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)

DIVISION OF RATEPAYER ADVOCATES' APPLICATION FOR REHEARING OF DECISION NO. 12-12-030

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I. INTRODUCTION

Pursuant to Rule 16.1 of the California Public Utilities Commission's (Commission) Rules of Practice and Procedure (Rules), and California Public Utilities Code § 309.5, the Division of Ratepayer Advocates (DRA) files this application for rehearing of Commission Decision (D.) 12-12-030, the Decision approving Pacific Gas and Electric Company's (PG&E) Pipeline Safety Enhancement Plan (PSEP).

As the Decision recognizes, PG&E's PSEP "represents a massive investment program funded largely by PG&E's ratepayers." Decision at 86. The Decision adopts a preliminary "budget" or "cost cap" of $1,168.8 million for Phase 1 of the PSEP,[1] which would require ratepayers to pay over $3 billion to PG&E over 65 years (including the return on equity, or profit, for PG&E's shareholders). PG&E estimates that Phase 2, to begin in 2015, will cost another $6.8 to $9 billion.[2]

Given the magnitude of this program, and what it represents in terms of gas safety for the State of California, it is essential that the Commission comply with the law in its rate treatment and implementation of the PSEP.

Pursuant to Rule 16, this application sets forth specifically the unlawful and erroneous aspects of the Decision. However, there are a number of issues that the Decision properly decided and which should not be substantively revised. The Decision properly:

- Disallows PG&E cost recovery for certain items, including records integration (Decision § 5.2.3);
- Establishes a hard cap on cost recovery based on PG&E's cost estimates (Decision at 127, Ordering Paragraph (OP) 6);
- Disallows the large contingency that PG&E added to its cost estimates (Decision § 5.2.4);
- Denies rate increases to cover costs incurred prior to the effective date of the Decision (Decision § 5.2.2.3); and

[1] Decision at Table E-4, page E3.
[2] Ex. 149, DRA Testimony, Chap. 9, p. 2 & note 5. PG&E has not yet submitted a proposal for Phase 2.

- Makes the authorized rate increases subject to refund pending Commission decisions in the related San Bruno investigations (Decision at 126, OP 3).

These determinations are lawful and should be upheld.

Notwithstanding these appropriate determinations, the Decision contains a number of legal errors that should be corrected.

First, the Decision misconstrues Public Utilities Code §§ 451 and 463,[3] which require the Commission to hold a utility, rather than its ratepayers, responsible for significant cost increases resulting from a utility's unreasonable errors and omissions. The record (including the National Transportation Safety Board's final report on its investigation of the September 10, 2010 San Bruno explosion) demonstrates that PG&E's decades of mismanagement and putting profit over safety were the root causes of the San Bruno explosion, and of the present unsafe conditions throughout PG&E's service territory.[4] As the Decision recognizes, PG&E has failed to properly maintain its gas transmission system for decades by either performing work inadequately (errors), or failing to do work altogether (omissions).[5]

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[3] Unless otherwise noted, all further section references are to the California Public Utilities Code.

[4] *See National Transportation Safety Board, Pipeline Accident Report, Pacific Gas and Electric Company, Natural Gas Transmission Pipeline Rupture and Fire, San Bruno, California, September 9, 2010, adopted August 30, 2011* (NTSB Report) at x-xii available at http://www.ntsb.gov/doclib/reports/2011/PAR1101.pdf. The NTSB Report was issued on August 30, 2011, after the Commission opened this proceeding. The NTSB Report is incorporated by reference into Ex. 121 (testimony of Thomas Long) and is properly within the record of this proceeding. As the Commission determined in the Order Instituting Rulemaking 11-02-019, p. 12, note 6: "We will take official notice of the record in other proceedings, including the investigation of PG&E's gas system record-keeping, in our ratemaking determination." This determination was affirmed in D.11-06-017, p. 23: "As we indicated in [the Order Instituting Rulemaking 11-02-019], we intend to take official notice of the record in other proceedings, including the investigation of PG&E's gas system record-keeping (R.11-02-016), in our ratemaking determination." *See also* Independent Review Panel report (IRP Report) at 5 ("the Panel concludes the explosion of the pipeline at San Bruno was a consequence of multiple weaknesses in PG&E's management and oversight of the safety of its gas transmission system.") available at http://www.cpuc.ca.gov/NR/rdonlyres/85E17CDA-7CE2-4D2D-93BA-B95D25CF98B2/0/cpucfinalreportrevised62411.pdf.

[5] While the Decision refuses to characterizes PG&E's behavior as "errors" or "omissions" in order to sustain its strained interpretation of §§ 451 and 463, the Decision contains ample findings that PG&E committed "errors" and "omissions." *See, e.g.,* Decision at 87 ("The document management costs PG&E seeks to recover from ratepayers in this application are for remedial work that stem from its previous failure to prudently perform its document management duties and to maintain accurate and reliable

(continued on next page)

State law requires the Commission to disallow rate increases to pay for increased costs resulting from a utility's unreasonable errors and omissions. Public Utilities Code §§ 451, 463. The Decision, however, sidesteps this requirement and rejects greater disallowances supported by the evidence. ***Although section 463 specifically addresses allocation of costs between ratepayers and shareholders in precisely the type of situation presented here – when large expenses become unavoidable as a result of utility errors and omissions – the Decision inexplicably and erroneously finds the law inapplicable.***

Given what is at stake – public safety, critical, urgent, and costly infrastructure improvements, and a pressing need to restore public confidence in PG&E and in this Commission – it is particularly important that the Commission's decision on the first phase of PG&E's PSEP be sound in all important respects. To correct legal errors, the Decision must be modified to:

- Correctly interpret and apply §§ 451 and 463 so that PG&E ratepayers are not forced to bear the financial consequences of PG&E's very serious errors and omissions;
- Apply the appropriate standard of proof with respect to rate increases;
- Correct internal inconsistencies in the Decision to clarify that non-adjacent class 1 and 2 pipeline segments may not be included in Phase 1 of the PSEP; and
- Modify elements of PG&E's decision tree, consistent with the record, to ensure that the highest priority work is done first and to avoid unnecessary pipe replacements.

