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)

APPLICATION FOR REHEARING OF DECISION 12-12-030

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I. INTRODUCTION

The Utility Reform Network ("TURN") applies for rehearing of Decision ("D.") 12-12-030 ("Decision"), pursuant to Public Utilities Code[1] Section 1731 and Commission Rule of Practice and Procedure 16.1. The Decision approves a Phase 1 Pipeline Safety Implementation Plan ("Implementation Plan" or "IP") for Pacific Gas & Electric Company ("PG&E") and authorizes gas service rate increases reflecting costs for various elements of the Implementation Plan. In particular, the Decision authorizes PG&E to recover from ratepayers over $850 million in estimated capital costs for pipeline replacement projects.[2]

The Decision commits serious legal error in each of two determinations. First, the Decision authorizes PG&E to recover $214 million of capital costs to replace pipeline installed after 1955, even though the Decision finds that such pipeline segments would not need to be included in PG&E's Implementation Plan if PG&E had "competently" retained pressure test records for these segments – records that would demonstrate the ongoing safety of PG&E's operating pressures. As a result, the Decision improperly requires ratepayers, not shareholders, to pay for the consequences of PG&E's imprudence. This determination directly conflicts with Sections 451 and 463, and the Commission's longstanding precedent holding that costs resulting from a utility's imprudence must be disallowed from rate recovery. In addition, contrary to Section 1757(a)(3) and (a)(4), imposing these avoidable pipeline replacement costs on ratepayers conflicts with the Commission's own findings in the Decision and is not supported by substantial evidence in the record.

Second, the Decision approves almost $450 million of capital cost recovery for pipeline segments identified for replacement by Action Box M2 of PG&E's Manufacturing Threat

[1] All statutory references are to the Public Utilities Code unless otherwise indicated.
[2] Decision, p. E3, Table E-3.

"Decision Tree," even though PG&E's own testimony acknowledged that some of this pipeline is not substandard and will likely not need replacement. Consequently, this determination is not supported by substantial evidence and violates PG&E's burden of proof obligation under Sections 451 and 454. PG&E has not yet met its burden of proof for all Box M2 segments, and rate recovery may not be approved until it does so.

The Commission should grant rehearing to correct these serious legal errors. In its decision granting rehearing, the Commission should: (1) disallow from rate recovery the $214 million of capital costs in PG&E's Implementation Plan for replacement of post-1955 pipeline segments; and (2) require PG&E to: a) make a showing, for all pipe segments that PG&E proposes to replace under Action Box M2, that substantiates the need for replacement rather than pressure testing; and b) obtain a Commission finding in a decision or resolution that PG&E has met its burden of proving the reasonableness of rate increases to pay for pipeline replacement.[3]

II. BACKGROUND

The chain of events leading to PG&E's proposed Implementation Plan was set in motion by the tragic explosion of a gas transmission line in San Bruno on September 9, 2010. The explosion killed eight people, injured many more, and resulted in a fire that destroyed 38 homes and damaged 80.

D.11-06-017 was one of the Commission's actions in response to the San Bruno explosion. In that decision, the Commission ordered PG&E and other California gas utilities to present an Implementation Plan to pressure test or replace pipeline segments that were not

[3] This paragraph summarizes the relief that TURN requests. A more detailed description of TURN's requested relief is set forth in Sections III.E and IV below.

pressure tested or for which the utilities do not have a sufficient record of a pressure test.[4] In this respect, the goal of D.11-06-017 was to ensure that all pipeline segments, regardless of age, have pressure tests that can serve as a reliable basis for calculating each segment's maximum allowable operating pressure ("MAOP"), thereby ensuring that the segments can withstand normal operating pressures with a margin of safety.[5] For this reason, as further discussed below, a segment that lacks a pressure test record is targeted for pressure testing or replacement under PG&E's IP, even though an otherwise identical segment with the requisite records does not need to be tested or replaced under the IP.

