PG&E analysis was admitted as Exhibit 156.

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ATTACHMENT A

TURN AND DRA JUNE 11, 2012 RESPONSE TO THE SEMPRA UTILITIES' MOTION FOR INTERIM RECOVERY OF COSTS IN A.11-11-002

(See Section III)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Diego Gas & Electric Company (U 902-G) and Southern California Gas Company (U 904-G) for Authority to Revise Their Rates Effective January 1, 2013, in their Triennial Cost Allocation Proceeding.	Application 11-11-002 (Filed November 1, 2011)

RESPONSE OF THE UTILITY REFORM NETWORK AND DIVISION OF RATEPAYER ADVOCATES IN OPPOSITION TO MOTION OF THE SEMPRA UTILITIES FOR INTERIM RECOVERY OF COSTS RECORDED IN PIPELINE SAFETY AND RELIABILITY MEMORANDUM ACCOUNTS

Robert Finkelstein
General Counsel

The Utility Reform Network
115 Sansome Street, Suite 900
San Francisco, CA 94104
Phone: (415) 929-8876
Fax: (415) 929-1132
E-mail: bfinkelstein@turn.org

Laura Tudisco
Attorney

Division of Ratepayer Advocates
505 Van Ness Avenue
San Francisco, CA 94102
Phone: (415) 703-2164
E-mail: ljt@cpuc.ca.gov

June 11, 2012

RESPONSE OF THE UTILITY REFORM NETWORK AND DIVISION OF RATEPAYER ADVOCATES IN OPPOSITION TO MOTION OF THE SEMPRA UTILITIES FOR INTERIM RECOVERY OF COSTS RECORDED IN PIPELINE SAFETY AND RELIABILITY MEMORANDUM ACCOUNTS

On May 25, 2011, San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) (referred to together as "Sempra Utilities") filed a motion seeking to recover costs recorded in their respective Pipeline Safety and Reliability Memorandum Accounts. Pursuant to Rule 11.1(e) of the Commission's Rules of Practice and Procedure, The Utility Reform Network (TURN) and Division of Ratepayer Advocates (DRA) submit this response in opposition to the utilities' motion.

The Sempra Utilities' motion seeks rate recovery of at least two distinct categories of costs. The first category consists of the costs recorded to date in each utility's Pipeline Safety and Reliability Memorandum Account (PSRMA), which were $9.0 million for SoCalGas and $1.0 million for SDG&E as of the date of the motion.[1] The second category represents the "forecasted revenue requirements" associated with O&M expenses the utilities anticipate recording in these accounts through the end of 2013, which appear to be in the order of $29.6 million for SoCalGas and $0.3 million for SDG&E.[2] As of the date the motion was filed, neither utility had incurred or recorded in its PSRMA any costs associated with this second category.

TURN and DRA urge the Commission to deny the motion without prejudice. The *Assigned Commissioner's Scoping Memo and Ruling* of February 24, 2012 (Scoping Memo) addressed concerns regarding avoidance of a "large" undercollection in the PSRMA, but the

[1] Motion for Interim Recovery, pp. 1-2.

[2] *Id.*, p. 2. These figures are calculated as the difference between the total forecasted revenue requirements through 2013 ($38.6 million for SoCalGas and $1.3 million for SDG&E) and the amounts reported as recorded through the date of the motion.

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motion fails to demonstrate that there is any near-term threat of the PSRMA balance reaching such a point in the near future. Furthermore, the Sempra Utilities seek to have an interim revenue requirement based on forecasts of future costs, rather than based on actually incurred costs already recorded in the PSRMA, an extraordinary approach to memorandum accounts and one that is not called for here. Finally, the interim revenue requirement proposed by the Sempra Utilities would include costs incurred in 2011 and early 2012, before the PSRMA was authorized. Consistent with the Commission's long-standing practice, only costs incurred after the memorandum account was authorized are eligible for rate recovery through the memorandum account. Removing the 2011 and early 2012 recorded costs reduces the Sempra Utilities PSRMA forecast balances to levels that further confirm that the utilities have failed to establish that there is a need to act now in order to prevent future "large" or "substantial" undercollections.

I. The Sempra Utilities Have Failed To Demonstrate That There Is A Near-Term Threat of a "Large" Undercollection Warranting Extraordinary Relief Such As Rate Recovery of As-Yet Unreviewed Amounts Recorded In A Memorandum Account.

The *Assigned Commissioner's Scoping Memo and Ruling* of February 24, 2012 addressed concerns regarding the possibility of a "significant" or "large" undercollection accruing in the memorandum account "if cost recovery is not addressed promptly."[3] However, the *Scoping Memo* did not indicate the threshold at which such an undercollection achieves the status of "significant" or "large" for this purpose. Still, it very clearly warned the Sempra Utilities that the obligation is on them to avoid the accumulation of a large undercollection in the memorandum accounts.

[3] *Assigned Commissioner's Scoping Memo and Ruling*, p. 7.

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The Sempra Utilities have apparently decided that the possibility of an undercollection of $50 million at the end of 2013 is sufficient risk of a "large undercollection" to warrant the extraordinary rate relief suggested in the *Scoping Memo*. In doing so, the utilities implicitly assume that the Commission will take no other action before the end of 2013 that might otherwise reduce the balance of this undercollection (for instance, by determining that some or all of the recorded costs are not appropriate for rate recovery, or by finding the recorded amounts reasonable and otherwise eligible for rate recovery). Their approach also fails to mention that the balance of the undercollection, even under the Sempra Utilities' very conservative assumptions, would only reach $50 million at the end of 2013 and will likely be far lower for much of the run-up until then. The current balance, even if one assumes that everything recorded in the PSRMAs to date is reasonable and appropriate for rate recovery, is something in the order of $10 million between the two utilities. And the utilities recorded a substantial portion of that amount before the Commission authorized the PSRMAs; as is discussed more fully below, such amounts are not eligible for rate recovery.

In the end, the Commission should decide that the amounts appropriately recorded in the PSRMAs at this time or likely to be added to the PSRMAs between now and the end of 2012 are unlikely to result in a "large" or "significant" undercollection that might warrant the extraordinary step of interim rate recovery, even subject to refund. Therefore, the Commission should deny the motion without prejudice to the Sempra Utilities seeking an interim rate consistent with the *Scoping Memo* once the recorded costs are closer to what might constitute a "large" undercollection warranting such extraordinary relief.

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II. The Sempra Utilities Fail To Adequately Support Their Proposal To Set Interim Rate Recovery Based On Forecasts of Future Costs To Be Recorded In The PSRMAs, Rather Than On Actually Incurred and Recorded Costs.

The Sempra Utilities seek to increase rates immediately (or at least as soon as possible) to achieve cost recovery in amounts that are based primarily on forecasts of costs not yet incurred. But the ostensible goal is to avoid an unduly large undercollection in a memorandum account. Memorandum accounts generally track recorded costs in order to permit future rate recovery of those recorded costs. The PSRMAs are no different in this regard: The advice letter each utility submitted to implement D.12-04-021 describes the tracking of recorded costs.[4] To the knowledge of TURN and DRA, the Commission has never approved a memorandum account that tracks forecasted, rather than recorded costs. Similarly, TURN and DRA are unaware of any example where the Commission has permitted current rate recovery based on a forecast of future costs that might be incurred and, if incurred and recorded in a memorandum account, might be found reasonable and otherwise appropriate for rate recovery. In short, the Sempra Utilities' reliance upon forecasted costs as a basis for near-term rate recovery of a balance not yet recorded in a memorandum account appears to be inconsistent with long-standing memorandum account ratemaking practices. The Commission should reject the Sempra Utilities' request to permit rate recovery based on forecasts of approximately $30 million of as-yet unincurred costs.[5]

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[4] See, for example, SoCalGas A.L. 4359, proposed tariff language, Section 4 (Accounting Procedures): The monthly entries in the PSRMA include "A debit entry equal to the actual incremental costs … associated with the PSEP costs incurred during the implementation of its PSEP." (emphasis added)

[5] As noted earlier, the $30 million is calculated as the total forecasted revenue requirement through the end of 2013 less the revenue requirement associated with costs recorded in the PSRMAs as of the date the Sempra Utilities filed their motion.

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III. Consistent With Longstanding Commission Practice, The Amounts Recorded In The PSRMA Must Be Limited To Costs Incurred After The Commission Approved The PSRMA.

The Sempra Utilities' motion seek an interim PSEP revenue requirement based in part on "the costs associated with document review/interim safety measures" as detailed in Attachment B of their January 13, 2012 filing referenced in D.12-04-021.[6] The motion makes clear that $6.7 million of the $11.8 million of SoCalGas's estimated review and interim safety measure costs were recorded in 2011. For SDG&E, of the $1.3 million estimated for these costs, $0.7 million were recorded in 2011.[7]

There is a long string of Commission decisions firmly establishing the principle that costs incurred prior to the establishment of a duly authorized memorandum account may not be recovered in rates. Otherwise, the rate increase would violate the rule against retroactive ratemaking enunciated by the California Supreme Court.[8] 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 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.[9]

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[6] Sempra Utilities Motion, p. 3.

[7] *Id.*, p. 3, fn. 4.

[8] *Pacific Telephone and Telegraph Co. v. PUC*, 62 Cal. 2d 634, 650 (1965).

[9] D.06-01-018, p. 3 (citing D.92-03-094, 43 CPUC 2d 596 (1992), 1992 Cal PUC LEXIS 236, at *7).

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To the extent the Sempra Utilities seek approval of interim rates based in part on costs incurred prior to the issuance of D.12-04-021, the Commission must deny the request in order to avoid violating the rule against retroactive ratemaking. Thus the 2011 costs, plus the 2012 costs incurred prior to April 20, 2012 (the date of issuance of D.12-04-021), should be excluded from any calculation of an authorized revenue requirement, including any interim recovery the Commission might provide in response to the Sempra Utilities' motion here.

The Sempra Utilities cite the language in D.12-04-021 that permits them to record in their respective PSRMAs the costs listed in "Attachment B" to their January 13, 2012 pleading, and remind the Commission that the listed costs included costs incurred in 2011.[10] TURN and DRA submit that while D.12-04-021 may not be a model of clarity on this point, the Sempra Utilities err in interpreting the decision as permitting recovery through the memorandum accounts of costs incurred prior to the accounts' establishment.

- Finding of Fact 6 of the decision sets forth the Commission's understanding that the utilities' cost estimates for interim safety measures and record review covered "2012 and the first quarter of 2013," even as it cites the utility figures that include "2011 Actuals" as well as the forecasts for 2012 and the first quarter of 2013.[11]

- In Conclusion of Law 3, the Commission authorized the Sempra Utilities to create a memorandum account "in order to record for later Commission ratemaking consideration the costs of its Pipeline Safety Enhancement Plan and document review costs." The phrasing suggests the recording of not-yet incurred costs for both the PSEP and document review.

- The Commission used the phrase "costs of document review and interim safety measures as set forth in Attachment B to the January 13, 2012, filing" in Ordering Paragraph 3 to describe the costs eligible for recording in the new memorandum accounts. As noted above, Attachment B includes 2011 "actuals" as well as forecasts for 2012 and the first quarter of 2013.

[10] Sempra Utilities Motion, p. 2.

[11] D.12-04-021, Finding of Fact 6. The $1 million and $12 million figures that appear in the Finding of Fact match the "Estimated Total Cost Through Q1 2013" from Attachment B to the January 13, 2012 pleading.

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- ϕϕι Nowhere in D.12-04-021 does the Commission explicitly identify 2011 recorded costs for document review and interim safety measures, or explicitly state that it intended to permit the Sempra Utilities to record pre-authorization costs in the newly-authorized memorandum account.

