BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Investigation on the Commission's Own Motion into the Operations and Practices of Pacific Gas and Electric Company with Respect to Facilities Records for its Natural Gas Transmission System Pipelines.	I.11-02-016 (Filed February 24, 2011) (Not Consolidated)
Order Instituting Investigation on the Commission's Own Motion into the Operations and Practices of Pacific Gas and Electric Company's Natural Gas Transmission Pipeline System in Locations with Higher Population Density.	I.11-11-009 (Filed November 10, 2011) (Not Consolidated)
Order Instituting Investigation on the Commission's Own Motion into the Operations and Practices of Pacific Gas and Electric Company to Determine Violations of Public Utilities Code Section 451, General Order 112, and Other Applicable Standards, Law, Rules and Regulations in Connection with the San Bruno Explosion and Fire on September 9, 2010.	I.12-01-007 (Filed January 12, 2012) (Not Consolidated)

OPENING BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES REGARDING FINES AND REMEDIES

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OPENING BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES REGARDING FINES AND REMEDIES

I. INTRODUCTION

A. Overview

In this brief, the Division of Ratepayer Advocates ("DRA") makes its recommendations to the Commission on what fines and other remedies should be imposed in the San Bruno Explosion, Recordkeeping, and Class Location Investigations.[1]

[1] These investigations are docketed as I.12-01-007, I.11-02-016, and I.11-11-009, respectively.

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These investigations represent the most important safety cases currently before this Commission, and they present exceptional challenges.

First, the amount of evidence adduced is staggering. This Commission's Consumer Protection and Safety Division ("CPSD")[2] with the help of outside experts, identified multiple unsafe practices by PG&E in the operation of its gas transmission system, many extending over 50 years. CPSD has proved thousands of violations with an enormous amount of solid evidence painstakingly collected, analyzed, and presented. There is a great deal of evidence for the Commission to consider.

The evidence in these investigations has shown that Pacific Gas and Electric Company's ("PG&E") inattention to the safety of its natural gas transmission system has been so pervasive and longstanding that the potential fines in all three investigations, taken individually and calculated at the maximum level provided by statute, exceed *hundreds of billions of dollars*. Even at the minimum level, the potential fines for all of the investigations taken together exceed $100 billion.

Faced with the likelihood of an extremely large fine, PG&E has made arguments throughout the San Bruno Explosion and Recordkeeping Investigations that are irresponsible, and even blatantly frivolous. PG&E's briefs in these two enforcement proceedings are also replete with misleading statements of fact and law. DRA has called attention to some of them in its briefs in these investigations.[3] PG&E claims to have accepted responsibility for the San Bruno explosion, but actions speak louder than words. By these actions PG&E has demonstrated that its "acceptance of responsibility" for its conduct is hollow.

What we have learned from all of this evidence is that PG&E is a company that has not kept its part of the bargain that we call "the regulatory compact." The regulatory compact requires a utility to provide safe and reliable service to the public at a reasonable price. In exchange, it is given a monopoly franchise in its service territory and an opportunity to earn a reasonable profit. PG&E has mismanaged its inherently dangerous gas transmission system so

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[2] The Consumer Protection and Safety Division was renamed the Safety and Enforcement Division (SED) effective January 1, 2012. However, for clarity and consistency, we refer to SED as CPSD throughout this pleading.

[3] *See, e.g.,* DRA Recordkeeping Investigation (RK) Opening Brief (OB) and DRA San Bruno Explosion Investigation (SB) Opening Brief (OB).

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badly and for so long that it has endangered the public and blown up a town, causing multiple deaths and injuries. For this failure to perform its obligation to provide safe service on the scale revealed in the aftermath of the San Bruno explosion, there is no commensurate penalty available, short of revoking PG&E's monopoly franchise to provide gas and electric service to two thirds of California.

Given these extreme circumstances, the greatest challenge facing the Commission in these cases is to determine what remedies will be *effective* to make PG&E operate safely.