D.11-06-017 further required that, for those pipeline segments proposed to be replaced, utilities must set forth criteria showing why replacement rather than pressure testing was justified.[6] In addition, the decision directed utilities' Implementation Plans to prioritize pipeline segments located in Class 3 and Class 4 (high density) locations and Class 1 and Class 2 high consequence areas ("HCAs").[7]

PG&E filed its IP on August 26, 2011. TURN submitted extensive testimony and briefs challenging aspects of PG&E's IP with respect to the adequacy of the safety measures in the IP, the scope of the projects included in the IP, and PG&E's proposed allocation of cost responsibility between shareholders and ratepayers for the proposed expenditures under the IP.[8] With respect to the cost responsibility issue, one of TURN's key themes was that PG&E's IP improperly sought to impose on ratepayers the obligation to pay for pressure testing and pipeline

[4] D.11-06-017, p. 19.
[5] D.11-06-017, pp. 19-20.
[6] D.11-06-017, pp. 20, 32 (OP 6).
[7] PG&E's IP framed its proposal to address these high priority segments as Phase 1, and indicated that it would present an IP for the lower priority segments, dubbed Phase 2, in a later application to the Commission. Ex. 2 (PG&E), p. 1-3.
[8] TURN testimony: Exhibits 121, 122, 131 and 132; TURN's Opening Brief (May 15, 2012); and TURN's Reply Brief (May 31, 2012).

replacement work that would not need to be done at all, but for PG&E's failure to maintain required pressure test records required by law and industry standards.[9]

The Decision, issued on December 28, 2012, authorized PG&E to recover $165 million in expenses and $1 billion in capital expenditures, most of the latter for pipeline replacement projects.[10] Based on this authorized cost recovery, the Decision approves revenue requirements and associated gas service rate increases for 2012, 2013 and 2014.[11] However, consistent with Commission ratemaking for capital costs, rate recovery (depreciation, rate of return and tax expense) for the authorized capital costs will continue for the useful life of the capital assets, which in the case of the replacement pipeline, will be 65 years.[12]

With respect to cost responsibility, the Decision reaches contrasting conclusions for pressure testing and replacement projects. With respect to pressure testing expenses, the Commission determined that, because PG&E should have both conducted and retained records of pressure tests for all pipeline segments installed after 1955, PG&E's ratepayers should not be required to pay for such pressure tests as part of the Implementation Plan.[13] However, with respect to capital expenditures for pipeline replacement, the Decision determined that ratepayers should pay for all but a *de minimus* portion of PG&E's proposed costs to replace post-1955 segments.[14] The Commission's rationale for these determinations is inconsistent and constitutes legal error as further discussed in the following section.

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[9] TURN Opening Brief (May 15, 2012), pp. 62-69, 74-83; TURN Reply Brief (May 31, 2012), pp. 3-6.
[10] Decision, pp. E2-E3 (Tables E-2 and E-3).
[11] Decision, pp. 3-4. The Decision makes this rate recovery subject to refund pending the outcome of Investigations I.11-02-016, I.11-11-009 and I.12-01-007. Decision, p. 4.
[12] Decision, p. 79.
[13] Decision, pp. 58-60, 117-118 (FOF 18).
[14] Decision, pp. 60-61, 122 (COL 16).

III. THE DECISION'S APPROVAL OF RATE INCREASES FOR PIPELINE REPLACEMENT COSTS THAT RESULT SOLELY FROM PG&E'S IMPRUDENT FAILURE TO RETAIN REQUIRED SAFETY RECORDS CONSTITUTES LEGAL ERROR IN SEVERAL RESPECTS

As explained below, the Decision's authorization of rate recovery for costs to replace pipeline segments installed after 1955 is: (1) not supported by the Commission's findings and conclusions, in violation of Section 1757(a)(3); (2) not supported by substantial evidence in the record, in violation of Section 1757(a)(4); (3) contrary to Section 451 and cases interpreting it holding that it is unreasonable to require ratepayers to pay for the consequences of a utility's imprudence; and (4) contrary to Section 463, which similarly prohibits the Commission from imposing on ratepayers costs resulting from a utility's errors or omissions.