TURN and DRA submit that the appropriate interpretation of D.12-04-021 would give meaning to the express limitation set forth in Finding of Fact 6 and have only costs incurred after authorization of the memorandum accounts eligible to be recorded in those memorandum accounts. This is also the interpretation that does not run afoul of the long-standing Commission tenet that ratemaking is done on a prospective basis. Rather than engage in retroactive ratemaking, the Commission should decline the Sempra Utilities' invitation to set an interim revenue requirement based in part on obtaining rate recovery of costs incurred before the Commission authorized the PSRMAs. Therefore, all 2011 costs (as well as costs incurred in 2012 prior to April 20) must be deemed ineligible for rate recovery, whether or not currently recorded in the PSRMA.

A final note regarding the document review and interim safety measure costs: TURN and DRA were unable to locate in the Sempra Utilities' PSEP Amended Testimony or workpapers any showing in support of the reasonableness of the costs incurred to date or the forecasts through the first quarter of 2013. Indeed, there is no explanation of what the amounts incurred to date have been spent on.[12] For the PSEP cost forecasts that the utilities wish to use in the interim revenue requirement, it seems clear that the utilities' PSEP testimony is intended to present the support for the reasonableness of those forecasts. Thus interested parties will have an opportunity to probe the merits of those forecasts and related issues in the further review of the PSEP proposal. It is not at all clear if and when interested parties would ever have an

[12] In the Amended Testimony, the 2011 recorded costs are described in general terms at pages 20-21, but with no detail beyond, "All of these costs are attributable to our review of records and our implementation of interim safety enhancement measures."

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opportunity to probe the reasonableness of the costs recorded or forecasted for document review and interim safety measures, given the Sempra Utilities' apparent failure to date to produce any evidence on these points.

IV. Conclusion

For the reasons described above, TURN and DRA urge the Commission to deny the Sempra Utilities motion without prejudice. Should costs recorded after the authorization of PSRMA reach a point that demonstrates a risk of the recorded balance reaching the point of constituting a "large" or "substantial" undercollection, the Sempra Utilities can seek appropriate relief. Having failed to make such a demonstration here, the Sempra Utilities' request should be denied at this time.

June 11, 2012

Respectfully submitted,

By: _____/s/_____
Robert Finkelstein
General Counsel

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

By: _____/s/_____
Laura Tudisco
Attorney

DIVISION OF RATEPAYER ADVOCATES
505 Van Ness Avenue
San Francisco, CA 94102
Phone: (415) 703-2164
E-mail: ljt@cpuc.ca.gov

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ATTACHMENT B

TURN REPLY BRIEF FILED NOVEMBER 9, 2012
IN A.11-11-002
(See Section III)

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BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Diego Gas & Electric Company (U 902-G) and Southern California Gas Company (U 904-G) for Authority to Revise Their Rates Effective January 1, 2013, in their Triennial Cost Allocation Proceeding.	Application 11-11-002 (Filed November 1, 2011)

REPLY BRIEF OF THE UTILITY REFORM NETWORK

ON PIPELINE SAFETY ENHANCEMENT PLAN ISSUES

Thomas Long
Legal Director

Robert Finkelstein
General Counsel

The Utility Reform Network
115 Sansome Street, Suite 900
San Francisco, CA 94104
Phone: (415) 929-8876
Fax: (415) 929-1132
E-mail: bfinkelstein@turn.org

November 9, 2012

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REPLY BRIEF OF THE UTILITY REFORM NETWORK ON PIPELINE SAFETY ENHANCEMENT PLAN ISSUES

The Utility Reform Network (TURN) submits this reply brief addressing issues associated with the Pipeline Safety Enhancement Plan (PSEP) that Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E) (referred to collectively as "Sempra Utilities") have presented for the Commission's consideration.

I. INTRODUCTION

There are several assertions that the Sempra Utilities make in their opening brief that warrant up-front identification and response.

A. Cost Responsibility

The Sempra Utilities fail to offer any credible arguments for imposing on ratepayers the potentially hundreds of millions of dollars of PSEP costs that result from their failure to retain post-1955 pressure test records. As they must, the Sempra Utilities all but acknowledge that they have violated industry standards and regulations in failing to document pressure tests for all pipeline segments installed from 1955 to the present. Long-established principles of California law are clear that ratepayers should not pay for the consequences of such imprudence and violations.

Faced with these facts and controlling legal principles, the Sempra Utilities rely heavily on the wholly unsupported argument that Decision (D.) 11-06-017 requires that every single pre-1970 pipe segment in the transmission system for every California gas utility must be re-tested or replaced, even if the utility can document a post-construction pressure test. This argument misrepresents D.11-06-017 and glaringly omits any reference to the ordering paragraph in that decision that clarifies that pre-1970 pressure test records

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are acceptable for PSEP purposes. The argument also conflicts with their own written and oral testimony, including their conclusion that reliance on pre-1970 pressure tests is advisable and fully consistent with safety. The Sempra Utilities' other attempts to escape responsibility for PSEP costs that result solely and entirely from their imprudence are similarly lacking in merit, as discussed in Section III.

B. "Cost-Effectiveness"

According to the Sempra Utilities, "cost effectiveness is the final major guiding principle of our Plan."[1] But in virtually the next breath, the utilities admit that "the PSEP cost estimates … are not as detailed or complete" as they might otherwise be,[2] due to the tight time constraints they claim dictated presenting rough estimates that they have not yet undertaken to update. The Commission must not lose sight of this disconnect – whatever claims of "cost effectiveness" appear in the Sempra Utilities' testimony and briefs, those claims are based on cost estimates that lack detail and are incomplete. In this light, the Commission has to wonder what the utilities have in mind when they refer to "cost effectiveness."

The fact that the work might get done more cheaply if it piggy-backs on other projects rather than waiting until later only means that the work might come in at a lower cost than would otherwise be the case. It does not demonstrate cost-effectiveness. And this seems to be the root of the Sempra Utilities' confusion on this point. For example, it is likely to be true that fiber optic equipment can be installed more cheaply if it is done when the pipe is being installed or replaced as compared to installing fiber optics as a separate

[1] Sempra Utilities Opening Brief, p. 14.

[2] *Id.*

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project, since it permits the utility to avoid or minimize the costs of excavation. But that does not make installation of fiber optic equipment "cost effective." Even at the reduced cost achieved through the piggybacking, if the benefits do not exceed the costs, the installation is not cost-effective. And if there is no showing that compares the costs and the benefits, there is no basis for a finding of cost-effectiveness.

To further illustrate, consider a proposal to gold plate an existing pipeline segment. It would probably cost less to perform that gold plating in conjunction with other work that has exposed the pipeline segment for other purposes (the argument underlying the utilities' claims regarding its proposal to install fiber optics). But that does not mean it would be "cost-effective" to engage in the gold plating. It only supports the conclusion that an expensive and unnecessary project could be achieved at a lower cost than it might otherwise have cost.

The Commission needs to do what the Sempra Utilities apparently did not do, that is, understand that demonstrating cost savings or cost reductions do not equate to a showing of cost-effectiveness.

II. BACKGROUND

III. RESPONSIBILITY FOR PHASE I COSTS: The Sempra Utilities Present No Good Arguments to Justify Requiring Ratepayers to Shoulder the Costs Resulting from Their Failure to Comply with Post -1955 Requirements to Document Pressure Tests for the Life of the Pipeline

In their opening brief, the Sempra Utilities all but acknowledge that they have violated industry standards and regulations in failing to document pressure tests for all pipeline segments installed from 1955 to the present. In this respect, they had no choice: their own vice president admitted under oath that his companies had violated General

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Order ("GO") 112 and the federal regulations,[3] and the record is also clear that the Sempra Utilities have failed to comply with the provisions of the ASME B31.8 standards to which the companies had agreed to adhere. These stark facts make it evident that, if the Sempra Utilities had fulfilled their regulatory obligations and retained pressure tests for the life of the pipeline, none of the post-1955 segments – and the attendant testing and replacement costs -- would need to be included in the PSEP.

Faced with this reality, the Sempra Utilities desperately reach for a wholly unsupported argument that contradicts their own testimony. They claim that ratepayers are not harmed by such imprudence and violations because Decision (D.) 11-06-017 requires that every single pre-1970 pipe segment in the transmission system for every California gas utility must be re-tested or replaced, even if the utility can document a post-construction pressure test. This argument has several problems, the principle one being that it misrepresents D.11-06-017. Even though the Sempra Utilities discuss their view of the decision numerous times in their brief, they never once mention Ordering Paragraph ("OP") 3, which states that pre-1970 pressure test records are acceptable for PSEP purposes. The Sempra Utilities' argument also conflicts with their written and oral testimony, which includes their conclusion that reliance on pre-1970 pressure tests was advisable and fully consistent with safety. Moreover, the Sempra Utilities fail to acknowledge the potentially crippling price tag that would attach to a requirement to re-test or replace in the next several years *more than half of the transmission pipeline miles in the*

[3] TURN Opening Brief, pp. 29-30, text accompanying footnotes 91 and 94.

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state, a result that is at odds with the Commission's determination in D.11-06-017 to proceed in an "orderly and cost effective" manner.[4]

The other striking – and frankly troubling – theme in the Sempra Utilities' opening brief is their dismissive attitude toward important record-keeping requirements. Failing to retain pressure test records is not an excusable "clerical error." Post-1955 standards and regulations have required operators to retain pressure test records for the life of a pipeline for good reason: such records are an essential means for regulators to ensure that pipelines are operating at safe operating pressures.

In the end, it is clear that there would be no need to test or replace the post-1955 segments in the Sempra Utilities' PSEP if they had fulfilled their regulatory obligations. As explained in TURN's opening brief, it particularly makes no sense to force ratepayers to pay the steep costs of replacing post-1955 pipelines, when the Sempra Utilities' own testimony shows that there would be no safety or reliability basis for replacement if the utilities had retained the required records.[5] Long-established principles of California law are clear that ratepayers should not pay for the consequences of a utility's imprudence and violations. It is neither just nor reasonable to make customers foot the bill for costs that arise solely because of the mistakes and violations of utility management.

A. Applicable Standards and Burden of Proof: This Is Not a Penalty Proceeding and the Sempra Utilities Have the Burden of Proving the Reasonableness of Recovering PSEP Costs from Ratepayers

The Sempra Utilities' opening brief repeats the tired refrain from their rebuttal testimony that the disallowances urged by TURN and other ratepayer representatives are

[4] D.11-06-017, slip. op., p. 1.

[5] TURN Opening Brief, pp. 36-38.

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effectively penalties for which these representatives bear the burden of proof.[6] As explained in TURN's opening brief, this argument willfully ignores Public Utilities Code Sections 451 and 463[7] and well-established Commission precedent, all of which mandate disallowances as a matter of ratemaking to prevent utilities from imposing on their customers unreasonable costs resulting from their imprudence.[8] As TURN further demonstrated, utilities are not entitled to a "presumption of prudence" and have the burden of demonstrating the reasonableness of each element of their cost recovery requests.[9]

For similar reasons, the Sempra Utilities are thoroughly misguided in claiming that disallowances would deprive them of due process.[10] The Scoping Memo for this case made clear that the Sempra Utilities would be subject to disallowances if they could not demonstrate the reasonableness of their requested cost recovery.[11] In addition, the Sempra Utilities had a full and fair opportunity to present a rebuttal to the various disallowance recommendations, and took advantage of that opportunity in several chapters of rebuttal testimony.

B. Transmission Pipeline Testing and Record-Keeping Requirements and Standards

TURN's opening brief fully describes the pipeline testing and record-keeping requirements that have applied in California beginning in 1955 and continuing to the

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[6] Sempra Utilities Opening Brief, pp. 17-19.

[7] All statutory references are to the Public Utilities Code, unless the context indicates a reference to the federal regulations in 49 C.F.R. Part 192.

[8] TURN Opening Brief, pp. 13-19.

[9] *Id.*, p. 16.

[10] Sempra Utilities Opening Brief, pp. 19-22.

[11] Assigned Commissioner's Scoping Memo and Ruling, Feb. 24, 2012, p. 5.