With respect to the fines to be imposed on PG&E for the San Bruno explosion,[4] it is clear that the relatively small fines imposed on PG&E in the past, even for serious safety violations, were ineffective. This time, a fine must be imposed that is large enough to have a deterrent effect. As the Commission and PG&E are well aware, the potential fines that could theoretically be imposed in these investigations pursuant to the statutory formula are so enormous that it would be impossible for PG&E to pay them. Thus, as a practical matter, the active parties in these proceedings have understood that the limiting factor for "penalties" in these investigations – defined as fines plus the costs of other remedies absorbed by PG&E – will not exceed what the company can absorb and remain financially viable. The records in these investigations demonstrate that the company can raise at least $2.25 billion, and potentially more, to cover fines and other penalties, including disallowances already imposed in the Commission's December 2012 decision approving PG&E's pipeline safety enhancement plan, Decision (D.) 12-12-030 ("PSEP Decision"). Thus, the Commission should require PG&E to pay a total of approximately $2.5 billion in combined fines and shareholder cost responsibility for fixing PG&E's gas transmission system. With these principles in mind, DRA recommends that the fine be set at $550 million and that the costs of the first phase of the PSEP be allocated entirely to shareholders, understanding that shareholder contributions to the PSEP are significantly offset by reduced taxes.

One clear lesson of the post-San Bruno investigations is that more effective Commission oversight of PG&E's operations is needed. To that end, DRA recommends that the Commission

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[4] "Fine" refers here to any payment made by PG&E pursuant to Public Utilities Code §§ 2107 and 2108. Fines are payable to the State's General Fund. As discussed in the testimony concerning PG&E's ability to absorb penalties, the term "penalties" is often used loosely by equity analysts and others to refer to any and all penalties imposed on PG&E, including unrecoverable costs. There are, however, important legal and tax differences between fines and cost disallowances or other remedies.

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engage a qualified independent monitor to ensure that Phase 1 of the PSEP is done properly and is completed consistent with NTSB recommendations. The cost of that monitoring should be allocated to shareholders and included in the total penalties.

B. Summary Of Recommendations

DRA's recommendations and comments regarding fines and other remedies are as follows:

1. Impose a penalty comprised of a combination of fines, disallowances for remedial gas pipeline-related expenses, and monitoring of the remedial work, for a total penalty of approximately $ 2.5 billion.

2. Recognize that the $2.5 billion total does not address the tax benefits of any disallowance portion of the penalty, and includes the partial disallowance of PSEP costs approved in D.12-12-030 ("PSEP Decision"), which DRA estimates to be approximately $820 million. [5]

3. Impose a fine payable to the state's general fund of $550 million pursuant to Public Utilities Code §§ 2107 and 2108. DRA understands such fines would not be tax deductible.

4. Hold PG&E shareholders responsible for all of the approved costs of Phase 1 of the PSEP, including the $1.169 billion approved in the PSEP Decision, regardless of when the work is completed. Shareholders should also remain responsible for any unapproved costs and cost overruns pursuant to the PSEP Decision. DRA understands that because these costs are for operations and capital investments, they should be tax deductible.[6]

5. Engage a *qualified and independent monitor* to ensure that PG&E properly performs and completes Phase 1 of the PSEP work, and to provide periodic reports to the Commission, intervenors, and the public on how the work is progressing. The independent monitor will monitor the pipeline work, the development of an effective integrity management program for the gas transmission system in all class locations, and the development of a functional recordkeeping system. The costs of this monitoring and reporting should be borne by PG&E shareholders. The monitoring should end when the

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[5] *See* footnote 71 below.

[6] PG&E's witness has testified that such tax treatment will result in PG&E shareholders bearing approximately 63% of the nominal cost of the disallowance. Jt 14 RT 1491: 7, Fornell/PG&E.

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Commission finds, based on the monitor's reports and any other relevant evidence, that Phase I of the PSEP has been successfully completed.[7]

6. Fully implement the following NTSB recommendation:

With assistance from PHMSA, the Commission should "conduct a comprehensive audit of all aspects of PG&E's operations, including control room operations, emergency planning, record-keeping, performance-based risk and integrity management programs, and public awareness programs.[8]

7. Require PG&E shareholders to reimburse the Commission for the reasonable costs of the three investigations, including CPSD's litigation costs. PG&E shareholders should also be required to compensate intervenors The Utility Reform Network ("TURN"), the City of San Bruno, the City and County of San Francisco, and DRA, for their litigation costs, including expert witness fees.