A. Summary of Decision Regarding Rate Recovery of Post-1955 Pipeline Replacement Costs

To understand the Decision's resolution of the issues regarding rate recovery for pipeline replacement costs first requires a discussion of the Decision's disposition of rate recovery for pressure testing costs.

With respect to IP expenses for pressure testing, the Decision disallows rate recovery for all costs to pressure test pipeline segments installed after 1955. The Decision finds that, beginning no later than January 1, 1956, industry standards with which PG&E stated that it complied required pre-service pressure testing of all pipeline segments and that the absence of pressure test records for post-1955 pipe segments reflects "an error in PG&E's operation of its natural gas system."[15] In light of this finding, the Decision concludes that it is reasonable for

[15] Decision, pp. 117-118 (FOF 18). PG&E acknowledged that, beginning in 1961, it was required by the Commission's General Order ("GO") 112 to retain documentation of pressure tests and that federal regulations imposed a similar requirement beginning in 1970. Ex. 21 (PG&E), p. 1-11 to 1-12. *See also* Ex. 54 (GO 112), p. 39, Section 841.417; and 49 C.F.R. Section 192.517.

PG&E shareholders to absorb the IP costs to pressure test post-1956 segments for which PG&E lacks a pressure test record.[16]

The Decision supplies two independent reasons for disallowing these pressure test expenses from rate recovery. The first is the general principle that it is not reasonable to require ratepayers to pay for costs resulting from a utility's imprudence. This principle is articulated in COL 13, which states that "[i]t is reasonable for PG&E's shareholders to absorb the portion of the Implementation Plan costs which were caused by imprudent management."[17] Applying this principle, the Decision text states that, because PG&E's record retention errors have required PG&E to re-test pipeline that should have previously been tested, "the cost of such re-testing is not a just and reasonable cost of providing public utility service." Put another way, the Decision explains that, if PG&E had "competently" retained the pressure test records, post-1956 pipe segments "would not be included in the Implementation Plan." Second, the text finds that the costs of the pre-1956 pressure testing that should have been performed were included in revenue requirement (i.e., rates)[18] and that it would not be reasonable to require ratepayers to pay again for re-testing "due to PG&E's failures in document management."

With respect to IP capital costs for replacement projects, TURN had argued in its briefs that PG&E's same imprudent failure to retain post-1955 pressure test records created the need to replace post-1955 segments in PG&E's IP and that Sections 451 and 463 did not allow ratepayers to be saddled with any such costs, as they result from PG&E's imprudence.[19] Without directly addressing TURN's imprudence argument, the Decision disallows only a small portion of post-1955 replacement costs in the IP. In the only finding or conclusion addressing

[16] Decision, p. 122 (COL 15).
[17] Decision, p. 122 (COL 13).
[18] Decision, p. 59.
[19] TURN Opening Brief (May 15, 2012), pp. 62-69, 74-83; TURN Reply Brief (May 31, 2012), pp. 3-6.

rate recovery of replacement costs, COL 16 adopts an "equitable adjustment" that reduces PG&E's capital cost recovery by the imputed cost of pressure testing these segments.[20] Based on cost figures in the record, TURN estimates that this adjustment only reduced the total post-1955 replacement costs of approximately $241 million by $27 million.[21] However, COL 16 does not explain why the Decision allows PG&E to recover the remaining $214 million of capital costs (almost 90% of the total) for post-1955 replacement projects. The only explanation in the Decision text is the statement that "ratepayers should not receive a new pipeline at no cost."[22] The Decision fails to offer any explanation why pressure testing costs that result from PG&E's imprudence should be disallowed while most replacement costs that result from PG&E's imprudence should be recovered from ratepayers.