Decision 12-12-030 was mailed on December 28, 2012. Therefore, this application for rehearing is timely filed.

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records.); Decision at 93 ("Curing PG&E's unreliable natural gas pipeline records was the goal of the NTSB's recommendation to obtain "traceable, verifiable, and complete" records."); Decision at 99 ("…[W]e find that the record shows that the need to do this amount of testing and replacement on an 'urgent' basis has been caused, in part, by PG&E's management of its natural gas transmission system over multiple decades. The majority of the pipeline to be tested or replaced has been part of PG&E's system for decades, and the safety value of pressure testing has similarly been well-known for decades."); and Decision at 100 ("Having let its natural gas transmission system deteriorate to the point where the Commission was required to order a massive and relatively short-term-testing and replacement plan ….").

II. THE DECISION COMMITS LEGAL ERROR

A. The Decision Misconstrues State Law and Allows PG&E To Pass On To Ratepayers Costs That Should Be Disallowed Pursuant to Public Utilities Code §§ 451 and 463

Section 463 is straightforward – the Commission *shall* disallow direct and indirect expenses related to the unreasonable errors or omissions of a utility costing more than $50 million.[6] And where the utility fails to maintain records related to the expense of "the planning, construction, or operation of the corporation's plant, the commission shall disallow that expense for purposes of establishing rates for the corporation." § 463(b). In addition, § 451 places the burden of proof on the utility to demonstrate that its requested rate increase is just and reasonable.

The Commission has relied upon § 463 both explicitly and implicitly (through references to its general ratemaking authority) to deny cost recovery for costs resulting

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[6] Section 463 provides in relevant part and with emphasis added: (a) For purposes of establishing rates for any electrical or gas corporation, the commission ***shall*** disallow expenses reflecting the direct or indirect costs resulting from any unreasonable error or omission relating to the planning, construction, or operation of any portion of the corporation's plant which cost, or is estimated to have cost, more than fifty million dollars ($50,000,000), including any expenses resulting from delays caused by any unreasonable error or omission. …

(b) Whenever an electrical or gas corporation fails to prepare or maintain records sufficient to enable the commission to completely evaluate any relevant or potentially relevant issue related to the reasonableness and prudence of any expense relating to the planning, construction, or operation of the corporation's plant, the commission shall disallow that expense for purposes of establishing rates for the corporation. …

(c) For purposes of this section:

… (3) "Operation" includes, but is not limited to, activities related to decisions affecting the timing and nature of the use of the plant; dispatch and control activities and decisions; and plant operation, fuel loading, and maintenance.

(4) "Error" includes, but is not limited to, any action or direction which causes an avoidable (i) increase in the time required to bring the plant to full commercial operation, (ii) change in the number or types of personnel or firms required to bring the plant to full commercial operation, (iii) increase in the number of worker hours required to complete any portion of the plant construction project, or (iv) change of equipment, configuration, design, schedule, or program.

(5) "Omission" includes, but is not limited to, any failure to act or to provide direction which causes an avoidable (i) increase in the time required to bring the plant to full commercial operation, (ii) change in the number or types of personnel or firms required to bring the plant to full commercial operation, (iii) increase in the number of worker hours required to complete any portion of the plant construction project, or (iv) change of equipment, configuration, design, schedule, or program.

from unreasonable utility errors and omissions.[7] Notwithstanding its history of disallowances for utility errors and omissions, the Decision, based on a misconstruction of § 463, declines here to disallow expenses incurred due to PG&E's errors and omissions.

A gas utility is required to operate its system in a safe manner at all times (§ 451) and it is undisputed that PG&E's rates have been set for decades at a level adequate to maintain adequate records and safe operations.[8] It is also clear, based on substantial unrebutted evidence, that the PSEP is needed to rectify unsafe conditions resulting from PG&E's decades of mismanagement and neglect of its gas transmission pipeline system (including failure to properly maintain pipeline records and an integrity management program essential to safe operations).[9] The Decision explicitly recognizes that PG&E is at fault:

> As set forth above, PG&E's history of addressing its natural gas transmission pipelines that were installed prior to a pressure testing requirement or for which pressure test records are not available reflects a long-standing avoidance of sound, safety-engineering-based decision-making in favor of financially-motivated nominal regulatory compliance.

Decision at 104-105.

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[7] Southern California Edison Company, D. 86-10-069, 22 CPUC 2d 124 (SONGS Units 2 & 3 disallowance) as modified by D.87-11-018, 1987 Cal. PUC LEXIS 343, * 11 (New Finding 127 is added to read: "Pursuant to Public Utilities Code Section 463, the Commission finds that all costs reflecting any unreasonable errors or omissions of Applicants relating to the planning or construction of SONGS 2 and 3 have been disallowed, to the extent the record in this proceeding warrants." Conclusion of Law 33 is modified to read: "If we determine that a utility's imprudent acts require the disallowance of specific direct costs related to those acts, then the utility's imprudence also requires the disallowance of indirect costs associated with those specific direct costs." Conclusion of Law 34 is modified to read: "Under the circumstances of this case, where the record was not developed in such a way as to allow discrete calculation of the reasonableness of specific indirect costs, it is within the Commission's discretion to adopt an equitable solution to this problem."). See also Pacific Gas and Electric Company, D.85-08-102, 18 CPUC 2d 700 (Helms disallowance); Pacific Gas and Electric Company, D.98-11-067, 83 CPUC 2d 208 ($100 million Diablo disallowance); Southern California Edison Company, D.94-03-048, 53 CPUC 2d 452 (Mojave disallowance); and Southern California Edison Company, D.85-03-087, 17 CPUC 2d 470 (SONGS Unit 1 disallowance).

[8] 9 RT 959-960, Bottorff/PG&E.