II. THE COMMISSION'S ENFORCEMENT AUTHORITY

A. The Commission Is Responsible For Ensuring That Public Utilities Comply With The Law And Has Broad Statutory Authority To Do *All Things Necessary* In The Exercise Of Its Powers And Jurisdiction

The Commission has wide ranging Constitutional and statutory authority to enforce the law and its own directives, as well as an *obligation* to ensure that all public utilities subject to its jurisdiction comply with those laws and directives.

Article XII of the California Constitution confers on the Commission broad regulatory power over public utilities "including the power to fix rates, establish rules, hold various types of hearings, award reparation, and establish its own procedures."[9] Article XII also gives the Legislature "plenary power, unlimited by other provisions of this constitution but consistent with this article, to confer additional authority and jurisdiction upon the commission …."[10]

"Pursuant to this grant of power the Legislature enacted Public Utilities Code section 701, conferring on the commission expansive authority to '*do all things*, whether specifically

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[7] *See* NTSB Report, Recommendations to the CPUC, p. 130.

[8] NTSB Report, p. 130, Rec. P-11-22.

[9] *See Wise v. PG&E*, 77 Cal.App.4th 287, 293 (1999).

[10] Cal. Const. Art. XII, § 5.

designated in [the Public Utilities Act] *or [in] addition thereto*, which are necessary and convenient' in the supervision and regulation of every public utility in California."[11]

Public Utilities Code § 2101 requires the Commission to enforce the laws of the state against public utilities:

> The commission shall see that the provisions of the Constitution and statutes of this State affecting public utilities … are enforced and obeyed, *and that violations thereof are promptly prosecuted and penalties due the State therefor recovered and collected,* and to this end it may sue in the name of the people of the State of California.[12]

These statutory powers and obligations have been "liberally construed" by the courts[13] and the Commission.[14]

The Commission's most articulate expression of its own enforcement authority is found in D.98-12-075. On December 17, 1998, on the same day that the Commission issued the *Carey* enforcement decision fining PG&E $800 per day for 1,221 days for continuing to delegate gas shut-off services after a 1994 gas explosion put PG&E on notice that the practice was unsafe,[15] the Commission also issued D.98-12-075, adopting rules to enforce standards of conduct between utilities and their affiliates. In light of the *Carey* case, the Commission perceived the need to specifically articulate its enforcement authority. Decision 98-12-075 expressly stated the Commission's intent that the decision be relied upon as precedent: "…[B]ecause these principles distill the essence of numerous Commission decisions concerning penalties in a wide range of cases, we expect that we will look to these principles as precedent in determining the level of penalty *in the full range of Commission enforcement proceedings*, and not just in affiliate transaction matters."[16]

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[11] *Consumers Lobby Against Monopolies v. CPUC,* 25 Cal. 3d 891, 905 (1979) *citing* Pub. Utils. Code § 701 (*italics in original*).

[12] California Public Utilities Code § 2101 (*emphases added*). Unless otherwise stated, all further section references are to the California Public Utilities Code.

[13] *Consumers Lobby Against Monopolies v. CPUC,* 25 Cal. 3d 891, 905 (1979) *citing People* v. *Superior Court,* 62 Cal. 2d 515 (1965); *People* v. *Western Air Lines, Inc*., 42 Cal. 2d 621 (1954); *Sale* v. *Railroad Commission*, 15 Cal. 2d 612 (1940); and *Kern County Land Co.* v. *Railroad Com*., 2 Cal. 2d 29 (1934).

[14] *See, e.g.,* D.98-12-075.

[15] *Carey v. PG&E,* D.98-12-076, 84 CPUC 2nd 196 (1998).

[16] D.98-12-075, 1998 Cal. PUC LEXIS 1016, *52 (*emphases added*).