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present,[12] and nothing in the Sempra Utilities' opening brief changes TURN's explanation of those requirements.

The Sempra Utilities incorrectly assert that, since 1970, "regulators have accepted" that not all pressure test records need be present.[13] The Sempra Utilities do not, and cannot, point to any official statement of this Commission or the federal pipeline safety regulatory agencies that support this assertion. In fact, as shown in TURN's opening brief, B31.8 standards, GO 112, and federal regulations have always required that pressure test records be retained for the life of the pipeline.[14] Furthermore, as TURN has shown, even the 1970 grandfathering provision of 49 C.F.R. Section 192.619(c) required an operator to have thorough records regarding the pipeline's history and condition before it could be invoked.[15]

C. Cost Responsibility

1. The Sempra Utilities Rely on an Unsupported Interpretation of D.11-06-017 that Ignores Key Provisions of the Decision and that Contradicts the Sempra Utilities' Own Written and Oral Testimony

Faced with the prospect of significant disallowances that follow inexorably from their inability to document safe operating pressure for pre-1970 pipelines, the Sempra Utilities rely heavily on an unsupported interpretation of D.11-06-017. They contend that it is inconsequential that they are unable to document pressure tests for pre-1970 pipeline because D.11-06-017 "explicitly" and "clearly" requires utilities to test or replace all

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[12] TURN Opening Brief, pp. 19-28.

[13] Sempra Utilities Opening Brief, p. 36.

[14] TURN Opening Brief, pp. 19-28.

[15] TURN Opening Brief, pp. 27-28.

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pipelines that have not been tested in accordance with post-1970 regulations, even if the utilities possess test records showing compliance with pre-1970 requirements.[16] This argument completely fails because it conflicts with: (1) clear provisions in D.11-06-017 that the Sempra Utilities' chose to ignore in their opening brief; (2) the oral testimony of their witness; and (3) the Sempra Utilities' opening testimony in which they took the view that relying on pre-1970 pressure test documentation is fully consistent with the Commission's safety goals.

a) The Sempra Utilities' Interpretation Conflicts with Ordering Paragraph 3 of D.11-06-017

The Sempra Utilities rely on Ordering Paragraph ("OP") 4 to support their claim that D.11-06-017 requires all pre-1970 pipeline segments to be tested or replaced. OP 4 states, in full:

> No later than August 26, 2011, San Diego Gas & Electric Company, Southern California Gas Company, Southwest Gas Corporation and Pacific Gas and Electric Company must file and serve a proposed Natural Gas Transmission Pipeline Comprehensive Pressure Testing Implementation Plan (Implementation Plan) 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). The Implementation Plan should start with pipeline segments located in Class 3 and Class 4 locations and Class 1 and Class 2 high consequence areas, with pipeline segments in other locations given lower priority for pressure testing. The schedule and cost detail for lower priority pipeline segments may be limited.[17]

The Sempra Utilities assert (without support, as shown below) that OP 4's preclusion of reliance on the grandfathering provision of 49 C.F.R Section 192.619(c) means that utilities may only rely on pressure test records meeting the requirements of Subpart J of the

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[16] *See* Sempra Utilities Opening Brief, *e.g.*, pp. 37-40.

[17] D.11-06-017, slip. op., p. 31.

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federal regulations adopted in 1970.[18] They claim that this interpretation of D.11-06-017 is consistent with the statement in the decision that all gas transmission pipelines in California must be brought into compliance with "modern standards" for safety.[19]

Surprisingly, the Sempra Utilities never mention either Conclusion of Law ("COL") 3 or OP 3, which directly address what constitutes a valid pressure test for purposes of determining the scope of pipelines that need to be tested or replaced. OP 3 states:

> A pressure test record must include all elements *required by the regulations in effect when the test was conducted. For pressure tests conducted prior to the effective date of General Order 112, one hour is the minimum acceptable duration for a pressure test.*[20]

OP 3 makes clear that, for purposes of establishing maximum allowable operating pressure under 49 C.F.R. Section 619 (exclusive of Section 619(c)'s grandfathering provision), utilities may rely on pre-1970 pressure test records meeting the requirements of General Order ("GO) 112 from 1961 to 1970 and pressure test records meeting the specifications of the ASME B31.8 standards from 1955 to 1960, provided that the pressure tests were at least one hour in duration.

Thus, in direct contradiction to the Sempra Utilities' argument, their failure to possess documentation of required pressure tests from 1955 to 1970 is highly consequential. OP 3 makes clear that, if the utilities possessed such documentation, the

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[18] Sempra Utilities Opening Brief, p. 39.

[19] D.11-06-017, slip. op., p. 18.

[20] D.11-06-017, slip. op. p. 31 (emphasis added). COL 3 (pp. 28-29) is identical to OP 3.

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Commission would have evidence that the requisite pressure tests had been performed and there would be no need to include such pipeline in the PSEP.[21]

Moreover, even OP 4 does not support the Sempra Utilities' interpretation. OP 4 bars utilities from using the grandfathering provision of Section 619(c) as the basis for establishing MAOP under Section 619 and requires all pipelines to have a pressure test consistent with the other provisions of Section 619. The Sempra Utilities fail to acknowledge that Section 619(a)(2) expressly allows MAOP to be based on pre-1970 pressure tests. Specifically, Section 619(a)(2)(ii) and the table set forth therein provide that, for pipeline installed before November 12, 1970, MAOP is determined by the pressure "to which the segment was tested after construction" divided by the appropriate class location factor. Nothing in Section 619 requires pre-1970 pipe segments to be tested in accordance with the more exacting requirements of Section 192.505 and 192.517 of Subpart J. To the contrary, pre-1970 pressure tests are expressly accepted as a basis for establishing MAOP.

In sum, contrary to the Sempra Utilities' claims, nothing in the plain words of D.11-06-017 indicates that all pre-1970 pipe segments -- even those with documentation of pressure tests in accordance with the regulations of the time -- need to be re-tested or replaced. As TURN pointed out in Section XI of its Opening Brief, the revision of D.11-

[21] It is notable that the proposed decision ("PD") regarding the Pacific Gas and Electric Co. ("PG&E") PSEP in R.11-02-019 (issued Oct. 12, 2012) ("PG&E PD") adopts precisely this interpretation in determining that costs to hydrotest post-1955 pipeline should be disallowed from PG&E's PSEP. (PG&E PD, pp. 60-62 (citing COL 3 in D.11-06-017), and Finding of Fact ("FOF") 21 and COL 18). While TURN agrees with the Sempra Utilities that a proposed decision does not serve as precedent, the fact that the administrative law judge reviewing PG&E's PSEP affirmed this interpretation of D.11-06-017 severely undercuts the Sempra Utilities' argument that the interpretation of TURN and other intervenors is "fundamentally incorrect" and contrary to the "plain meaning" of that decision. (Sempra Utilities Opening Brief, p. 39). If the Sempra Utilities' view were so self-evident from the decision, one would not expect a proposed decision to reach a contrary interpretation.

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06-017 that the Sempra Utilities now urge would add to Phase 2 a requirement to test or replace over 2,000 miles of pipeline -- more than half of their system! -- at a cost that the Sempra Utilities have not even begun to estimate, but that is sure to be astronomical.[22] The Sempra Utilities' interpretation would also greatly expand the scope of PG&E's PSEP by requiring most of PG&E's pipeline miles to be tested anew or replaced. Decision 11-06-017 gives no indication that the Commission intended to require the utilities to re-test or replace more than half of their transmission systems – built over the span of nine decades -- in the space of 5 to 10 years. To the contrary, D.11-06-017 stated that the Commission was ending historic exemptions with an "orderly and cost-[conscious]" implementation plan.[23]

b) In Hearing Testimony, the Sempra Utilities Conceded That D.11-06-017 Does Not Necessarily Require Re-Testing or Replacement of All Pre-1970 Pipeline Segments

The Sempra Utilities' opening brief would have the Commission believe that the interpretation they now espouse is the only possible way to read D.11-06-017.[24] However, their witness, Mr. Schneider, conceded at hearing that the Sempra Utilities' view was not supported by the plain words of the decision and that TURN's reading[25] of the decision was legitimate:

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[22] TURN Opening Brief, pp. 95-96.

[23] D.11-06-017, slip op., p. 18. The above quotation replaces the word "cost-conscience" in the original with the apparent intended word.

[24] Sempra Opening Brief, *e.g.*, p. 38 (intervenors' arguments rooted in a "clear misunderstanding" of D.11-06-017), p. 39 (intervenors' interpretation is "fundamentally incorrect"), and p. 39 (intervenors' view ignores the "plain meaning" of the words in OP 4).

[25] The opening briefs of DRA (p. 19), Southern California Indicated Producers ("SCIP") pp. 4-5), and Southern California Generation Coalition ("SCGC") (p. 42) demonstrate that they share TURN's interpretation of D.11-06-017.

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Q. . . . [Y]ou're relying on Ordering Paragraph 4 of the Decision; is that right?

A. Yes.

. . .

Q. But Ordering Paragraph 4 does not refer to Subpart J; correct?

A. It doesn't specifically say Subpart J.

. . .

Q. . . . [C]an you point to anything explicit in [Decision 11-06-017] that says that modern standards means testing performed in accordance with Subpart J?

A. All I can point to is – is that elimination of the grandfather clause and requiring everything to be tested to modern standards leads to Subpart J.

Q. Well, I would like an answer to my question. *Can you point to anything in the Decision that says that modern standards means testing performed in accordance with Subpart J?*

A. *No, that is our interpretation of the Decision.*

. . .

Q. . . . [W]ouldn't a fair reading of Ordering Paragraph 3 and Ordering Paragraph 4 put together be that the Decision is saying that MAOP cannot be based on grandfathering, but it can be based on a pressure test under pre-1970 standards as long as the test duration was longer than 1 hour and otherwise met the standards of the time? Is that a possible reading of these ordering paragraphs?

A. *It is a possible reading . . ..*[26]

[26] Schneider, Sempra Utilities, 3 RT, p. 473, line 18, to p. 476, line 27 (emphasis added). Mr. Schneider went on to state that, at workshops, Commission staff indicated that "they wanted a Subpart J pressure test." 3 RT 477, ll. 1-4. As noted in Section XI, p. 96, fn. 285 of TURN's Opening Brief, TURN recognizes that CPSD staff appears to be leaning toward the view that all pre-1970 pipe should be tested to Subpart J standards. However, for the reasons explained above, this staff view is not consistent with what the full Commission ordered in D.11-06-017. In light of the huge and unknown cost implications of modifying D.11-06-017 in such a fundamental way, the Commission should not order such a modification until the costs and benefits of such a modification have been fully explored in a later phase of this proceeding.

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Mr. Schneider's admission that nothing in OP 4 or any other part of the decision states that all pressure tests must meet Subpart J standards directly contradicts numerous assertions in the Sempra Utilities' opening brief, such as the claim that OP 4 "*requires* all in-service natural gas transmission pipelines to have documented pressure tests in accordance with Subpart J standards or to conduct such pressure tests or replace the pipeline."[27] As Mr. Schneider conceded, the plain words of OP 4 simply do not support this claim, especially when read in conjunction with OP 3.

Mr. Schneider's cross examination testimony also contradicts the Sempra Utilities' assertion in its brief that the interpretation of TURN and other intervenors is inconsistent with the Commission's determination to end grandfathering (which TURN fully supports).[28] The elimination of grandfathering means that California gas operators can no longer rely on the highest operating pressure from 1965 to 1970 as the sole means to establish MAOP, and now must use other methods specified in Section 192.619, particularly pressure test results, to establish and validate MAOP. OP 3 indicates that pre-1970 pressure test results may be used for this purpose. Even Mr. Schneider did not deny that this was a legitimate interpretation of the decision.

c) The Sempra Utilities' New Interpretation Conflicts With Their Original Position that Reliance on Pre-1970 Pressure Tests Would Meet the Commission's Safety Goals

The Sempra Utilities' new interpretation of D.11-06-017 is further undermined by the utilities' own opening testimony, which contradicts their opening brief in two respects.