[9] DRA Opening Brief at 5-6, 8, and 41-49; TURN Opening Brief at 1-4, and 69-107.

The law is clear that pursuant to § 463 (which, by its terms merely clarified the Commission's ratemaking authority and its obligation to ensure that all rate increases are just and reasonable as required by § 451), the Commission must disallow all PSEP costs, direct or indirect, associated with PG&E's errors or omissions in the operation of its gas system.

But instead of applying § 463 to disallow such costs for errors or omissions, as the law requires, the Decision concludes that § 463 does not apply unless there is a showing that ratepayers previously paid for work that PG&E did not perform.[10] This conclusion is clearly incorrect; there is no basis for it in law or in fact. The plain language of § 463 requires no such showing, and even if such a showing were required – which it is not – it would be PG&E's burden to demonstrate that its ratepayers *did not* pay for such activities in the past.

Having concluded that § 463 is inapplicable, the Decision then disregards, for purposes of the disallowance analysis, most of the evidence regarding PG&E's errors and omissions.[11] This too constitutes legal error. Section 463 *requires* the Commission to *at least consider* the evidence of errors and omissions. Furthermore, if it finds that unreasonable errors and omissions resulted in added costs, it must disallow *both direct and indirect costs.* § 463 (a).

The Decision's rationale for holding § 463 inapplicable is difficult to follow and is based on the premise that PG&E ratepayers enjoyed lower costs in the past because PG&E had not previously performed the "needed but not performed" safety work now being done in the PSEP – a finding with no basis in the record:

> … PG&E's ratepayers have not been subject to unreasonable costs; ***rather, as a result of needed but not performed safety improvement projects, ratepayers ended up paying rates lower than may have been reasonable due to the absence of the needed projects.*** The public utility code standards for rate recovery, i.e., just and reasonable, and the disallowance

[10] The Decision disallows certain expenses proposed in PG&E's PSEP, but only on the basis that the proposed expenses are "unreasonable" pursuant to § 451 and it only disallows "direct" expenses.
[11] *See, e.g.,* DRA Opening Brief, pp. 7-9 and 25-49; and TURN Opening Brief, § 2.3.

> concept reflected in § 463 do not combine to provide an analytical basis for disallowing reasonable costs on the basis that the utility should have made the expenditures at an earlier date.

Decision at 54 (emphases added).[12]

The Decision seeks to distinguish the PSEP from prior Commission decisions ordering disallowances. It acknowledges that the Commission disallowed certain expenses associated with a 1985 accident at the Mohave Power Plant, but supposes that the Commission surely would not have disallowed cost recovery for safety improvements to a hypothetical second plant like Mojave. Decision at 54, note 43. Thus, the Decision relies upon a hypothetical example, and speculates regarding the Commission's resolution of that hypothetical, to rationalize its conclusion that § 463 is inapplicable here. This sleight of hand effectively converts § 463 into a refund statute requiring ratepayers to prove that they previously paid for the work that has become necessary today because of the utility's errors or omissions.

Under the Decision's logic, § 463 does not apply unless parties challenging a rate increase affirmatively demonstrate that the utility previously received money in rates to perform the work that has become necessary because of the utility's errors or omissions, but did not do that work. That is not what the statute says. Moreover, it would be all but impossible to make such a showing. And there is no record evidence whatsoever to support the Decision's supposition that "ratepayers ended up paying rates lower than may have been reasonable due to the absence of the needed projects."

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[12] The Decision makes a nearly identical argument in rejecting The Utility Reform Network (TURN) and City and County of San Francisco (CCSF) contentions that § 463 requires disallowance of certain pipeline replacement costs. The Decision ignores the fact that ratepayers paid for an ineffective Integrity Management Program which resulted in lines not being inspected and replaced when they should have been and performed other, unnecessary work at ratepayer expense instead: "For ratemaking purposes … it is not clear how PG&E's failure to perform certain types of pipeline assessment in the past, even if an imprudent decision, justifies disallowing ratemaking recovery for the currently proposed pipeline assessment. TURN is not arguing that PG&E obtain ratepayer funding for the more expensive pressure testing, but opted instead to actually perform less-expensive direct assessment. Delay in implementing needed safety expenditures does not render the current expenditures imprudent and thus subject to disallowance, as we have set forth in detail previously." Decision at 71-72.

The Decision's interpretation of § 463 shifts the burden of proof from the utility to the parties opposing the rate increase. Even if one accepted the Decision's improper shifting of the burden of proof, the evidence shows that "[a]ll of PG&E's integrity management work – over nearly three decades – has been funded by ratepayers through rates," and that this work has been incompetently managed and ultimately ineffective.[13] Thus, even with the burden erroneously shifted to ratepayers, the record shows that PG&E's failure to operate its gas transmission system safely is not due to inadequate ratepayer funding.[14]

The Decision's reliance on *Mohave* (D.94-03-048) is also misplaced because that decision expressly affirmed SCE's obligation to justify rate increases by clear and convincing evidence. The Commission disallowed expenses in that case because, among other things, SCE had failed to keep critical operational records, and because it should have known that there were problems with its operation of Mohave based on experience with another SCE plant at Mohave. The Decision's suggestion that the Commission would (hypothetically) allow expenditures disallowed at Mohave for another sister plant has no basis in either fact or law and provides no support for allowing cost recovery in this case. Rather, given that the evidence shows that PG&E knew or should have known

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[13] DRA Opening Brief at 36; *see also Id. at* 25-49, which describes the deficiencies in PG&E's record keeping which resulted in a deficient integrity management program; *see also Id.* at 27 ("The NTSB found that PG&E's pipeline integrity management program, which should have ensured the safety of the system, was deficient and ineffective because it was inaccurate and incomplete, was missing mission critical information, and was not designed to consider the most relevant information – such as pipeline design, materials, and repair history - when determining how to prioritize repairs and replacements. As a result, the NTSB concluded that PG&E's integrity management program "led to internal assessments …. that were superficial and resulted in no improvements." Citations to Ex. 45 and the NTSB Report at p. xi omitted here).