B. The Record Irrefutably Shows That, But For the Lack of Pressure Test Records, PG&E Would Not Need to Replace Post-1955 Pipe Segments

As the Decision recognizes, the record is indisputable that the post-1955 pipeline segments that PG&E proposed either to pressure test or replace would not need to be addressed in the IP but for PG&E's imprudence and mismanagement in failing to retain pressure test records. The Decision text finds that "if PG&E had competently retained the pressure test records for pipeline installed from 1956 to 1961, we would have evidence that such pressure tests did, in fact, occur and this pipeline would not be included in the Implementation Plan."[23]

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[20] Decision, p. 122 (COL 16).
[21] TURN Comments on Proposed Decision (Nov. 16, 2012), p. 9, fn. 28. (TURN notes that the figure in the text accompanying footnote 28 in that pleading should have been $214 million, not $241 million.) These figures are based on PG&E's proposal to replace 54 miles of post-1955 segments that lack the requisite records, at an average cost of $4.5 million per mile. TURN Op. Br., pp. 76, 82, 83.
[22] Decision, p. 61.
[23] Decision, p. 59. The only reason this statement is limited to the time period ending in 1961 is that PG&E acknowledged that applicable regulations beginning in 1961 required pre-service pressure tests for

Although this finding is made in the context of discussing the disallowance of pressure test expenses, it applies equally to post-1955 segments proposed for replacement. Nothing in the Decision indicates that the finding does not apply to replacement projects.

An examination of the Decision Trees upon which PG&E's IP projects are based (reprinted in Appendix C to the Decision) confirms that, but for PG&E's imprudent failure to retain pressure test records, the IP replacement projects would be unnecessary. For example, in the Manufacturing Threats Decision Tree,[24] Box M2 is responsible for 100 miles of the total 186 miles of pipeline to be replaced in PG&E's IP.[25] Box 1H shows that, if PG&E has records showing that a pressure test was conducted,[26] the segment is never considered for inclusion among the Box M2 replacement projects. Similarly, in the Fabrication and Construction Threat Decision Tree,[27] an affirmative answer to Box 2F (regarding whether the company has a pressure test record) keeps a segment from being considered for replacement in Box F2.[28] These Decision Trees show that, for two pipeline segments of identical age and specifications (e.g., weld types, material strength) that potentially warrant replacement, *only the segments for which PG&E lacks a pressure test record are actually targeted for replacement in the IP*. In other words, under PG&E's Decision Trees, for two otherwise identical segments A and B, where PG&E has a

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all pipeline segments and further required the retention of such records for the life of the segment. See footnote 15 above.

[24] Decision, p. C1.

[25] Decision, p. 72.

[26] Although Box 1H references a "Subpart J [of federal regulations that became effective in 1970] strength test", in practice, PG&E actually gave a "Yes" answer to this box if the company possessed a pressure test meeting the standards in place at the time of the test, in accordance with OP 3 of D.11-06-017. *See* Ex. 28, PG&E Response to TURN Data Request 18-9(c).

[27] Decision, p. C2.

[28] The Construction and Latent Mechanical Damage Threat Decision Tree (p. C3) does not have any conclusion boxes that would require pipeline replacement in Phase 1.

pressure test record for Segment A but lacks this necessary record for Segment B, only Segment B will be replaced.

C. The Decision's Approval of Substantial Rate Increases for Post-1955 Pipeline Replacement Costs Is Not Supported By the Findings Or By Substantial Evidence in the Record

Section 1757(a) sets forth six independent grounds for a reviewing court to set aside a Commission decision. This section focuses on two of those grounds. Under Section 1757(a)(3), a reviewing court may set aside a Commission decision when the decision is not supported by the findings, and Section 1757(a)(4) requires Commission decisions to be supported by substantial evidence in light of the whole record. The Decision falls far short of both requirements when it approves rate recovery for over $200 million of capital costs to replace post-1955 pipe segments for which PG&E lacks required pressure test records.