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[27] Sempra Utilities Opening Brief, p. 46 (emphasis added).

[28] Sempra Utilities Opening Brief, p. 39.

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First, the Sempra Utilities' opening testimony does not accept the opening brief's view that D.11-06-017 "clearly and explicitly" requires re-testing of all pre-1970 pipeline segments. Instead, citing OP 3, the testimony views the decision as "unclear" as to whether all pre-1970 segments need to be re-tested.[29] The Sempra Utilities do not even try to explain why a provision of D.11-06-017 that was *unclear* to them in the opening testimony, before any party recommended a disallowance, became so indisputably clear after the utilities realized that their initial position made them vulnerable to disallowances.

Second, the Sempra Utilities have changed positions on whether re-testing of all pre-1970 pipeline segments is necessary for safety. In their brief, the Sempra Utilities assert that reliance on pre-1970 pressure tests would run contrary to "the safety-oriented goals of the Commission."[30] However, in their testimony, they advocated, consistent with OP 3, that pre-1970 pressure tests should be accepted by the Commission and used to obviate the need for any new testing.[31] Moreover, they contended that this approach would achieve the standard of safety desired by the Commission.[32]

In light of this change in position, the Sempra Utilities' new concerns about the safety of using pre-1970 pressure tests meeting OP 3 standards ring hollow. It is evident that the Sempra Utilities' top priority is avoiding any disallowances resulting from their

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[29] Ex. SCG-09 (Rivera, Sempra Utilities), p. 119, fn. 20. (TURN's opening brief, p. 95, fn. 281, incorrectly attributed this testimony to Mr. Schneider.) As noted above, there was no reason for the Sempra Utilities even to find the decision unclear, as D.11-06-017 plainly states that pre-1970 pressure tests meeting the requirements of OP 3 are sufficient.

[30] Sempra Utilities' Opening Brief, pp. 39-40.

[31] Specifically, the Sempra Utilities recommended in opening testimony that the Commission find that a pre-1970 test record showing test medium and test pressure to at least 1.25 times MAOP was one of four means by which California utilities should be able to validate the stability of long seams. Ex. SCG-04 (Schneider Opening), p. 46. The other three means are discussed at length in the Opening Brief of the Southern California Generation Coalition ("SCGC") at pages 43-48.

[32] Ex. SCG-04 (Schneider Opening), p. 45.

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failure to adhere to important safety requirements – and that, in furtherance of that priority, they have resorted to abandoning their previous positions and recommendations.[33]

2. The Sempra Utilities' Attempt to Trivialize Their Inability to Validate Safe Operating Pressures Exhibits Disrespect for Important Safety Regulations

The Sempra Utilities' opening brief makes a concerted effort to trivialize the importance of gas pipeline record-keeping in general and specifically the importance of retaining documentation of post-construction pressure tests. This stance betrays an unhealthy disrespect for important pipeline safety standards and regulations and should not be condoned by the Commission.

Littered through much of the Sempra Utilities' opening brief are numerous statements that are dismissive of the need to retain pressure test records. Here are some examples:

- Statement that the Commission should not penalize the Sempra Utilities for "a few missing records"[34]
- Testimony from Dr. Montgomery referring to the inability to document pressure tests as an "infraction" and a "clerical error"[35]
- Testimony from Dr. Montgomery that the missing records are "perfectly innocent" and "something that . . . inevitably [is] going to happen"[36]
- Characterization of the pressure test records that the utilities failed to retain as "missing paperwork"[37]

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[33] Although the Sempra Utilities' opening brief conspicuously omits any reference to their testimony recommendation to use pre-1970 pressure tests to validate operating safety, that testimony has not been withdrawn and still remains the companies' position of record.

[34] Sempra Utilities Opening Brief, p. 3. In fact, as documented in TURN's opening brief (pp. 29-30), the Sempra Utilities are missing pressure test records for 452 pipe segments (234 from 1955-1961, 151 from 1962-1970, and 67 from 1970 to the present), hardly a "few" missing records.

[35] *Id.*, p. 51.

[36] *Id.*

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- Claim that the companies' lack of "strict compliance" with industry standards and regulations is not evidence of imprudence[38]
- Claim that pressure test records "are only one consideration"[39]

Although the Sempra Utilities claim to have a "rule-following" culture,[40] statements such as these are evidence of a dismissive attitude toward regulation and safety expectations. Since 1961, California regulations have explicitly required gas utilities to retain pressure test records for the life of the pipeline. Prior to that, beginning in 1955, industry standards that the Sempra Utilities swore adherence to and even helped to develop similarly required retention of pressure test records for the life of the pipeline. These standards and regulations were unambiguous. The Sempra Utilities cannot point to any decision of this Commission indicating that these requirements were unimportant or otherwise not worthy of observance. To the contrary, as noted in TURN's opening brief, the Commission took pains when it first adopted GO 112 in 1960 to prescribe additional record-keeping requirements beyond those in the prevailing B31.8 industry standards.[41] Those requirements specified that utilities must keep records to establish compliance with the rules and have them "available for inspection at all times" by the Commission staff.[42] The Sempra Utilities' regulatory expert admitted that, if a utility does not have a record to show that something was done, the regulator has to assume it was not done.[43]

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[37] *Id.*, p. 54.

[38] *Id.*, p. 49.

[39] *Id.*, p. 50.

[40] Ex. SGC-16 (Stewart, Sempra Utilities), p. 8.

[41] TURN Opening Brief, pp. 23-25.

[42] Ex. TURN-9 (GO 112),

[43] Tenley, Sempra Utilities, 6 RT 1014, line 27 - 1015, line 9.

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The Sempra Utilities seem to fail to realize that it is not their place to conclude that they are following the necessary safety requirements and that record-keeping is a second-order consideration. The Commission bears the ultimate responsibility for safety regulation and needs to retain the right to review records necessary to demonstrate safe operation. By failing to retain required records, the Sempra Utilities have deprived the Commission of documentation necessary to demonstrate that the pipelines are safe. As a result, the Commission is taking the responsible step of requiring the utilities to re-test or replace the segments for which the required records are lacking. For segments installed in 1955 or later (and for which test records satisfied OP 3), such re-testing or replacement would be unnecessary if the Sempra Utilities had *actually* followed the rules.

Regulatory compliance aside, the suggestion that pressure test records are unimportant is simply wrong. There is a reason that the B31.8 standards and post-1960 regulations have required retention of pressure test records for the life of the pipeline. Pressure tests are essential for ensuring that pipelines will not rupture at normal operating pressure and that there is a margin for safety built into the MAOP calculation. Furthermore, the date of the pressure test and test pressure can be important to the integrity management assessment of pipelines, particularly if a manufacturing threat is present. Pressure test records convey significant information and, for this reason, regulations require operators to take all reasonable steps necessary to preserve these records. The attitude conveyed in the Sempra rebuttal testimony[44] and opening brief that losing some records is "inevitable" shows a troubling disregard for the value of pressure test records in responsibly managing pipelines carrying highly combustible natural gas.

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[44] SCIP's opening brief (pp. 14-15) does a good job of cataloguing the numerous excuses for missing records advanced in the Sempra Utilities rebuttal testimony.

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3. The Commission Should Not Be Swayed By the Sempra Utilities' Self-Proclaimed 'Commitment to Safety'

The Sempra Utilities claim that they have had a "consistent commitment to pipeline safety."[45] This proceeding is not a referendum on whether the totality of the Sempra Utilities' management of its gas pipeline operations has been safe or unsafe. Certainly, a few self-serving pages in their rebuttal testimony[46] and opening brief are not going to answer that question one way or the other.[47] However, the Sempra Utilities' evident disdain for important pipeline record-keeping obligations certainly calls into question their professed safety commitment.

The focus here needs to be the failure of the Sempra Utilities to retain, for many pipe segments, the records the Commission needs to validate the pressure at which it is safe to operate those segments. For the reasons explained in TURN's opening brief, this failure is both imprudent and a violation of Section 451 and applicable regulations, and shareholders, not ratepayers, are obliged to pay for the consequence of such violations and imprudence.

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[45] Sempra Utilities Opening Brief, pp. 49-50.

[46] The Commission should recognize that the Sempra Utilities first presented testimony regarding their supposed commitment to safety in rebuttal, and that ratepayer representatives had no opportunity to submit testimony in response.

[47] The Sempra Utilities make passing reference to a statement in a CPUC staff document in the early 1970s as supposed evidence that the utilities were in full compliance with all applicable regulations. Sempra Utilities Opening Brief, pp. 41-42. However, CPUC safety audits generally allow just a high-level look at a utility's operations and records and are not intended to examine every detailed aspect of a utility's system and find every possible violation. Ex. TURN-16, p. 5 (testimony of CPSD's Raffy Stepanian in I.12-01-007).

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4. Incentives Matter Indeed: The Commission Would Send a Terrible Message to the Utilities If It Allowed Them to Recover Costs that Result Solely From Their Violations and Imprudence

In a section of their opening brief bearing the heading "Incentives Matter," the Sempra Utilities argue that the Commission would create bad incentives for California utilities by denying the Sempra Utilities anything less than full recovery for their Phase 1 PSEP.[48] They go on to suggest that, if the recommended disallowances are approved: (1) the Sempra Utilities will not fully invest in pipeline improvements; and (2) they will over-invest in regulatory compliance.[49]

TURN fully agrees that incentives matter, but disagrees with the Sempra Utilities' assessment of the key incentives that are at stake. In this case, the most important incentive is the utilities' incentive to comply with important pipeline safety regulations. Here, with respect to hundreds of pipeline segments, the Sempra Utilities have contravened industry standards, GO 112 and its successors, federal regulations, and Section 451 by failing to retain essential pressure test records.[50] The consequence of such imprudence and violations is that hundreds of millions of dollars of costs to re-test or replace post-1955 pipeline will be incurred solely because the Sempra Utilities did not fulfill their regulatory obligations. If the Sempra Utilities were to prevail and these costs to remedy imprudence and violations were imposed on ratepayers, the Commission would send a terrible message to regulated utilities that the Commission does not take seriously its regulatory obligations, even in an area as manifestly vital to the public interest as gas pipeline safety.[51]

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[48] Sempra Utilities Opening Brief, pp. 52-53.

[49] *Id.*, pp. 53-55.

[50] TURN Opening Brief,

[51] To date, no enforcement action has been brought against the Sempra Utilities for their admitted violations. If such an action were brought, the remedies sought would need to include an order

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The disincentives alleged by the Sempra Utilities only make sense if one accepts their patently incorrectly claim that their failure to possess the required pressure test records is neither imprudent nor a violation of applicable law. The requirement to retain such records for the life of the pipeline has been abundantly clear since at least 1955 and is not, contrary to their claim, retroactively holding the Sempra Utilities to a "new and higher standard."[52] The disallowances urged by TURN will only vindicate existing regulatory responsibilities, for which the utilities have been, and continue to be, fully compensated in rate cases.

Furthermore, the suggestion that the Sempra Utilities will not make the necessary investments in pipeline safety if they do not receive all they money they request here has the ring of a threat that the Commission should not countenance. As TURN showed in its opening brief, California law has long been clear that utilities may not force their customers to pay the costs of their imprudence.[53] The Sempra Utilities have indeed imprudently risked pipeline safety and have no grounds to argue that disallowances that follow from this imprudence would create new regulatory uncertainty or chill future investment. By adopting the disallowances urged by TURN, DRA, SCIP and SCGC, the Commission will affirm – as it should -- that utilities will face adverse consequences if they fail to operate their systems prudently and violate existing regulations.

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requiring shareholders to pay for all PSEP costs resulting from the violations, precisely the result that TURN seeks here. For all the reasons set forth in TURN's opening brief, California law and fundamental fairness requires disallowance of these costs in *this* proceeding.