[14] To the extent the Decision is read to distinguish between ratepayer funding of record keeping, which is disallowed, and other PG&E errors and omissions related to the failures of its integrity management system – this is a distinction without a difference because PG&E's deficient record keeping resulted in the wrong lines being maintained and/or replaced at the wrong time – all at ratepayer cost. Thus, PG&E's record keeping deficiencies led to deficiencies in its operating and maintenance of its gas pipeline system – which is what the remainder of the PSEP costs address.

as far back as the 1980s that its integrity management program was deficient,[15] *Mojave* is further support for disallowances pursuant to § 463.

Hypothetical Commission decisions notwithstanding, the Decision commits legal error by misconstruing § 463, and ignoring the plain language of the statute and actual Commission decisions interpreting it. First, nothing in § 463 contemplates an inquiry into past rates to determine if ratepayers "ended up paying rates lower than may have been reasonable due to the absence of the needed projects." Second, such a requirement would shift the burden of proof away from the utility in violation of §§ 451 and 454, which would also be inconsistent with the holding in *Mohave*. Third, no other Commission decision approving a disallowance, whether under § 463 or otherwise, has required such a showing.[16] Fourth, even if there were such a requirement for § 463 to apply, nothing in the record supports the Decision's supposition that ratepayers paid lower rates as a result of PG&E's errors and omissions. To the contrary, the uncontroverted record shows that PG&E has for decades received ratepayer funding at a level that PG&E and the Commission deemed adequate to operate its gas and electric systems safely,[17] and that its gas transmission and storage operations have been very profitable over more than a decade.[18]

Since 1998, PG&E's revenues are estimated to have exceeded the amount needed to earn its authorized rate-of-return by $430 million.[19] The record also shows that PG&E's errors and omissions are the result of a corporate culture that valued profits over safety – and PG&E made a conscious decision to limit investment in pipeline safety,

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[15] *See* Note 13 above.
[16] *See* Note 7 above; *see e.g.,* So Cal Gas, D.93-12-043, 1993 Cal. PUC LEXIS 728, *70 ("… Public Utilities (PU) Code Section 463 requires that we disallow any unreasonable costs of construction for projects which cost more than $ 50 million.")
[17] *See* Note 8 above.
[18] DRA Opening Brief at 13-15; *see also* Decision at 82 ("The Overland Report shows that PG&E enjoyed the protection of the rule against retroactive ratemaking when, from 1997 to 2010, PG&E consistently underspent Commission-authorized amounts, resulting in approximately $430 million in excess earnings for shareholders.")
[19] Ex. 42, "Focused Audit of Pacific Gas and Electric Gas Transmission Pipeline Safety-Related Expenditures for the Period 1996 to 2010" by Overland Consulting, dated December 30, 2011, p. 1-1 (Overland Report); *see also* Note 18 above.

notwithstanding the fact that it collected rates sufficient to maintain a safe system.[20] Thus, ratepayers presumably *did* pay for work PG&E never did. But even if that question remains unanswered, the Commission is required to apply § 463 to disallow both direct and indirect costs resulting from those unreasonable errors and omissions. No showing that ratepayers have already paid those costs is required for § 463 to apply.

In sum, the Decision errs by declaring § 463 inapplicable to this case. There is no legal or factual basis for the Decision's interpretation.

B. The Decision Applies The Wrong Standard For The Burden Of Proof

State law requires that PG&E bear the burden of showing that its proposed costs and revenue requirements (ratepayer funding) for the PSEP, which are enormous, are just and reasonable.[21] "Intervenors do not have the burden of proving the unreasonableness of [the utility's] showing." D.06-05-016 at 7. "… PG&E has the burden of affirmatively establishing the reasonableness of all aspects of the application." Decision at 42.

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[20] *See* Note 19 above; *see also* DRA Opening Brief at 13-15; *see also Id.* at 27-28 ("CPSD identified other causes for the disaster, including …. 'a systemic failure of PG&E's corporate culture to emphasize safety over profits.'" *citing to* California Public Utilities Commission, Consumer Protection and Safety Division, Incident Investigation Report, September 9, 2010 PG&E Pipeline Rupture in San Bruno, California, released January 12, 2012 (CPSD San Bruno Report), p. 1.) The CPSD San Bruno Report was supplemented and submitted as CPSD's testimony in I.12-01-007 on March 16, 2012. The CPSD San Bruno Report is properly within the record of this proceeding. As the Commission determined in the Order Instituting Rulemaking 11-02-019, p. 12, note 6: "We will take official notice of the record in other proceedings, including the investigation of PG&E's gas system record-keeping, in our ratemaking determination." This determination was affirmed in D.11-06-017, p. 23: "As we indicated in [the Order Instituting Rulemaking 11-02-019], we intend to take official notice of the record in other proceedings, including the investigation of PG&E's gas system record-keeping (R.11-02-016), in our ratemaking determination."

[21] Section 454 requires that PG&E bear the burden of demonstrating that its new rates are justified before they may be charged to customers:

> … no public utility shall change any rate … as to result in any new rate, except upon a showing before the commission and a finding by the commission that the new rate is justified….

Section 451 requires that PG&E's rates be just and reasonable and finds that unjust or unreasonable rates are unlawful:

> All charges demanded or received by any public utility … shall be just and reasonable. Every unjust or unreasonable charge demanded or received for such product or commodity is unlawful.