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Since that time, the Commission has looked to D.98-12-075 as precedent, applying it in numerous enforcement cases.[17]

In addition to articulating the factors the Commission considers when imposing a fine, D.98-12-075 explained the reasons for the Commission's *obligation* to aggressively pursue its enforcement authority: "It is *fundamental* to the Commission's exercise of its powers and jurisdiction *that the agency take reasonable steps to ensure that the utilities comply with its orders and rules*."[18] Because of the harm, not only to consumers, but to the "integrity of the regulatory processes," Decision 98-12-075 explained that utility violations of statutes or Commission directives, "*regardless of the effects on the public, will be accorded a high level of severity*."[19]

Thus, consistent with both the Commission's statutory authority, and its interpretation of that authority, the Commission has both an *obligation* to ensure utilities comply with state laws and Commission directives, and a wide range of enforcement tools to punish utilities, deter future violations, and redress the harm committed by violations. In sum, the Commission has expansive authority to "'*do all things*, whether specifically designated in [the Public Utilities Act] *or [in] addition thereto*, which are necessary and convenient' in the supervision and regulation of every public utility in California."[20] Some of the specific enforcement tools available to the Commission are described below in more detail.

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[17] *See, e.g.,* D.11-11-001 (Rancho Cordova); D.08-09-038 (SCE Performance Based Ratemaking); D.04-09-062 (Cingular); D.02-10-059 (Qwest).

[18] D.98-12-075, 1998 Cal. PUC LEXIS 1016, *6 (*emphases added*).

[19] D.98-12-075, 1998 Cal. PUC LEXIS 1016, *55-56 (*emphases added*).

[20] *Consumers Lobby Against Monopolies v. CPUC,* 25 Cal. 3d 891, 905 (1979) *citing* Pub. Utils. Code § 701 (*italics in original*).

B. The Commission Has The Authority To Impose Fines[21]

Decision 98-12-075 emphases that "[a]s part of its enforcement efforts, the Commission has traditionally imposed fines when faced with persuasive evidence of non-compliance."[22]

1. Statutory Authority

Sections 2107 and 2108 establish the Commission's authority to impose fines for violations of laws and regulations. Section 2107 states that, "in a case in which a penalty has not otherwise been provided," penalties shall be not less than $500 nor more than $50,000 for each offense.[23] Section § 2108 provides that each day a violation continues "shall be a separate and distinct offense":

> Every violation of the provisions of this part or of any part of any order, decision, decree, rule, direction, demand, or requirement of the commission, by any corporation or person is a separate and distinct offense, and in case of a continuing violation each day's continuance thereof shall be a separate and distinct offense.

The Commission's authority to impose fines pursuant to § 2107 was upheld in 2006 by the California Court of Appeals in the *Cingular Appeal.*[24]

2. Factors Considered By The Commission In Setting The Amount Of Fines

For more than a decade, the Commission has looked to the factors set forth in Public Utilities Code § 2104.5 and D.98-12-075 to establish the amount of fines to be assessed in gas enforcement cases. As explained in the recently issued D.11-11-001 (*Rancho Cordova*), the analysis required by D.98-12-075 for affiliate transaction violations is applicable to *all* fine

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[21] As used throughout this brief, the term "fines" means monies collected from a utility pursuant to §§ 2107 and 2108 and payable to the State's General Fund. A fine is one remedy available to the Commission. Other statutory remedies include reparations (§ 734). The Commission also has the power to impose equitable remedies such as restitution, injunctive relief, or any other actions the Commission may take pursuant to its equitable authority. The term "penalty," as used in this brief, refers to the entire range of remedies available to the Commission.

[22] D.98-12-075, 1998 Cal. PUC LEXIS 1016, *6.

[23] California Public Utilities Code Section 2107 was amended by SB 876 (2011) and the maximum penalty as of January 1, 2012 is $50,000. Previously, the maximum penalty was $20,000.

[24] *Pacific Bell Wireless, LLC v. Public Utilities Commission,* 140 Cal. App. 4th 718 (2006) (*Cingular Appeal*).