[52] Sempra Opening Brief, p. 54.

[53] TURN Opening Brief, pp. 12-19.

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5. The Claim that Disallowances Would Increase Rates Defies Common Sense and Has No Credible Support in the Record

The Sempra Utilities make the counterintuitive claim that Commission adoption of the disallowances urged by TURN and the other ratepayer representatives would result in an "unambiguous cost increase" for Sempra Utilities ratepayers.[54] This claim results from a deeply flawed theory that is not supported by any empirical analysis.

The premise of the theory, supplied by the Sempra Utilities' highly compensated[55] economics consultant, Dr. Montgomery, is that the recommended disallowances "amount to an arbitrary and disproportionate penalty."[56] Starting with this incorrect premise, the theory posits that investors will recognize the disproportionate nature of the penalty and will conclude that California regulation poses undue risks and demand a higher rate of return.[57]

The flaws in this theory are obvious. First, it incorrectly assumes that it would be unfair and disproportionate to disallow costs that arise from the inability of the Sempra Utilities to document required pressure tests. As shown in TURN's opening brief, such an outcome is entirely justified – indeed mandated – by basic and longstanding principles of public utilities law. Second, the theory casts discredit upon the Commission, by speculating that the Commission would be duped into adopting a draconian penalty that would be poorly justified and signal to the investment community that California regulators had taken leave of their senses. TURN is confident that the Commission's

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[54] Sempra Utilities Opening Brief, pp. 57-58.

[55] Dr. Montgomery received $700 per hour and a total of approximately $75,000 for his 19-page rebuttal testimony. Ex. TURN-11 (Data Request Response TURN-6-8).

[56] Sempra Utilities Opening Brief, p. 57.

[57] *Id.*, pp. 57-58.

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decision adopting the disallowances urged by TURN can and will demonstrate that the result is neither arbitrary nor disproportionate to the failure to preserve important safety records.

Finally, Dr. Montgomery made no effort to perform any quantitative analysis to support his assertion that disallowances would cause an "unambiguous" rate increase. In particular, he did not compare the rate reductions from disallowances with the rate increases he hypothesized would result from increased financing costs.[58] In fact, he did not even attempt to estimate how much utility borrowing costs might increase under his theory.[59] Thus, even if the Commission were to accept Dr. Montgomery's unsupported and speculative theories, the record is completely devoid of any information to assess the real-world impact of those theories.

6. Takings Law Does Not Apply to Disallowances for Imprudence

The Sempra Utilities contend that the disallowances recommended by TURN and others would constitute a taking in violation of the United States and California Constitutions.[60] They are incorrect.

As even the Sempra Utilities' recognize, the general rule that utilities are entitled to a reasonable return on assets devoted to utility service does not apply when utility imprudence would make it unreasonable to approve full recovery. Their vice-president, Mr. Morrow, agreed that disallowances for imprudence are one well-understood means by which a utility could fall short of a reasonable rate of return.[61] The Sempra Utilities do

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[58] Montgomery, Sempra Utilities, 6 RT 739, ll. 18-26.

[59] Montgomery, Sempra Utilities, 6 RT 740, line 19 – 741, line 2.

[60] Sempra Utilities Opening Brief, pp. 63-64.

[61] Morrow, Sempra Utilities, 1 RT 73, line 9 – 74, line 15.

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not, and cannot, point to any decisions that hold that the takings doctrine insulates a utility from disallowances for imprudence.[62]

IV. REASONABLENESS OF SOCALGAS' AND SDG&E'S PHASE 1A RECOMMENDATIONS

A. Decision-Making Process (Test or replace, Decision tree)

The Sempra Utilities' description of their decision-making process for determining whether to pressure test or replace a pipeline segment, including the current version of the "decision tree" that will purportedly guide those decisions, should cause the Commission to better understand the need for after-the-fact review of the reasonableness of those decisions. The utilities acknowledge the prominent role that the exercise of judgment has played in the development of its plan up to this point, and will continue to play as the plan is refined and implemented.

> In implementing their PSEP, SoCalGas and SDG&E are requesting that we be provided the flexibility to apply prudent engineering judgment to determine the most cost-effective, logical and operationally feasible approach to bring pipelines up to the new safety standards that are being set by the Commission.[63]

But the fundamental flaw of their proposed decision-making process is that the Commission would never perform meaningful review of the results of the utilities' application of judgment, or ascertain whether the results were truly the most cost-effective approach. Such determinations require the exercise of judgment or discretion that go to the core of the Commission's statutory and Constitutional authority regarding ensuring just and reasonable rates. As the Commission recently recognized in D.11-12-035, it "cannot

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[62] 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).

[63] Sempra Utilities Opening Brief, p. 77.

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delegate its authority and responsibility to determine recoverable costs."[64] Under the Sempra Utilities proposal, the amount of costs ultimately deemed "recoverable" would be determined by the utilities through their claimed exercise of "prudent engineering judgment" to make assessments of cost-effectiveness, among other things. Rather than approve a process that is either an impermissible delegation of the Commission's authority or comes right up to the edge of such impermissible delegation, the Commission should approve a process that provides for a meaningful opportunity for its after-the-fact review of the outcomes produced by whatever decision-making approach the Commission approves at this time.

The need for such after-the-fact review is highlighted by some of the utilities' descriptions of how they intend to make the test-or-replace decisions that will be a hallmark of PSEP implementation. For example, for pipeline segments under 1,000 feet, absent approval of non-destructive examination methods that TURN supports, the Sempra Utilities proposed to replace and abandon these segments, rather than pressure test them. This is based on the assertion that "logistical costs associated with pressure testing … can approach or exceed the cost of replacement."[65] But if the costs of pressure testing "approach" the cost of replacement, the more prudent and reasonable approach may well be to conduct the pressure testing. This is especially true where a comparison of the direct costs associated with the O&M expenses from pressure testing and capital expenditures for replacement activities might appear relatively close, but a comparison of the associated

[64] D.11-12-035 (EPIC Phase 1 decision in R.11-10-003), p. 23.

[65] Sempra Utilities Opening Brief, p. 75.

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revenue requirements would produce a much greater disparity for the impact on ratepayers.[66]

TURN does not dispute that there may be particular projects for which pressure testing may have greater financial consequences on ratepayers than replacement of a pipeline segment,[67] even with the magnified revenue requirement impacts that capitalization causes as compared to expensing an equal amount of direct project costs. The point here is not to make a final determination as to which option is more reasonable for any particular pipeline segment, but rather to ensure that the Commission's role in the decision-making process provides appropriate opportunities to assess that reasonableness once such determinations are actually made. It is not enough for the utilities to present an ever-evolving decision tree and claim that it "should reassure the Commission that the appropriate factors … will be considered when assessing the determination of whether to pressure test or replace the lines."[68] The Commission needs to understand that under the Sempra Utilities' approach, it would play no role in assessing the outcomes produced by this decision tree. And that makes their approach inappropriate.

B. Review of Decisions (Expedited Application Docket, Advisory Panel, etc.)

There is a fundamental misperception underlying the Sempra Utilities' arguments regarding the appropriate role of the Commission in reviewing their decisions regarding the development and implementation of the Pipeline Safety Enhancement Plan. It seems that in their view, the fact that Commission review might be cumbersome is a reason to

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[66] SCGC Brief, pp. 25-26.

[67] Sempra Utilities Opening Brief, pp. 81-82.

[68] *Id.*, p. 83.

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largely eliminate such review once the Commission has issued its decision here.[69] This approach is simply wrong. The fact of the matter is that there needs to be meaningful Commission review in order to ensure that the product of the regulatory process meets the statutory standards for just and reasonable rates, among other reasons. There is no disputing that a process that involves regulatory review is likely to be more cumbersome and time-consuming than a process that does not involve such review. But where, as here, there must be an appropriate level of meaningful regulatory review, the focus should be on how to best achieve that level of review. Taking a position that there should be no such review going forward is not helpful to that effort.

The Commission must also summarily reject the Sempra Utilities' argument that "there should be no need for after-the-fact reasonableness review of the costs recorded in the cost recovery accounts or for expedited applications for pipeline replacement projects so long as the costs incurred have been approved by the Commission."[70] Even if the utilities' statement were true as applied to circumstances where "the costs incurred have been approved by the Commission," the record here simply does not support any finding or conclusion that the Commission is in a position to approve the costs the utilities expect to incur. The Sempra Utilities did not even attempt to present the criteria that would be used to determine whether a pipeline would be replaced or pressure tested until their rebuttal testimony.[71] Even then, they chose to outline "several guidelines that provide direction

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[69] Sempra Utilities Opening Brief, pp. 102-105.

[70] *Id.*, p. 103.

[71] Ex. TURN-01 (Long Testimony), p. 4, quoting Sempra Utilities response to TURN DR 4-4(a).

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while maintaining flexibility" rather than "criteria to define the test or replace decision making process."[72]

It is hard to fathom how the Commission can reasonably be expected to pass judgment on the reasonableness of the utilities' proposals and the associated costs when the utilities are not yet in a position to explain how they intend to make the decisions underlying those proposals, and can only offer the "guidelines" that they intend to use to "provide direction."

> Even after they develop the criteria, there will then be the question of the reasonableness of the criteria themselves, the reasonableness of the utilities' application of those criteria in the decision-making process that results in the actual proposed projects, and, finally, whether the costs associated with the actual proposed projects are reasonable themselves. Thus the Commission is several steps removed from having the "comprehensive analysis" [called for in D.11-06-017 as] necessary to assess the Sempra Utilities' proposals for purposes of determining whether the associated revenue requirement is reasonable.[73]

Thus the Commission must reject the assumption underlying the Sempra Utilities' position on the appropriate review of its PSEP activities and decisions going forward; the review the Commission is performing of the instant application and associated materials does not suffice. There must be a further review of the reasonableness of the Sempra Utilities' actions going forward, including the consistency of those actions with the guidelines that the Commission adopts at this juncture.

The question then becomes what approach is the most reasonable approach to reviewing the reasonableness of the Sempra Utilities' PSEP-related activities. TURN's testimony described an approach to performing that ongoing review in a manner that

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[72] Ex. TURN-23 (Response to TURN DR 8-1), Response 1a.

[73] Ex. TURN-1 (Long Testimony), pp. 4-5.

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would balance the need for expeditious action with the statutory obligation to ensure just and reasonable rates.[74] TURN submits that the more detailed description of a similar process presented in the SCGC opening brief is well-considered and very consistent with the approach described in our testimony.[75] TURN agrees with SCGC that even if this approach required over 100 expedited applications for the replacement projects, the process could still work to deliver timely decisions. However, based on informal conversations with counsel for SCGC, TURN understands that if the Commission was to adopt a threshold spending estimate of $1 million, the number of potential projects requiring an expedited application would drop significantly, and a threshold of $5 million would bring the number of potential projects to approximately 45. According to the Sempra Utilities, the expedited application docket (EAD) approach worked for review of gas contracts because there were only "dozens of proposed contracts, not hundreds of construction projects that are complex in scope."[76] Setting aside the hyperbole (there were never "hundreds" of projects for PSEP), the Commission could achieve the "dozens" threshold that the Sempra Utilities seem to think is achievable by limiting the EAD process to projects with initial estimates in excess of $5 million.

Finally, the Commission should reject the Sempra Utilities claim that their recommended approach is consistent with the approach adopted in Georgia for Atlanta Gas Light Company's pipeline replacement program.[77] There are any number of factual

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[74] *Id.*, pp. 8-14.

[75] SCGC Opening Brief, pp. 24-33.

[76] Sempra Utilities Opening Brief, p. 104.

[77] Id., p. 100. The Georgia Public Service Commission's decision is available at http://www.psc.state.ga.us/factsv2/Document.aspx?documentNumber=123496.