The question is: "What standard applies to this burden of proof?" Must PG&E meet the burden with "clear and convincing evidence" or only a "preponderance of the evidence" as the Decision finds? Decision at 42. Generally, the preponderance of the evidence standard requires a party to have more weighty evidence on its side than there is on the other side. The clear and convincing standard is more stringent, requiring evidence "so clear as to leave no substantial doubt…"[22]

The Decision commits legal error by deviating from long-established Commission rules which require that the more stringent clear and convincing standard applies to rate cases. Instead, it adopts the less stringent preponderance of the evidence standard in this rate case. This deviation from the Commission's own Rules constitutes legal error – a failure to proceed as required by law – which must be remedied on rehearing.[23]

The Decision cites to D.08-12-058 (*Sunrise*) in support of its reliance on the substantial evidence standard (Decision at 42 and note 31), but the Decision's reliance on *Sunrise* is misplaced. *Sunrise* involved an application for a certificate of public convenience and necessity (CPCN); it was *not* a rate case. *Sunrise* even noted that the utility in that case argued that the clear and convincing standard applies to rate cases (*Sunrise* at 18), but adopted the preponderance of the evidence standard because *Sunrise* was *not* a rate case. Because no one could show that the clear and convincing standard had ever been applied to a CPCN application *Sunrise* applied the "default" standard for civil and administrative litigation. *Id.* at 18-19. Notably, the *Sunrise* appeal addressed the issue of the standard of proof and the Commission reiterated to the appellate court in that case that the clear and convincing evidence standard applied to rate cases.[24] Thus, the Decision's reliance on *Sunrise* to lower the standard of proof for a rate case to

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[22] Conservatorship of Wendland, 26 Cal.4th 519, 552 (2001 as quoted in D.09-07-024 at 3; *see also UCAN v. PUC,* 187 Cal. App. 4th 688, 698 (2010).

[23] *See, e.g., Southern California Edison Co. v. Public Utilities Com.*, 140 Cal App 4th 1085 (2006) (decision annulled for Commission's prejudicial failure to proceed in the manner required by law).

[24] *UCAN v. PUC,* 187 Cal. App. 4th 688, 698 (2010) ("The Commission reiterated in the Modified Decision that it had limited application of the clear and convincing standard to 'general rate cases and reasonableness reviews which are specialized proceedings.' …[T]he Commission … repeat[s] those arguments here…")

"substantial evidence" is mistaken, since *Sunrise* clearly stands for the proposition that the "clear and convincing" standard applies to rate cases.

The Decision also errs because the Commission has repeatedly stated that clear and convincing evidence is the standard for rate cases. For example, D.94-03-048, disallowing certain Mojave-related expenses, reiterated the rule from prior CPUC decisions, relying itself on a 1983 decision:

> In D.83-05-036, 11 CPUC2d 474, [footnote omitted] we explained:
>
> "the fundamental principle involving public utilities and their regulation by governmental authority is that the burden rests *heavily* upon a utility to prove it is entitled to rate relief and not upon the Commission, its staff or any interested party . . . to prove the contrary. Unless SCE meets the burden of proving, *with clear and convincing evidence*, the reasonableness of all the expenses it seeks to have reflected in rate adjustments, those costs will be disallowed."[25]

Later, in PG&E's 1999 general rate case (GRC),[26] the Commission conducted an historical review of the applicable standard. That decision concluded that, since at least 1952, the Commission required that "[t]he utility seeking an increase in rates has the burden of showing by *clear and convincing evidence* that it is entitled to such increase. The presumption is that the existing rates are reasonable and lawful."[27] The clear and convincing evidence standard was adopted in that GRC and affirmed on rehearing in D.01-10-031, which modified PG&E's GRC decision to make this point even clearer.[28]

Notably, the Commission has recently deviated from the clear and convincing standard in at least two rate cases: the 2009 Southern California Edison Company (SCE) GRC and PG&E's 2012 GRC. The SCE GRC gave no explanation for the change in standard, and no citations were provided. D.09-03-025 at 8. The PG&E GRC decision relied on the "default" standard articulated in the Evidence Code, with no explanation of why

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[25] D.94-03-048, 53 CPUC 2d 700, 1994 Cal. PUC LEXIS 216, *35, quoting D.83-05-036, 11 CPUC2d 474 (citations omitted; emphases added).
[26] D.00-02-046, 2000 WL 289723 (Cal. P.U.C) (February 17, 2000) at § 4.2.2, "Burden of Proof and Evidentiary Standard."
[27] *Id.* (emphases added).
[28] Order Granting Rehearing of and Modifying Decision 00-02-046 (2001), D.01-10-031, 2001 Cal LEXIS 917 *5-6.

the Commission would deviate from long-standing precedent of applying a higher standard for rate cases (D.11-05-018 at 68-69), especially given that the Evidence Code does not apply to Commission proceedings. *See* § 1701 (technical rules of evidence need not be applied) and Commission Rule of Practice and Procedure 13.6.[29]

It is legal error for the Commission to change the long-standing standard of proof for rate cases without explanation. The Commission has long held that the clear and convincing evidence standard is necessary to address the information imbalance between the utility (which holds all the information) and intervenors who must obtain the information from the utility to challenge the rate increase. *See, e.g.,* D.00-02-046 at § 4.2.2. This information imbalance has not changed. It is also legal error for the Commission to continually move the ball on the standard of proof issue. Among other things, both changing the standard, and applying it inconsistently, are violations of due process.[30] Rather than perpetuate this error, the Commission should affirm, consistent with a long line of cases, that the proper standard of proof for review of proposed rate increases is clear and convincing evidence, and apply that standard to this Application and to all applications seeking rate increases.

C. The Decision Is Internally Inconsistent On The Exclusion Of Class 1 and 2 Pipeline Segments From Phase 1

The Decision mandates "pressure testing of 783 miles of pipeline, replacement of 186 miles of pipeline,…, and upgrades to 199 miles of pipeline to allow for in-line inspection" for Phase 1 of PG&E's PSEP. Decision at 3. These are the same lengths of pipeline proposed by PG&E, and include Class 1 and 2 segments.[31] This wholesale acceptance of PG&E's proposed scope, including Class 1 and 2 segments, is inconsistent with D.11-06-017, the Decision, and evidence provided by DRA.