The record and the Decision's own findings and conclusions fail to support this determination. To the contrary, they fully support the outcome urged by TURN -- full disallowance of post-1955 replacement costs. COL 13 correctly states the controlling principle, reflecting the requirements of Section 451's just and reasonable standard and Section 463's mandate to disallow costs resulting from utility errors: "It is reasonable for PG&E's shareholders to absorb the portion of the Implementation Plan costs which were caused by imprudent management." Thus, under the Commission's own correct statement of the governing standard, shareholders, not ratepayers, should pay for IP costs when: (1) the utility's management was imprudent, and (2) such imprudence causes the IP costs to be incurred.

The Decision clearly determines that PG&E's failure to retain post-1955 pressure test records was imprudent. FOF 18 finds that PG&E's failure to produce records of post-1955 pressure tests that it was supposed to conduct was an "error in PG&E's management of its

natural gas system."[29] Similarly, FOF 38 references PG&E's "imprudent management decisions regarding pipeline records and pressure testing older pipeline,"[30] and the text bluntly concludes that "PG&E has imprudently managed its gas system records . . .."[31]

The causation requirement is also plainly satisfied. As shown in the previous section, the record, and the Decision text itself, show indisputably that PG&E would have no need to incur post-1955 replacement costs if it had not lost pressure test records that a prudently managed utility would have retained. Indeed, under the IP, pipe segments identical to those being replaced, *but for which PG&E prudently retained the required pressure test records*, will not be replaced. In other words, but for PG&E's imprudence, the post-1956 segments "would not be included in the Implementation Plan."[32]

The Decision's only rationale for imposing these capital costs on ratepayers – that ratepayers should not receive a new pipeline at no cost – ignores the fact that the new pipelines would not be necessary if PG&E had "competently" kept the necessary records.[33] If PG&E were replacing the pipe in the IP because PG&E demonstrated that <u>all</u> pipe meeting certain specifications (e.g., age, seam weld type, material strength) need to be replaced, then it would be appropriate for ratepayers to pay for the costs of the new pipe. In that situation, pipeline characteristics, not PG&E's imprudence, would be the reason for the replacement. But this is a much different case. Here, PG&E's imprudent failure to retain important safety records is the determining factor. Moreover, requiring ratepayers to pay for pipe that is only being replaced in the IP because of PG&E's imprudence contradicts the Decision's COL 13, which correctly

[29] Decision, p. 117-118 (FOF 18).
[30] Decision, p. 120 (FOF 38).
[31] Decision, p. 87. See also p. 60, referring to PG&E's "poor document management."
[32] Decision, p. 59.
[33] Decision, p. 59.

concludes, in accordance with Sections 451 and 463, that shareholders must absorb costs resulting from their imprudence.

The Decision implies that it would be unfair for ratepayers to benefit from new pipeline without paying for it. However, this line of thinking ignores the key question of why the pipeline is being replaced. When, as shown, the only reason PG&E is replacing the post-1955 pipeline is because of PG&E's managerial failure, it not only is appropriate for PG&E's shareholders to absorb the costs, it would be grossly unfair to require ratepayers to pay for PG&E's mistakes. Furthermore, requiring utilities to pay for capital replacements made necessary by imprudence is sound public policy. The utility must be held accountable for properly maintaining capital equipment and keeping proper records of such maintenance. Otherwise, the utility would have the perverse incentive to allow equipment to degrade so that it could replace it early and increase rate base unnecessarily.

In sum, requiring ratepayers to shoulder hundreds of million of dollars of replacement costs that would be absent from the IP if PG&E had managed its system prudently is neither supported by the Decision's own findings nor supported by substantial evidence in the record.

D. The Commission's Failure to Disallow the Post-1955 Replacement Costs, Which Result from PG&E's Imprudence, Violates Both Sections 451 and 463

Section 1757(a)(2) provides that Commission decisions may be set aside when the Commission has failed to proceed in the manner required by law. By imposing on ratepayers the IP costs to replace post-1955 segments, the Decision violates both Section 451 and Section 463 and therefore runs afoul of Section 1757(a)(2).[34]

[34] Although this pleading discusses Section 451 and Section 463 in the same section, they each separately require the disallowance of the post-1955 replacement costs.