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questions that arise regarding the comparability of the Georgia program and the PSEP proposal here; by raising this point for the first time in their brief, the Sempra Utilities have limited the ability to fully explore those questions. But the stipulation attached to and adopted by the decision suggest at least a few material differences. First, there are quarterly "financial and prudence of implementation" audits to be performed by staff, with the utility bearing the auditing expenses.[78] Second, while initial engineering estimates are used for the development of preliminary budgets, the projects go out for competitive bid once they are fully designed.[79] Third, the utility seems to have the option to reject Commission-recommended changes to the plan, which suggests a very different regulatory structure than California's.[80] In short, the Commission should reject the Sempra Utilities' assertion that the Georgia case provides any support for adoption of their recommended approach here.

In conclusion, TURN submits that the Commission's fundamental choices are two. In order to appropriately discharge its statutory duties regarding just and reasonable rates, it must either perform an after-the-fact reasonableness review of the Sempra Utilities' PSEP-related activities and spending, or adopt cost forecasts based on project-specific cost estimates that reflect something closer to final engineering and analysis than the utilities were able to provide at this time. The Sempra Utilities' preferred approach would have the Commission NEVER assess the reasonableness of anything other than the very preliminary figures and plans put forward to date. And that is the fundamental flaw that requires the Commission's rejection of that approach.

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[78] Stipulation, pp. 5-6.

[79] *Id.*, p. 8.

[80] *Id.*, p. 2.

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C. Base Case

D. Proposed Case

1. Pre-1946 Pipeline "Mitigation" – Girth welds and wrinkle bends

The Sempra Utilities argue that the removal of pipeline segments from service for pressure testing creates a window of opportunity for replacement of girth welds and wrinkle bends in pre-1946 pipeline segments.[81] The utilities are confusing the notion of cost-minimization with the concept of cost-effectiveness; the fact that it may be less expensive to replace those segments under the circumstances does not itself demonstrate the reasonableness of making those replacements. The utilities' justification is that "vintage welds of similar quality pose a potential risk during any earth movement event."[82] But the utilities are already addressing the replacement of wrinkle bends where they are located within a high consequence area identified for ground movement as part of its GRC-funded efforts.[83] And the proposal here is to replace all wrinkle bends, whether or not they are located in a higher risk area. Indeed, the Sempra Utilities propose as a fall back an approach that would permit "selected mitigation of a higher risk subset of wrinkle bends on affected pipelines."[84] The Commission should note that this sounds very much like the effort that is already underway as part of the Transmission Integrity Management Program, for which costs are already included in authorized revenue requirements.

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[81] Sempra Utilities Opening Brief, p. 124.

[82] *Id.*, p. 125.

[83] Ex. SCG-18 (Schneider Rebuttal), p. 26.

[84] Sempra Utilities Opening Brief, p. 126.

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2. Technology Enhancements

The Sempra Utilities emphasize in their opening brief that the proposal for fiber optic monitoring is not intended to be limited to the pipeline segments addressed within the PSEP effort. Rather, the utilities intend for the proposed installation to become "a new technology standard to apply to new or replaced high pressure pipelines with specific risk characteristic." Thus the Commission's approval of fiber optic monitoring here would apply not only to PSEP projects, but also pipeline work "which might be performed under normal General Rate Case funded programs."[85]

The Commission should decline to grant the utilities request for such a far-reaching "new technology standard" here, given that the scope of the proceeding is limited to the Sempra Utilities' PSEP activities. If the Sempra Utilities were interested in a broader standard that would encompass GRC-funded programs, they could have made that pitch in their GRCs for test year 2012. But there's nothing in the record to suggest that any such proposal was incorporated in their GRC request.

Furthermore, the Sempra Utilities' allude to a "specific risk characteristic" without ever having identified that characteristic. TURN understands the utilities' position to now be that the fiber optics would be installed in all new or replaced pipelines, whether or not they are part of PSEP. This broad and general application is inconsistent with the notion of a "specific" risk characteristic, so it is not surprising that the Sempra Utilities merely allude to such characteristic without any further detail.

The Sempra Utilities also argue that the Commission should not wait for further analysis of the merits of this proposal, given that it is cost-effective to pursue it while the

[85] Sempra Utilities Opening Brief, p. 135.

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pipes are exposed.[86] But earlier in the brief they had quoted with favor a passage of D.11-06-017 that referred to the need for the Commission to have "comprehensive analysis of the advantages and disadvantages of potential actions."[87] The record here contains no such "comprehensive analysis of the advantages and disadvantages" of installing fiber optics; indeed, there is nothing to indicate that the utilities considered any other options to their preferred fiber optic solution. And as noted at the outset of this brief, the fact that it might cost less to install fiber optics while the pipes are exposed would apply with equal force to any proposal to gold plate the pipes themselves. While true, it is in no way a sufficient demonstration that the installation of fiber optics is itself "cost-effective."

Finally, the Sempra Utilities argue that TURN's concern about potential other operating revenue (OOR) that might be generated from the fiber optic equipment is "baseless" because the equipment would be installed primarily to provide utility service, not to generate such revenues.[88] This argument reflects a fundamental lack of understanding about OOR from non-tariffed products and services. The utility equipment or resources that are utilized in offering such products and services are by definition originally installed or obtained to provide utility service; the OOR is from marketing products and services that rely in part or in whole on temporarily available capacity of equipment or resources otherwise devoted to providing utility service.[89]

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[86] *Id.*, pp. 135-136.

[87] *Id.*, p. 132, quoting D.11-06-017, pp.16-17.

[88] *Id.*, p. 136.

[89] D.99-09-070 (on SCE's non-tariffed products and services).

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3. Enterprise Asset Management System

The Sempra Utilities' argument in support of the Enterprise Asset Management System fails because the utilities' rebuttal testimony was inconsistent with their direct testimony. The claim that this "solution is not an activity designed to remediate inadequate governance, processes, and systems" or to bring systems up to existing standards[90] simply ignores the utilities own testimony that the proposal is partly geared toward ensuring that asset information is "readily available," an existing requirement of the Transmission Integrity Management Program.[91] It is noteworthy that the utilities opening brief's discussion on this topic makes no mention of the direct testimony on making existing information "readily available."

V. REASONABLENESS OF COST ESTIMATES

The parties other than the Sempra Utilities generally agree – the cost estimates put forward by the utilities are not sufficiently well-developed to be used for ratemaking purposes. The UWUA brief was somewhat kinder in its description ("There is very little basis for judging the reasonableness of the current generation of cost estimates…."[92]), but TURN submits that the SCGC description was more apt ("The Applicants' cost estimates are so wildly inaccurate that they are arbitrary."[93])

The Sempra Utilities attempt to excuse the state of their cost estimates by pointing to the fact that they were required to submit their implementation plan a mere two months

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[90] Sempra Utilities Opening Brief, p. 138, citing Ex. SCG 23 (Rivera Rebuttal).

[91] TURN Opening Brief, p. 70, citing Ex. SCG-07 (Rivera Direct), p. 90, Ex. SCG-23 (Rivera Rebuttal), p. 23, and Rivera, Sempra Utilities, 7 RT 1294, ll. 2-15.

[92] UWUA Brief, p. 33.

[93] SCGC Brief, p. 38.

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after D.11-06-017 issued.[94] This may excuse the guesstimate nature of the figures put forward in August of 2011, but it does not justify the failure to provide more refined and fully-developed estimates in December 2011, when the Sempra Utilities submitted their amended PSEP, or June 2012, when they submitted supplemental testimony.

The Commission should also reject the Sempra Utilities' logic that the cure that would make these very preliminary cost estimates suitable for ratemaking purposes is to inflate those estimates with "risk-based allowances provided by contingencies [of 10-20%]."[95] Where, as here, the utilities have presented cost estimates that are inadequately developed and supported, making those estimates 10-20% higher serves no purpose other than to make them inadequate estimates that are now 10-20% higher.

The Sempra Utilities engage in the regulatory equivalent of grade inflation when they now characterize their estimates as "between Class 4 and Class 5,"[96] – their prepared testimony on this subject repeatedly referred to the estimates as "Class 5"[97] with a single reference to them as "Class 5 or slightly better."[98] More importantly, the utilities claim that such rough estimates "will be used to establish funding authorizations and preliminary program budgets," but can only cite their own data request response as support for this claim,[99] rather than any of the materials from the Association for the Advancement of Cost Engineering (AACE) that were included in the evidentiary record. As SCGC noted, the

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[94] Sempra Utilities Opening Brief, p. 139.

[95] *Id.*, p. 140.

[96] *Id.*

[97] Ex. SCG-21 (Buczkowski Rebuttal Testimony), pp. 2, 4, 15-16.

[98] *Id.*, p. 3.

[99] Sempra Utilities Opening Brief, p. 141, citing Ex. DRA-38 (Responses to DRA-PZS-TCAP-PSEP-14).

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Sempra Utilities could provide no examples of instances when the Commission had relied on Class 5 or Class 4 to set rates.[100]

And the Sempra Utilities appear to forget their own earlier recognition that "additional project definition and analysis is typically required to refine the estimates to support a more detailed budget authorization."[101] TURN submits that the Commission should find that for purposes of setting rates on a forecast basis, even where the forecast will ultimately be trued up to actual recorded costs, it needs the more refined estimates reflecting additional project definition and analysis.

The Sempra Utilities' brief confirms that these more refined estimates will arrive in the future:

> Further analysis, project definition, and updating of the PSEP cost estimates will be performed during the engineering, design, and execution planning phase of each project. This will ensure that decisions made based on estimated costs, particularly the decision to pressure test or replace, will be based on a greater level of project definition than currently exists.[102]

But under the utilities' approach, this further development will inform their decisions. In order for the Commission to ensure that it is setting just and reasonable rates with regard to the recovery of PSEP-related costs, it needs to ensure that this further development informs the agency's decisions. A key defect of the Sempra Utilities' proposal is that they would have the Commission decide first, and the "further analysis, project definition, and updating of the PSEP cost estimates" happen thereafter.

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[100] SCGC Brief, p. 39.

[101] Ex. SCG-21 (Buczkowski Rebuttal Testimony), p. 4.

[102] Sempra Utilities Opening Brief, p. 141.

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Finally, the Sempra Utilities exaggerate the record evidence when they claim that that the cost estimates put forward in their testimony were "reviewed and approved" by utility construction managers "who regularly engage in related work."[103] The utilities cite hearing testimony to support this claim, but the cited transcript pages tell a different story. The testimony that the first cite points to refers merely to "reviews" that occurred "to the extent we had time … we certainly weren't able to do comprehensive types of reviews."[104] The second transcript cite is to testimony that again describes such review as occurring "to the extent we were able," an assertion that appeared just before a confirmation that "the cost estimates for pipe replacement and hydrotesting that we have included in the filing were prepared by SPEC Services."[105] Thus the only testimony or record evidence on this point suggests a "review" that, at most, consisted of "run[ning] these by" utility construction managers.[106] And there is no evidence that these managers, to the extent they had time and were able to perform any level of review, served in any "approval" role whatsoever.

A. Pipeline Replacement and Testing

1. Interim Safety Cost Estimates

The Sempra Utilities' testimony on "Interim Safety Enhancement Measures" consisted of two paragraphs that described, among other things, "costs for contractors to assist in the record review process" among the incremental costs "being incurred and

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[103] *Id.*, p. 143.

[104] Buczkowski, Sempra Utilities, 5 RT 844, ll. 21-23.

[105] *Id.*, at 868, ll. 16-21 and 869, ll. 1-4.

[106] *Id.*, at 844, ll. 23-26.

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tracked since February 2011.[107] As TURN's opening brief explains, these record review costs are the vast majority of the amount discussed as "interim safety measures."[108] But in the Sempra Utilities' opening brief, there is no mention of the records review costs included in this category. The utilities' brief cites the same testimony of the same witness, but simply omitted any mention of the records review costs that represent nearly the entirety of the costs at issue in this category. Instead, the brief re-casts the testimony as if these costs are solely the result of implementing additional leak surveys and pipeline patrols, installing pressure control equipment, and running TFI. And with that re-casting, the Sempra Utilities have presented information to the Commission that is simply untrue.