Based on D.11-06-017, the Decision correctly adopts a "general rule … that pipeline segments in Class 1 or 2 locations will not be included in Phase 1." Decision at

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[29] *See also, UCAN v. PUC,* 187 Cal. App. 4th 688, 699 (2010) ("The California Constitution authorizes the Commission to establish its own procedures. (*Cal. Const., art. XII, § 2.*) The Commission need not apply 'the technical rules of evidence.' (*§ 1701.*)")

[30] U.S. Constitution, Fifth Amendment; Cal. Constitution, Art. I, § 7.

[31] Ex. 2, PG&E Direct Testimony, p. 3-22, line 29; p. 3-26, line 17; p. 3-29, line 27.

66. As an exception to this general rule, for purposes of "sound engineering" or "economic reasons," the Decision allows PG&E to include Class 1 or 2 segments in Phase 1 that are *adjacent* to priority locations. *Id.* Consistent with this exception, Finding of Fact ("FOF") 22 concludes that "[c]ost and engineering engineering efficiency may be achieved by pressure testing pipeline segments adjacent to high priority segments." Decision at 118, FOF 22. The Decision text appropriately concludes: "Pipeline segments in Class 2 or Class 1 locations which are not high consequence areas, or *adjacent* to Class 3 or 4 locations or high consequence areas, must be deferred to Phase 2 of the Implementation Plan." Decision at 67 (emphasis added).

Based on these clear conclusions in the Decision, the Commission should have ordered PG&E to remove from Phase 1 all non-adjacent, non-HCA Class 1 and Class 2 segments, but it did not do so. There is no dispute that the 783 miles of hydrotesting and 186 miles of replacement, upon which the authorized revenue requirement increases are based, include such non-adjacent Class 1 and 2 segments. PG&E has not contested TURN's estimate that only 10% of non-HCA Class 1 and Class 2 segments are adjacent to priority Phase 1 segments.[32]

Unfortunately, the clear language in the body of the Decision and FOF 20 is muddied by Conclusion of Law (COL) 20, which suggests that Phase 1 may include not only adjacent Class 1 or 2 segments, but also Class 1 or 2 segments "with economic or engineering supporting rationale." Decision at 123, COL 20. Contrary to the Decision text and FOF 22, COL 20 could be read to expand the scope of Phase 1, even though the only economic or engineering rationale discussed in the Decision is adjacency to priority segments.

Accordingly, the Decision should be modified in two respects. First, COL 20 should be clarified to be consistent with the Decision text and FOF 22. Second, OP 11 should be modified to require PG&E to remove all non-adjacent Class 1 and 2 segments

[32] TURN Opening Comments on the PD, pp. 4-5. TURN estimated that the inclusion of these non-adjacent, non-HCA Class 1 and 2 segments increased the costs of Phase 1 by $233 million, a figure that PG&E did not challenge.

from Phase 1 in its PSEP database update. In this way, the Phase 1 scope will be reduced to include only the Class 1 and 2 segments that are in High Consequence Areas or adjacent to the priority segments the Commission intended to target in Phase 1. In addition, the revenue requirements and Phase 1 budgets will be reduced to match the actual scope of Phase 1 work that the Decision authorizes PG&E to perform.

D. The Decision Ignores Evidence Requiring Modifications To PG&E's Decision Tree To Ensure That Projects Are Correctly Prioritized

At least two aspects of PG&E's Decision Tree proposal were shown to require modification, yet the Decision ignored the record evidence and failed to make those modifications. Section 1757 requires that findings in Commission decisions be "supported by substantial evidence in light of the whole record." Thus, the Decision's failure to consider the "whole record" and to appropriately modify PG&E's proposal consistent with the record, including PG&E's own admissions, is legal error.[33]

1. Outcome M2 Allows Unnecessary Pipeline Replacements

The Decision adopts PG&E's PSEP Decision Tree proposal wholesale, ignoring expert testimony that demonstrated the need for some technical modifications. Both TURN and DRA challenged the Decision Tree's outcome that replaces *all* pipeline that reaches Outcome M2.[34], [35] This outcome mandates the Phase 1 replacement of approximately *100 miles of pipeline*, including all pre-1970 pipeline operating in a high consequence area (HCA) at a pressure greater than 30% of Specified Minimum Yield Stress (SMYS) that is not seamless or Double Submerged Arc Welded (DSAW) pipe. In sum, Outcome M2 of the Decision Tree would require replacement, rather than testing, of

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[33] *See* Note 23 above and Note 47 below.

[34] TURN Opening Brief, pp. 28-31; DRA Opening Brief, p. 56. While the Decision at pp.72-73 addresses TURN's arguments concerning Outcome M2, it fails to acknowledge DRA's recommendation of hydrotesting as the default for M2. *See* DRA Opening Brief, p. 56.

[35] Note that while Outcome M2 would actually mandate replacement of approximately 133 miles of pipe, rather than the approximately 100 miles noted above, in another example of PG&E deviating from its Decision Tree based on its undocumented "judgment," PG&E plans to hydrotest 15.5 miles of pipes, and defer 17.9 miles to Phase 2. See Ex. 144, DRA Testimony, p. 42, Table 6.

approximately 100 miles of pre-1970 pipeline in a HCA that presents a possible manufacturing defect.

Notwithstanding DRA and TURN proposals to revise this aspect of the Decision Tree and their supporting evidence, the Decision accepts without question PG&E's characterization that pipes reaching Outcome M2 have "substandard welds." Decision at 73 and 123, Conclusion of Law 23. It concludes that the "increased probability of a manufacturing defect in the now suspect welds, coupled with the potentially catastrophic failure mode, counsels us that, while expensive, PG&E has justified the cost of replacing these pipeline segments." Decision at 73.

This finding ignores *overwhelming* evidence, including PG&E's own consultant report and rebuttal testimony, demonstrating that PG&E's use of the 1970 cut-off date is arbitrary, and that PG&E's blanket inclusion of all welds except for welds in DSAW pipes is overbroad.