Section 451 sets forth the bedrock requirement of California public utilities law that all utility charges must be "just and reasonable." As the Decision recognizes, "it is beyond dispute" that this provision gives the Commission authority to disallow rate recovery for costs imprudently incurred by utilities.[35] The Decision further recognizes in COL 13 that it is reasonable for PG&E's shareholders to absorb costs caused by the company's imprudent management.[36]

Commission decisions interpreting Section 451 have consistently held that it is not reasonable for utility rates to include costs that result from a utility's imprudence. For example, in D.94-03-048, the Commission held that it is not reasonable to pass on to Southern California Edison ratepayers costs resulting from the Mohave Coal Plant accident.[37] Similarly, D.85-08-102 held that ratepayers are not responsible for bearing the consequences of PG&E's imprudence with respect to the construction of the Helms Pumped Storage Project.[38] As the Commission emphatically stated in D.84-09-120, "it would be unconscionable from a regulatory perspective to reward . . . imprudent activity by passing the resultant costs through to ratepayers."[39]

The Commission's longstanding and consistent interpretations that the "just and reasonable" requirement of Section 451 bars rate recovery of costs resulting from a utility's imprudence compel disallowance of the post-1955 replacement costs. As shown above, the Decision properly finds that PG&E's failure to retain pressure test records for segments installed

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[35] Decision, p. 53.
[36] Decision, p. 122 (COL 13).
[37] 53 CPUC 2d 452, 456.
[38] 18 CPUC 2d 700, 715-716. *See also* D.11-10-002, slip. op. at pp. 16-17 (disallowing costs resulting from utility's unreasonable actions causing a prolonged electric plant outage); D.93-05-018 (holding that ratepayers must be held harmless against replacement power costs resulting from unreasonable electric plant outages); D.94-03-050 (disallowing $90 million of costs resulting from PG&E's imprudence in procuring gas supplies).
[39] 16 CPUC 2d 249, 283.

after 1955 was erroneous and imprudent, and the record incontrovertibly shows that, absent this imprudence, the IP would not include post-1955 replacement projects.

Section 463 imposes a similar, but independent, requirement to disallow all costs resulting from utility imprudence. Section 463(a) is a broadly worded provision directing that the Commission "shall disallow" both "direct and indirect" costs resulting from "any" unreasonable error or omission "relating to . . . any portion" of the utility's plant estimated to cost more than $50 million.[40] By its plain words, Section 463(a) mandates that the Commission disallow all costs resulting from PG&E's errors and omissions relating to the proposed Implementation Plan. PG&E's errors and omissions in failing to retain required pressure test records directly relate to the cost to replace segments installed after 1955. In fact, those errors and omissions directly cause the need for the replacement work.

The Decision's discussion of Sections 451 and 463 fails to address TURN's *imprudence* argument under those statutes and therefore is irrelevant. The Decision states:

> The public utility code standards for rate recovery, i.e., just and reasonable, and the disallowance concept reflected in Section 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.[41]

However, TURN's imprudence argument in its post-hearing briefs was the same argument TURN makes in this pleading[42] -- that Sections 451 and 463 do not allow the Commission to saddle ratepayers with costs resulting from a utility's imprudence. It is no answer to this

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[40] The $50 million threshold is easily surpassed here as the capital expenditures for the new utility plant proposed in just the Pipeline Modernization Program portion of PG&E's IP amount to $928 million. Ex. 2 (PG&E Op. Test.), p. 1-16, Table 1-3.

[41] Decision, p. 54 (footnote omitted).

[42] *See* TURN Opening Brief (May 15, 2012), pp. 62-69, 74-83; TURN Reply Brief (May 31, 2012), pp. 3-6.

argument that neither Section 451 nor Section 463 compels disallowance of costs that should have been expended earlier.