2. Technology Enhancement Estimates

The Sempra Utilities' discussion of "Technology Enhancement Estimates" introduces a new rationalization for the cost estimate for fiber optic right-of-way monitoring. According to the brief, the estimated costs for such monitoring were developed in part based upon "a review of historical excavation costs [to provide] concrete historical cost examples for excavation in the pipeline right of way; the primary fiber optic cost driver."[109] But earlier in the brief, the utilities had claimed their proposal here is to install fiber optic technology on pipelines that are exposed for testing or repairs or on new pipelines,[110] that is, where no incremental excavation (or excavation costs) would be associated with the installation. The utilities' attempt to demonstrate the reasonableness of

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[107] Ex. SCG-09-R (Rivera Direct Testimony), p. 112.

[108] TURN Opening Brief, pp. 51-52, citing Ex. SCG-32 (Sempra Utilities Workpapers), p. WP-IX-4-1. For SoCalGas, of the $10.6 million for "interim safety measures," $9.7 million are "records search" costs. For SDG&E, the "records search" costs are $1.39 million of the $1.42 million deemed "interim safety" measures.

[109] Sempra Utilities Opening Brief, p. 147.

[110] *Id.*, p. 129.

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their cost estimates by citing their review of costs that they had earlier said the project is designed to avoid further illustrates the questionable veracity of that showing.

3. PSEP Contingency

The Sempra Utilities describe their contingency estimates as having been developed to cover "costs that may result from incomplete design, unforeseen and unpredictable conditions, or uncertainties within the defined project scope."[111] In other words, the Sempra Utilities believe that because of factors such as incomplete design, the Commission should authorize rate recovery not only of the cost estimates that are directly based on that incomplete design, but an additional 20-30% contingency amount as well.

The Commission needs to make the distinction between project planning and ratemaking purposes that seems to have eluded the Sempra Utilities in this case. Rather than provide for rate recovery of contingency factors in the 20-30% range "to account for uncertainty associated with project scope,"[112] the Commission should require the utilities to first present projects that have more certainty to their scope and, as a result, a substantially lower contingency factor.

VI. ALTERNATIVES TO REPLACEMENT OR PRESSURE TESTING

VII. REVENUE REQUIREMENTS

A. Proposed Revenue Requirements

The SCGC opening brief presents a good explanation of why the uncertainties surrounding the Sempra Utilities' potential projects and the associated cost forecasts

[111] Sempra Utilities Opening Brief, p. 149.

[112] *Id.*

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warrant rejecting proposals to set rates based on a forecasted revenue requirement.[113] Deeming the cost forecasts "almost Class 4" (as the Sempra Utilities have done) is little solace when even if those estimates improved to warrant a solid Class 4 designation, they would still carry a -30% to +50% range of expected accuracy. SCGC also correctly notes that the utility-developed forecasts set forth in the December 2011 version of their PSEP proposal are likely to be overstated, since they include projects that their January 2012 "Attachment A" indicated will not be pursued as part of PSEP.[114] Furthermore, the Sempra Utilities have for a variety of reasons not met the schedule upon which their cost forecasts are premised. Even if the utilities were entirely blameless for the lag, it would still mean the cost forecasts are now likely to be stale or outdated.[115]

The Sempra Utilities' opening brief did not attempt to address any of SCGC's points or the record evidence supporting those points. Instead, the utility merely presented a condensed version of how it developed the PSEP-related revenue requirements, and replicated the tables from its direct testimony for the actual revenue requirement calculations.[116]

TURN found in the Sempra Utilities' opening brief no mention of the word "attrition" or the separate attrition mechanism that the utilities had proposed in their direct testimony.[117] The Commission should not permit the utilities to make the proposal here and then attempt to pull it back in favor of raising it in some future GRC or other proceeding. It should address the proposal here and find it to be inappropriate.

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[113] SCGC Brief, pp. 48-49.

[114] *Id.*, p. 50.

[115] *Id.*, pp. 50-51.

[116] Sempra Utilities' Brief, pp. 154-155, and 158.

[117] TURN Opening Brief, p. 85.

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B. Intervenor Proposals Relating to Revenue Requirements

The SCGC opening brief describes a reasonable approach to identifying recorded costs for which rate recovery may be appropriate. TURN very much agrees that the utilities "should not be permitted to use any forecasted revenue requirement to calculate the [amount of PSEP costs to be recovered in rates]."[118]

The Sempra Utilities appear to generally oppose all of the intervenor proposals relating to revenue requirements.

- AFUDC – The Sempra Utilities acknowledge that SPEC Services did not include any allowance for funds used during construction (AFUDC) in the estimates that firm prepared and the utilities included in their application, but point to the fact that the phrase appeared in their direct testimony as evidence that they had incorporated AFUDC in their capital cost revenue requirement calculations.[119] The utilities also renew their rebuttal testimony's claim that their use of the authorized rate of return is appropriate,[120] but without addressing the question of why they use an approach that assumes that no portion of the investment is funded with short-term debt, particularly in the current financial environment with historically low short-term debt costs.

- SCGC Proposal to Expense All NDE-Related Costs – The Sempra Utilities object to the SCGC proposal to expense rather than capitalize all NDE-related costs, and instead call for treating those costs in a manner consistent with the utilities' regular capitalization policies.[121] While it may well be true that the Sempra Utilities

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[118] SCGC Opening Brief, p. 51. SCGC referred to the calculation of the "PSEP surcharge" without explaining what was intended by the reference to the surcharge. TURN's assumption is that SCGC has in mind a rate component reflecting PSEP-related costs authorized for rate recovery, but NOT necessarily a rate component that is separately called out as a line item or in some other format on the customer's bill. TURN's understanding is that the question of whether there should be a separate PSEP line item on a customer's bill is a subject for the upcoming TCAP phase of this proceeding.

[119] Sempra Utilities' Brief, p. 159, citing Ex. SCG-10 (Reyes Direct), p. 123. The only reference to AFUDC in the utilities direct testimony seems to be in the sentence, "The revenue requirement evaluation assumes all Capital costs, including Allowance For Funds Used During Construction, are recovered through depreciation …." TURN did not see anything in the related workpapers that mentioned AFUDC, much less explained how the utilities had calculated it for purposes of developing their proposed revenue requirement. Ex. 32 (Sempra Utilities' Workpapers), pp. WP-X-1-16 to WP-X-1-24.

[120] Sempra Utilities' Brief, pp. 159-160.

[121] *Id.*, pp. 160-161.

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"cannot simply decree that an expenditure that is traditionally capitalized … can be expensed because we want it to be,"[122] SCGC is not asking for a decree from the Sempra Utilities, but rather one from the Commission. Given the potential cost savings to ratepayers should the NDE-related costs get expensed rather than capitalized, all else equal, and given the circumstances leading to the utility and, by extension, its ratepayers incurring these costs, and in light of the potential magnitude of the total ratepayer burden from PSEP-related activities, the Commission should order this variation from the usual capitalization policies.

- TURN Proposal To Deny Rate Recovery For The Incentive Compensation Loader – The Sempra Utilities continue to oppose TURN's recommendation that the "incentive compensation loader" be removed from the revenue requirement calculations. The utilities mischaracterize TURN as having said "providing incentive compensation to employees working on PSEP is somehow 'not in the ratepayers' best interest.'"[123] But as the material from TURN's testimony that the utilities had just quoted in their brief made clear, TURN's opposition was limited to the loader itself; if the Sempra Utilities want to pay their employees incentive compensation, nothing in TURN's position would prohibit them from doing so. But where, as here, the revenue requirement from the proposed loaders would total nearly $145 million,[124] and where the incentive compensation loader represents approximately 25% of the total overhead loaders,[125] the Commission should relieve ratepayers of the burden of the incentive compensation loader.

- SCIP Proposal for a One-Way Balancing Account for TIMP – The Sempra Utilities ask the Commission to reject the Southern California Indicated Producers (SCIP) proposal for a one-way balancing account for costs associated with the Transmission Integrity Management Program (TIIMP) in part because they claim there is no overlap between the PSEP and TIMP.[126] But elsewhere the Sempra Utilities acknowledge such overlap. In describing the claimed accuracy of the cost forecast for the Valve Enhancement Plan, the utilities emphasized, "The work that we're doing in our TIMP project is identical to the work that we propose to do on PSEP."[127] And the utilities explained that it is addressing wrinkle bends both as part of the PSEP and "in response to the TIMP regulations."[128] The one-way balancing account for TIMP costs, as proposed by SCIP, seems a reasonable

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[122] *Id.*, p. 161.

[123] *Id.*

[124] DRA Brief, p. 109 (The utilities provided information indicating total overheads of $130 million for SoCalGas and $15 million for SDG&E.)

[125] Ex. SCG-10 (Reyes Direct), p. 122, Table X-1.

[126] Sempra Utilities Opening Brief, p. 165.

[127] *Id.*, p. 145, quoting hearing testimony from Sempra witness Rivera.

[128] Ex. SCG-18 (Schneider Rebuttal), p. 26.

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approach to ensuring that Sempra makes good on its commitment to avoiding overlap between the PSEP and TIMP activities.

VIII. RATEMAKING TREATMENT FOR RECOVERY OF PHASE 1A COSTS

A. PSEP Cost Recovery Account

The Sempra Utilities contend, "[o]ne-way balancing account treatment could potentially impact progress on the plan."[129] DRA suggests that the Commission should reject such a utility "ultimatum."[130] Whether the Commission deems it an inappropriate ultimatum or a feeble attempt at thuggery, it should be viewed as another factor in favor of after-the-fact reasonableness reviews, at least until the cost forecasts are based on more robust and accurate estimates. Under the two-way balancing account that the utilities favor, the Commission would have no idea whether the reasons why the recorded amounts are exceeding the forecasted total spending levels are due to the utility completing more work than expected in a given period, mismanagement of the projects, or unexpected cost inflation. Each of these factors might warrant a different regulatory response and amount authorized for rate recovery, but under the two-way balancing account the Sempra Utilities propose, each would be treated the same.

The Sempra Utilities cannot expect to be taken seriously when they claim that there is "no potential harm to customers" from adoption of a two-way balancing account, rather than a one-way account (or no balancing account at all).[131] As the utilities explain later in the same paragraph, under their proposal expenditures in excess of the cap would be recoverable from ratepayers, while under the intervenor proposal rate recovery of such

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[129] Sempra Utilities Opening Brief, p. 166.

[130] DRA Brief, p. 111.

[131] Sempra Utilities Opening Brief, p. 166.

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expenditures would be barred.[132] Worse, under their proposal the Commission would have no clear opportunity to formally review the reasonableness of the recorded costs to ensure that the cause of the utilities exceeding the cap is not a factor that would warrant prohibiting rate recovery of some or all of that amount.

The Commission should recognize that the Sempra Utilities' insistence on a two-way balancing account for the PSEP costs is a further indication of the lack of faith they have in their own estimates. The total forecast becomes far less meaningful when the utility has a two-way balancing account. If the utilities had any confidence in the accuracy or reasonableness of the estimates they have put forward so far, they would not be so reticent to have the PSEP operations subject to the cap created by a one-way balancing account.

B. Rate Recovery of Authorized Phase 1A Costs

TURN fully agrees with DRA that any rate recovery of authorized Phase 1A costs should only occur after a Commission determination of reasonableness.[133] Such reasonableness review must serve as an "opportunity for the Commission to assess the prudence of those costs before they are incorporated into rates."[134] As SCGC describes it, the estimates presented to date are too inaccurate for ratemaking purposes, and the expedited advice letters are not a sufficient alternative to an actual reasonableness review.[135]

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[132] *Id.*, p. 167.