The basis for PG&E's arguments is provided at Attachments 3B and 3C of PG&E's direct testimony (Ex. 2). PG&E states there the fundamental rationale for the 1970 cutoff date: "The significance of 1970 is that year demarks the effective start of U.S. Department of Transportation minimum Federal pipeline safety standards under 49 CFR."[36] PG&E further explains that manufacturers ceased production of pipe with low frequency Electric Resistance Welded ("ERW") seams and flash-welded seams by 1970, and that manufacturers ceased the production of butt-welded and furnace-welded pipe in the 1960's.[37] PG&E also discussed improvements in steel-making that occurred during the 1960's.[38]

However, as illustrated graphically in PG&E's table of "pipe making practices,"[39] reproduced below, the 1970 cut-off date is arbitrary.

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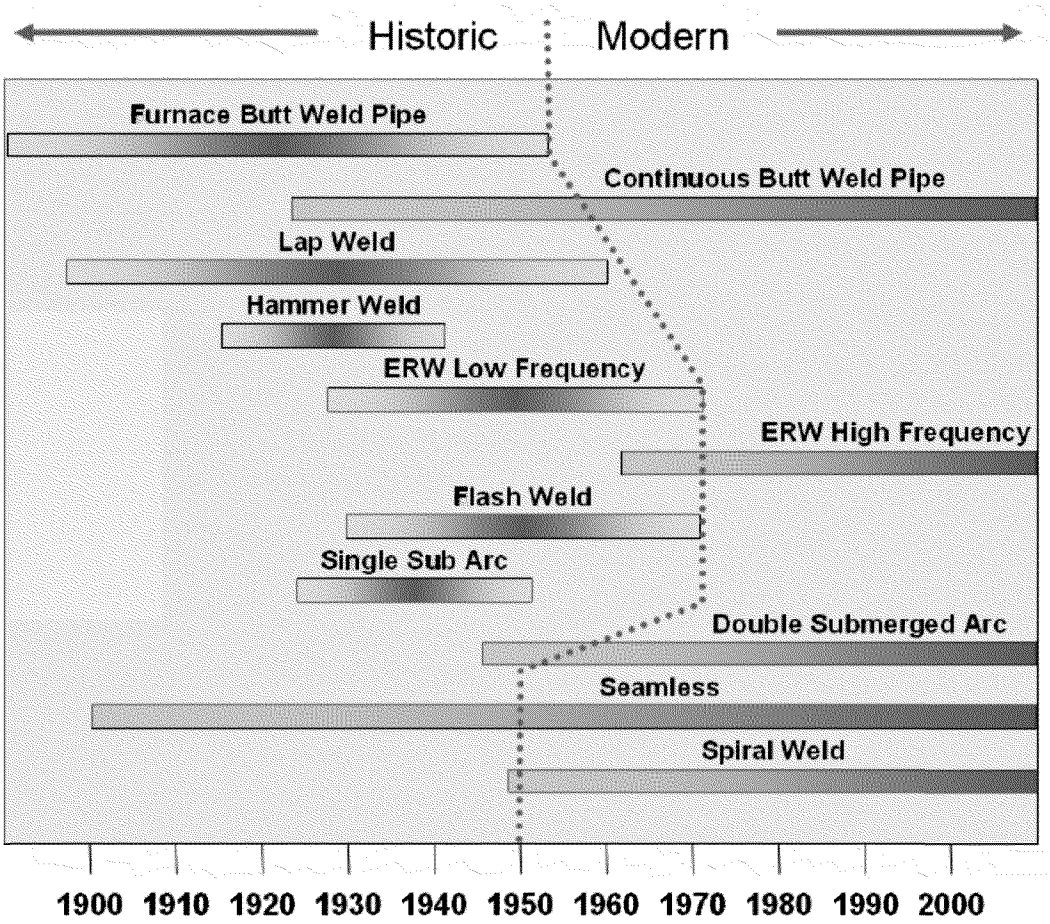
[36] Ex. 2, p. 3B-9.
[37] Ex. 2, pp. 3B-10 to 3B-11.
[38] *Id.*
[39] *See*, Ex. 2, p. 3B-9.



Pipe Making Practices [40]

As the table shows, aside from DSAW and seamless pipe, there are pipelines with at least three other seam types – continuous butt weld pipe, spiral weld, and ERW high frequency– that were manufactured starting in about 1925, 1950 and 1960, respectively, and continue to be manufactured today. PG&E provided no data or analysis as to whether these manufacturing techniques changed over time, such that prior variations of these techniques are substandard and prone to failure.

The PG&E consultant's evaluation and testimony regarding PG&E's program further explained that the significance of the 1970 date is simply that "[p]ipelines under Federal jurisdiction installed after that date were required to undergo a hydrostatic

[40] PG&E's citation for the "Pipe Making Practices" Table at Ex. 2, p. 3B-9 reads: Clark, E.B., Leis, B.N., Eiber R.J., "Integrity Characteristics of Vintage Pipelines," The INGAA Foundation, Inc., 2005.

pressure test before entering service."[41] PG&E's consultant testified that 1970 marked the end of flash-welded seam and low-frequency ERW seam manufacturing, but the consultant also concluded that PG&E's inclusion of all seam types, including spiral welds and flash welded pipe, as 'problem' pipe is "conservative" and "unnecessary."[42] *Thus, PG&E's own consultant viewed the M2 decision tree step as overly inclusive.*

PG&E acknowledged in hearings that strength testing is the preferred method for addressing manufacturing threats:

> Question: Isn't it correct that the – Part 192 of the Federal Regulations and the incorporated operating procedures under B31.8S state that strength testing is the proper means for assessing and mitigating manufacturing threats?
>
> Answer: It is the most prevalent way to assess for those threats, but it's not an absolute.[43]

PG&E also acknowledged that the Outcome M2 result of replacing 100 miles of pipeline constitutes a significant portion of PSEP costs:

> Question: Now are you aware that about two-thirds of the capital budget you've proposed for the pipeline project results from this single Decision Tree Box M2?
>
> Answer: I don't know the percentage, but the percentage seems reasonable that you've quoted.[44]