Although not clearly stated, the Decision's implicit response to TURN's imprudence argument appears to be that costs resulting from a utility's imprudence should only be disallowed if ratepayers are being asked to pay for the same work a second time. This view is suggested in footnote 43 at the conclusion of the passage quoted above, in which the Decision constructs a hypothetical based on the Commission's disallowance of costs stemming from the 1985 accident at the Mohave power plant. The Decision claims that, if, hypothetically, the utility in that case had sought ratepayer funding to make needed safety improvements at a second plant, the reasonableness standard would not support a disallowance unless the utility had previously obtained ratepayer funding to make the improvements.[43]

This footnote misstates the Commission's precedent under Section 451 and ignores the plain words of Section 463. While certainly it is neither just nor reasonable under Section 451 to require ratepayers to pay twice for the same work, that is hardly the sole basis for disallowing costs under Sections 451. As demonstrated, the cases interpreting Section 451 also require disallowance of costs that arise from a utility's imprudence, without regard to whether or not ratepayers had previously paid for the costs in question. For instance, in D.94-03-038 regarding the Mohave coal plant accident, the Commission simply required SCE to absorb any costs resulting from the accident, without asking whether such costs were previously reflected in rates. Indeed, by definition, a "disallowance" is a denial of rate recovery for costs that a utility has incurred or will incur. Whether or not prior rates included these costs, the disallowance is

[43] Decision, p. 54, fn. 43.

reasonable and necessary because the utility could and should have avoided the costs simply by managing its operations prudently.

Moreover, Section 463 contains no language whatsoever indicating that the Commission's obligation to disallow costs resulting from utility errors or omissions only applies if prior rates had included the same costs. Thus, the Decision arbitrarily engrafts a new requirement on the settled principle that ratepayers should not pay for the consequences of a utility's imprudence, contrary to Section 463 and the Commission's longstanding precedent under 451.

In sum, both Section 451 and Section 463 require the Commission to disallow from rate recovery all of the replacement costs resulting from PG&E's imprudent failure to retain necessary safety records for post-1955 segments. By imposing these costs on ratepayers, the Decision violates both provisions.

E. The Commission Should Grant Rehearing and Disallow from Rate Recovery Replacement Costs for All Post-1955 Segments

The foregoing demonstrates that the Decision's authorization of rate recovery for replacement of post-1955 segments is contrary to the Decision's own findings and conclusions, not supported by substantial evidence, and a violation of Sections 451 and 463. The record needs no further development on these issues. Accordingly, the Commission's decision on rehearing should: (1) disallow from rate recovery the approximately $214 million of capital costs in PG&E's IP for replacement of post-1955 pipeline segments, and (2) adjust accordingly the Decision's Tables E-3 and E-4, as well as the revenue requirements and associated rate recovery.

IV. THE DECISION'S CONCLUSION THAT ALL PIPELINE SEGMENTS IDENTIFIED BY DECISION TREE BOX M2 SHOULD BE REPLACED IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE IN THE RECORD AND IS CONTRARY TO PG&E'S BURDEN OF PROOF REQUIREMENT UNDER SECTIONS 451 AND 454

Decision Tree Box M2 is responsible for more of the approved costs of PG&E's IP than any other element of the Implementation Plan. As the Decision recognizes, the M2 Action Box reflects replacement of 100 miles of pipeline at an estimated cost of $450 million.[44] The Decision affirms the Decision Tree logic that leads to replacement of pipeline under Box M2 and authorizes rate recovery of most of the $450 million of projected capital costs.[45]

The pipeline scheduled for replacement under this box includes *all* pre-1970 pipeline that is neither DSAW (double submerged arc welded) nor seamless and operates in an HCA at a pressure greater than 30% of SMYS.[46] In support of its approval of all proposed M2 replacement projects, the Decision concludes that the segments in Box M2 have "substandard welds," such 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."[47]