[133] DRA Brief, p. 112.

[134] *Id.*, p. 53.

[135] SCGC Brief, p. 63.

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C. Rate Recovery of Costs Recorded in PSEP Memorandum Account

TURN agrees with SCGC that there must be a determination of reasonableness of the costs recorded in the PSEP Memorandum Account before the Commission permits rate recovery of any portion of those costs, and with DRA's point that no such showing of reasonableness has been made to date.[136]

The Sempra Utilities do not go so far as to claim that they have made a showing of reasonableness for the costs recorded to date in the PSEP Memorandum Account, but claim those recorded costs "should be authorized for recovery in this proceeding."

> In fact, the rationale for recovery of these particular costs is particularly strong because the particular projects and related costs were spelled out in detail in the utilities' January 13, 2012 comments, and SoCalGas and SDG&E have only been doing the limited work deemed necessary to keep their PSEP reasonably on track while our PSEP is evaluated by the Commission.[137]

The Commission must reject the utilities' claims for a number of reasons. First, it may be that by Sempra standards the material included in the January 13, 2012 comments constitutes being "spelled out in detail." But the comments themselves describe the list of projects as "the scope of work and estimate of the costs [the utilities] may expect to incur if their request for a memorandum account is granted."[138] And the attachment first reaffirms that the "[e]stimate accuracy is Class 5" for the figures that appear in the attachment, and then lists a number of pipelines by number, with either a capital or O&M cost estimate and

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[136] SCGC Brief, p. 65, and DRA Brief, p. 113.

[137] Sempra Utilities Opening Brief, p. 170.

[138] Sempra Utilities January 13, 2012 Comments and Supplement to Request for Memorandum Account, p. 6.

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a very cryptic entry under "Notes/Basis."[139] There is nothing in Attachment A that would permit the Commission to make any assessment of the reasonableness of the amounts as forecasts. More importantly, there is nothing in Attachment A that would tell the Commission anything about the reasonableness of the amounts recorded in the PSEP Memorandum Account. And in D.12-04-021, the Commission indicated its intent to assess the reasonableness of properly recorded costs before permitting rate recovery of amounts in this memorandum account.[140]

Second, the Sempra Utilities only mention the costs listed in Attachment A that are potentially eligible for recording in the PSEP Memorandum Account. TURN is not aware of any evidence demonstrating that the amount of recorded costs associated with any of the projects listed in Attachment A. As described in TURN's opening brief, there is, however, clear evidence that the costs recorded to date that are "Records Review and Interim Safety Measure Costs" in Attachment B to the January 2012 pleading are included in the PSEP Memorandum Account.[141]

In short, at this point the Commission only knows that the PSEP Memorandum Account includes an unknown amount of PSEP-related costs associated with projects that may have been on the list included in Attachment A, for which the utilities have made no showing of reasonableness, and a known amount of records review costs that are patently unreasonable and should be precluded from rate recovery. The Commission must reject

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[139] Ex. SCGC-3 (Attachment A to January 13, 2012 Comments and Supplement), pages 1-3 (for reference to Class 5 estimate accuracy), and 4-7 (for list of projects).

[140] D.12-04-021, p. 7.

[141] TURN Opening Brief, pp. 50-54. In D.12-04-021, the Commission granted the utilities request to include the Attachment B costs in the pipeline safety memorandum account. (Ordering Paragraph 3). The Commission described the "vast majority" of SoCalGas's costs and "all but a trivial amount" of SDG&E's costs as being for records review. D.12-04-021, p. 4.

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the utilities proposal that the agency authorize rate recovery of the amounts recorded in the PSEP memorandum accounts.

D. Expedited Advice Letter for Proposed Adjustments to PSEP Funding

Among the non-utility parties there is near uniform opposition to the Sempra Utilities' proposal for an expedited advice letter to adjust PSEP funding in the future. SCGC points out that there would be no need for such mechanism under the superior process it has proposed, and that such an advice letter would be unfair to other parties due to its limits on their ability to meaningfully respond to the utility request.[142] SCIP also points to the inadequate opportunity such an advice letter would provide for purposes of reviewing the reasonableness of the proposed additional spending.[143] And DRA makes the important point that the only purpose served by the proposed accelerated process is to ensure that the Sempra Utilities accelerate their rate recovery of incurred costs, whether or not those actual costs are reasonable.[144] While UWUA expresses support for the expedited advice letter, that support is based on the presumption that UWUA's other proposals for "an expanded, inclusive, transparent and effective Advisory Committee are adopted." If the presumption proves inaccurate, UWUA supports the SCGC expedited application docket (EAD) approach over the expedited advice letter.[145]

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[142] SCGC Brief, p. 66.

[143] SCIP Brief, p. 31.

[144] DRA Brief, p. 115.

[145] UWUA Brief, p. 42. With all due respect to UWUA, TURN understands its proposal for the Advisory Committee would effectively provide participants with the authority to approve or deny the utilities' proposed PSEP projects and spending. The Commission cannot delegate its authority or its obligation to make determinations of reasonableness for amounts to be included in rates, even if it was convinced that the super-Advisory Committee that UWUA describes would be an appropriate body to make those determinations.

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The Sempra Utilities, on the other hand, claim that its proposal for expedited advice letters to seek changes in the overall PSEP funding is "a reasonable compromise between the desire of intervenors and the Commission for information" and their own desire "to pursue PSEP-related work in a timely manner."[146] This belittles the underlying concern – it is not a matter of a desire for "more information," but rather a requirement that the Commission only permit rate recovery of amounts found to be just and reasonable. The Commission should harbor serious doubts about whether it can make a finding of reasonableness for a proposed future increase in PSEP funding through the advice letter process running its normal course. The Sempra Utilities have utterly failed to support their claim that an accelerated advice letter process, with severely limited opportunity for intervenors or the Commission to review the proposed funding changes, can lead to a supportable or defensible finding of reasonableness.

The Commission should ignore the Sempra Utilities' attempt to cite D.04-09-022 as an example of a similar process adopted for similar purposes in the past.[147] There the process was adopted for interstate pipeline capacity commitments, with a far more limited range of variables that would need to be considered as compared to the factors underlying determinations of whether to test or replace a pipeline segment and the appropriate and reasonable prioritization for that work, not to mention the reasonableness of associated costs. Furthermore, the process adopted in D.04-09-022 was based in part on the Commission's determination that the process was "needed to provide the utilities with the opportunity to acquire needed core capacity in the most efficient and cost-effective

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[146] Sempra Utilities Opening Brief, p. 171.

[147] *Id.*, fn. 688.

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manner."[148] There has been no such showing here that the expedited advice letter process serves any need other than the utilities' interest in achieving earlier rate recovery of unreviewed costs. Furthermore, the process approved in D.04-09-022 was premised in part on participation of TURN and DRA in the "agreement aspect of the expedited pre-approval processes," and had the expedited process applicable only where there was agreement among the parties involved in that process.[149] The Commission should reject the Sempra Utilities' attempt to analogize the proposed process here to the different process that was adopted to serve very different purposes in D.04-09-022.

E. Annual PSEP Update Report

TURN agrees with SCGC and UWUA that the proposed "update report" is of limited usefulness or value here.[150] The Sempra Utilities attempt to justify the report by merely reiterating their testimony's bullet-pointed list of information the report would contain, repeating the assertion first made during the evidentiary hearings that the annual hazardous substance reports may be a template for the report here, and finally observing that no party appears to have opposed this element of their proposal.[151]

The Commission needs to understand that the likely reason no party raised any objection to the annual update report as originally proposed is because there was very little to the utilities' proposal, and very little risk that the proposal's infirmities would matter. The entirety of the direct testimony on this subject was a single sentence with four bullet

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[148] D.04-09-022, Finding of Fact 4.

[149] *Id.*, Findings of Fact 15 and 16.

[150] SCGC Brief, p. 67, UWUA Brief, p. 42.

[151] Sempra Utilities Opening Brief, p. 172.

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points.[152] But as the Sempra Utilities began to concoct a strategy that relies on claims of developing a "governance structure and control environment" that includes "detailed reporting requirements" that are as yet unspecified, it became clear that the utilities might rely on this annual update report to serve some role beyond being just another annual report that no one ever really considers.[153]

The Commission needs to reject outright the Sempra Utilities claim that the annual hazardous substance report can serve as an appropriate starting point for the annual report here. According to the utilities, the annual PSEP reports will include "substantial additional detail not found in the annual hazwaste reports."[154] The problem is that the substantial additional detail is also not found in the record here; all the Commission has are the four bullet points from the original testimony, and allusions of grandeur that remain to be fleshed out. Rather than approve the proposed annual report and then wait for the Sempra Utilities to decide what will actually be contained in those reports, and the purposes the reports might serve, the Commission should direct the utilities to first present a clear proposal about what the report will contain and is intended to do, and then proceed accordingly.

IX. ADDITIONAL INTERVENOR PROPOSALS

X. PHASE 1B

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[152] Ex. SCG-10 (Reyes Direct), p. 127.

[153] Ex. SCG-21 (Buczkowski Rebuttal), p. 16. When asked to define the "transparent control environment" referred to in the rebuttal testimony, the Sempra Utilities' witness included the "annual report" as one element of such an environment. Buczkowski, Sempra Utilities, 3 RT 571, ll. 6-21. Interestingly, TURN found no reference to either "governance structure" or "control environment" in the Sempra Utilities' opening brief.

[154] Sempra Utilities Opening Brief, p. 172.

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XI. PHASE 2: The Commission Should Reject the Sempra Utilities' Request for Authorization to Develop a Plan to Test or Replace All Remaining Pre-1970 Segments in Phase 2

As noted in Section III.C.1.c above, the Sempra Utilities have taken contradictory positions on whether pre-1970 pipeline with documented pressure tests needs to be tested or replaced in Phase 2. In opening testimony, they urged the Commission to find that pre-1970 pressure tests to 1.25 times MAOP are one means of ensuring the safe operation of these pipelines.[155] This testimony has not been withdrawn and therefore still represents the position of the companies. However, as noted above, their brief now espouses the conflicting view that D.11-06-017 requires testing or replacement of all pre-1970 pipelines, even segments with documented pressure tests.

In Section III.C above, TURN has already demonstrated that the Sempra Utilities' new interpretation of D.11-06-017 conflicts with the plain words of the decision, which specifically concludes that pre-1970 segments with pressure tests meeting the requirements of OP 3 do not need to be re-tested (or replaced) at this time. Moreover, as noted in TURN's opening brief, mandating re-testing of all pre-1970 segments would be a huge expansion of the implementation plans for all California gas utilities, without any record of the costs of such a dramatic change.[156] Accordingly, the Commission should reject the Sempra Utilities' request for authorization of its Phase 2 "decision-making process",[157] to the extent it includes authorization to plan for testing or replacement of all pre-1970 segments.

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[155] Ex. SCG-04 (Schneider Opening), p. 46.

[156] TURN Opening Brief, pp. 95-96.

[157] Sempra Utilities Opening Brief, p. xviii (Summary of Recommendations, first bullet at top of page).

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As explained in TURN's opening brief, if the Commission is considering changing D.11-06-017 and OP 3 to require re-testing or replacement of some or all pre-1970 segments, it should not do so until parties have had notice and an opportunity to be heard regarding such a modification.[158] As such a change would affect all California gas utilities, this opportunity should be provided in a generic proceeding such as R.11-02-019 and should afford all parties the chance to develop a record on the costs and benefits of such a significant expansion of the current scope of the PSEPs.

XII. CONCLUSION

For the above-describe reasons, TURN urges the Commission to adopt a decision that appropriately balances the need to move forward on pipeline safety-related activities and the need to ensure that ratepayers fund only the appropriate costs associated with those activities.

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Respectfully submitted,

By: _____/s/_____

Robert Finkelstein
General Counsel

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

[158] TURN Opening Brief, p. 96; Public Utilities Code Section 1708.

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