In rebuttal testimony PG&E clarified that it will apply "practical engineering judgment … on a case-by-case basis" to determine whether for some of the Outcome M2 pipelines "a strength test would provide the same level of safety as replacement."[45] PG&E's witness Hogenson further explained on the stand that PG&E will evaluate for each replacement project "the particular pipeline, its location, its operating stress, its history, … the year it was manufactured, the type of long seam, its location on our

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[41] Ex. 2, p. 3C-11 to 3C-12.
[42] Ex. 2, p. 3C-12.
[43] 12 RT 1512, ll. 2-10, Hogenson/PG&E.
[44] 12 RT 1513-14, Hogenson/PG&E.
[45] Ex. 21, A45, p. 3-22:3-8, Hogenson, PG&E.

system."[46] In other words, PG&E conceded that it is not reasonable to replace every non-DSAW pipe segment – including those with spiral welds or continuous butt welds – just because it was manufactured prior to 1970.

While the Commission has a great deal of discretion in weighing conflicting evidence, it is not free to pick and choose the evidence it wants to rely upon, and ignore the rest.[47] Among other things, such an approach does not comport with the concept that PG&E bears the burden of proof in this proceeding. By failing to address all of the evidence on this issue, including PG&E's own admissions, the Decision violates § 1757 and is inconsistent with PG&E's burden of proof. The practical consequences of this error are significant, as it results in unnecessary work being performed at great expense, in contravention of the Commission's oft repeated commitment to ensure that only "necessary" work should be performed in the PSEP:

> In D.11-06-017, the Commission required that the Implementation Plans explicitly analyze cost and demonstrate that the proposed expenditures obtain the greatest safety value for ratepayers. The Commission stated its commitment to ensuring that California's working families and businesses pay only for necessary safety improvements…

Decision at 13.

To ensure that PG&E does not spend capital on unnecessary replacement projects, the Decision must be modified to reflect the record evidence that demonstrates that Outcome M2 is arbitrary, including PG&E's own clarifications on this point. If hydrotest results or other sound engineering justification supports replacement, PG&E should be required to provide that justification to CPSD and obtain its approval before proceeding

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[46] RT 1508-1509, Hogenson, PG&E.

[47] TURN v. PUC, 166 Cal. App. 4th 522, 537 (2008) ("Certainly the PUC has, as it states, 'wide discretion in determining what the market rate should be based on the evidence in the record.' *But it cannot ignore the unrebutted evidence in the record,* and set a market rate that does not account for the difference in services offered by outside counsel experienced in federal trial and appellate litigation and those offered by practitioners before the PUC." *Emphases added.*) *See also, Southern Pacific Co. v Railroad Comm'n,* 13 Cal. 2d 125 (1939).

with the replacement, and to identify such projects in the compliance reports required by the Decision (described in Attachment D).

2. Decision Point 2F Improperly Defers to Phase 2 Pipeline Segments That Should Be Replaced in Phase 1

In addition to their analysis regarding Outcome M2, both DRA and TURN engineering experts recommended the elimination of Decision Point 2F. The purpose of this change would be to replace, rather than test, certain line segments to ensure a lower risk of pipe failures due to construction defects.[48]

Under Decision Point 2F, if a segment with a construction defect has a hydrotest record, that segment would be moved to section 3 of the Decision Tree, which either delays mitigation or applies less stringent mitigation. In other words, the segment would not be replaced in Phase 1. However, the unrebutted evidence shows that a hydrotest record is not an accurate means of determining the safety of a segment with a construction defect. As TURN's expert testified: "Hydrotesting is not the most effective assessment tool to test girth welds and other connections because of the lower hoop stresses."[49] DRA's expert independently concluded that "a hydrostatic test is not well suited for evaluating the condition of these features" and recommended removing the Subpart J query.[50]

In response, PG&E explained that eliminating Decision Point 2F would require re-testing or replacement of the segment and that such action was not consistent with the priority to "execute work on non-tested pipe segments":

> PG&E included the Subpart J query at Box 2F as a screening tool to ensure that mitigation (whether strength testing or replacement) occurred on untested pipelines within urban areas first, in compliance with the Commission's mandate to strength test or replace previously untested pipelines. If the Subpart J query at Box 2F were removed, the outcome would be to re-test or replace many segments that have already been strength tested, resulting in an inefficient use of resources.

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[48] Ex. 145, Testimony of David Rondinone, p.12.
[49] Ex. 131, Testimony of Richard Kuprewicz, p.22.
[50] Ex. 145, Testimony of David Rondinone, p.12.

> As the Commission indicated in Decision 11-06-017, a higher priority use of resources is to execute work on non-tested pipe segments. The presence of a Subpart J query at Box 2F provides this important screening tool.

PG&E Opening Brief at 10 (footnotes omitted).

This PG&E response is nonsensical in that it fails to rebut or even to address the concern of two expert witnesses that a hydrotest is not sufficient to determine if a segment with a construction defect is safe. PG&E insists on deferring consideration of these segments until Phase 2 for reasons that are unclear. And notwithstanding the significant public safety concerns raised by DRA and TURN's experts, the Decision is silent on the Decision Point 2F issue.

Again, the Decision has ignored the record in this proceeding in favor of wholesale adoption of the technical aspects of PG&E's Decision Tree. In sum, rather than engaging in any meaningful consideration of the technical evidence (mainly expert opinion) concerning proposed corrections to the Decision Tree, the Decision simply defers to PG&E. .

Pursuant to § 1757, the Commission is required to review the "whole record" and should do so here. The Decision should be modified to eliminate Decision Point 2F, without requiring further testing of segments already tested. This modification is supported by the technical evidence in the record and is in the public interest, even though it will increase PSEP costs, because it properly prioritizes pipeline replacement work needed to ensure public safety.

III. CONCLUSION

For all the foregoing reasons, and as set forth in the record of this proceeding, the Decision should be revised to correct the errors described above.

Respectfully submitted,

/s/ TRACI BONE

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