The Decision's conclusion that all pre-1970 non-DSAW or non-seamless pipe warrants replacement due to "substandard" or "suspect" welds is not supported by substantial evidence and thus runs afoul of Section 1757(a)(4). This conclusion ignores overwhelming evidence,

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[44] Decision, p. 72.
[45] As noted above, the Decision rejects a small portion of pipeline replacement costs equal to the cost of pressure testing the post-1955 segments for which PG&E failed to retain required pressure test records. Decision, p. 61. TURN estimates the disallowed replacement capital costs at approximately $25 million. See TURN Reply Brief (May 31, 2012), Appendix A.
[46] Decision, p. C1 (PG&E Manufacturing Threats Decision Tree).
[47] Decision, pp. 73, 118 (FOF 25), and 123 (COL 23).

including PG&E's own consultant report and rebuttal testimony, demonstrating that PG&E's blanket inclusion of all pre-1970 pipe of all welds aside from DSAW is overbroad.

The evaluation of PG&E's IP by PG&E's own consultant explained that the significance of the 1970 date is simply that "pipelines under Federal jurisdiction installed after that date were required to undergo a hydrostatic pressure test before entering service."[48] The consultant agreed 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."[49] Thus, PG&E's own consultant viewed the M2 decision tree step as overly inclusive.

Furthermore, in rebuttal testimony, PG&E admitted that replacement, which is on average nine times more expensive than pressure testing,[50] may not be necessary for all segments included in Box M2. PG&E stated that it will apply "practical engineering judgment … on a case-by-case basis" to determine whether for some of these pipelines "a strength test would provide the same level of safety as replacement."[51] 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 system."[52] 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.

[48] Ex. 2 (PG&E), pp. 3C-11 to 3C-12.
[49] Ex. 2 (PG&E), p. 3C-12.
[50] TURN Reply Brief, Appendix A.
[51] Ex. 21, A45, p. 3-22:3-8, Hogenson, PG&E.
[52] RT 1508-1509, Hogenson, PG&E.

In light of these admissions by PG&E, the record evidence does not support the Decision's conclusion that all Box M2 segments need to be replaced. To the contrary, the record shows that some of the Box M2 segments contain welds that are not substandard and that PG&E's own assessment will likely show do not warrant replacement. Yet, the Decision approves rate recovery for all Box M2 segments, contrary to the substantial evidence in the record.

In this respect, the Decision also violates PG&E's burden of proof obligation under Sections 451 and 454. As the Decision recognizes, "PG&E has the burden of affirmatively establishing the reasonableness of all aspects of the application."[53] Yet, the Decision grants rate recovery for Box M2 segments that even PG&E concedes may only need pressure testing, not replacement. PG&E has not yet met its burden of proof for all Box M2 segments and rate recovery may not be approved until it does so.

The goal of D.11-06-017 was to implement Plans that would address important safety concerns in an "orderly and cost-conscious" manner.[54] The Decision undermines this goal by allowing PG&E to spend capital on replacement projects that are not necessary at this time and that serve PG&E's interests in increasing rate base and solving other problems not related to weld types.

Accordingly, for all pipe segments that PG&E proposes to replace under Box M2, the Commission's decision on rehearing should require PG&E to make a showing that substantiates the need for replacement rather than pressure testing. To meet the requirements of Section 451 and 454, the Commission must conclude in a decision or resolution (in response to a Tier 3

[53] Decision, pp. 40-41.
[54] D.11-06-017, p. 18.

advice letter) that PG&E has met its burden of proving the reasonableness of rate increases to pay for pipeline replacement.

V. CONCLUSION

The legal errors identified in this application for rehearing are serious and need to be corrected expeditiously to prevent PG&E from imposing on ratepayers the costs of post-1955 pipeline replacement work that properly should be absorbed by ratepayers, and, in the case of pipeline identified by Decision Tree Box M2, does not need to be done. The Commission should grant rehearing and issue a decision that corrects these errors with dispatch.

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Respectfully submitted,

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