

**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 ADMINISTRATIVE LAW JUDGE BUSHEY**



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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 concern⁵ 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.

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.

III. THE PD PROPERLY EXCLUDES THE CONTINGENCY 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 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

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.”).

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 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.

¹⁰ PG&E Comments, p. 7.

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 2011 and 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

(<http://docs.epuc.ca.gov/SearchRes.aspx?DocFormat=ALL&DocID=61840>).

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 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)

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.

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. 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

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).

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 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

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).

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 (<http://docs.cpuc.ca.gov/SearchRes.aspx?DocFormat=ALL&DocID=31735002>).

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.

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.

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

³² PG&E Opening Comments, pp. 16-18.

³³ TURN Opening Brief, pp. 111-113.

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;

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 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

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.

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.

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. TURN’s Reply Brief in that docket demonstrates that the Sempra Utilities’ interpretation is both contrary to the words of the decision and contrary to the Sempra Utilities’ own testimony.³⁹

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

³⁹ TURN Reply Brief in A.11-11-002, Nov. 9, 2012, pp. 3-23 (<http://docs.cpuc.ca.gov/SearchRes.aspx?DocFormat=ALL&DocID=31735002>). 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).

⁴⁰ Dynegy, p. 2-3; NCGC, p. 2-5; NCIP, p. 8-9.

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 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.

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.

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.

Date: November 29, 2012

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