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proceedings, including the gas explosion investigation addressed by that decision, and those principles "closely parallel" the considerations in Public Utilities Code § 2104.5.[25]

Decision 98-12-075 sets forth the five factors the Commission considers in establishing an appropriate penalty amount, and it emphasizes the *deterrence value* of such penalties, especially when violations threaten public safety:

> In establishing the appropriate fine, the principles call for the Commission to take into account the severity of the offense, the conduct of the utility (before, during and after the offense), the financial resources of the utility and the totality of circumstances related to the violation. The resulting fine should also be considered in the context of past Commission decisions. . . .[26]

and

> The purpose of a fine is to go beyond restitution to the victim and to effectively deter further violations by this perpetrator or others. For this reason, fines are paid to the State of California, rather than to victims.
>
> Effective deterrence creates an incentive for public utilities to avoid violations. Deterrence is particularly important against violations which could result in public harm, and particularly against those where severe consequences could result. To capture these ideas, the two general factors used by the Commission in setting fines are: (1) severity of the offense and (2) conduct of the utility. These help guide the Commission in setting fines which are proportionate to the violation.[27]

The Commission has routinely applied D.98-12-075 to consider the following five factors whenever it assesses fines against a utility:

- The severity of the offense;
- The conduct of the utility before, during, and after the offense;
- The financial resources of the utility;
- The totality of the circumstances in furtherance of the public interest; and

[25] D.11-11-001, p. 35, note 21 ("D.98-12-075 … addressed the principles that should be applied for imposing a fine for a violation of the affiliate transaction rules. As stated in [D.98-12-075] 'these principles distill the essence of numerous Commission decisions concerning penalties in a wide range of cases….' The principles set forth in D.98-12-075 closely parallel the considerations set forth in Pub. Util. Code §2104.5.").

[26] D.98-12-075, 1998 Cal. PUC LEXIS 1016, *9.

[27] D.98-12-075, 1998 Cal. PUC LEXIS 1016, *53-54.

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- The amount of the fine in the context of prior Commission decisions.[28]

3. The Commission Has Authority To Impose Daily Fines For As Long As The Violation Persists

PG&E has asserted in the Recordkeeping Investigation that CPSD may not "assert 'continuing' violations going back decades."[29] PG&E also claims that the Commission may not find a "continuing" violation unless it proves that the utility could have cured the violation, but failed to do so.[30] PG&E further argues that "the equitable doctrine of laches precludes CPSD from raising claims of violations going so far back in time that PG&E cannot reasonably be expected to have the evidence to meet the charges."[31]

PG&E's arguments have no merit.

CPSD did not arbitrarily decide to assess fines on a daily basis. Public Utilities Code § 2108 expressly provides that each day a violation continues "shall be a separate and distinct offense." As PG&E is well aware, the Commission has relied upon this statutory provision for decades to assess fines for each day that a utility is in violation of the law or a Commission directive.[32]

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[28] *See, e.g.,* footnote 17, above.

[29] PG&E RK OB, p. 11.

[30] PG&E RK OB, p. 11.

[31] PG&E RK OB, p. 11.

[32] *See, e.g., Carey,* D.98-12-076, 84 CPUC2d 196, Ordering Paragraph (OP) 1 (1998); D.98-12-075, 1998 Cal. PUC LEXIS 1016, *56 (discussion the policy behind daily fines and affirming that "[f]or a "continuing offense," *Public Utilities Code § 2108* counts each day as a separate offense."); *Cingular Investigation,* D.04-09-062, p. 62 ("Section 2108 provides, in relevant part, that 'in case of a continuing violation each day's continuance thereof shall be a separate and distinct offense.' … Both violations constitute continuing offenses during the relevant time periods. Considering the record as a whole, we find that the penalty for each violation should be calculated on a daily basis.") and Conclusion of Law (COL) 4 ("Pursuant to §§ 2107 and 2108 and Commission precedent, for the violations of law for the period January 1, 2000 to April 30, 2002 (849 days), Cingular should pay a penalty of $10,000 per day, or $8,490,000."); *Qwest*, D.02-10-059, p. 43, n. 43 ("Sections 2107 and 2108 address fines. According to § 2107, Qwest is liable for a fine of $500 to $20,000 for every violation of the Public Utilities Code or a Commission decision. Section 2108 provides that every violation is a separate and distinct offense, and in case of a continuing violation each day's continuance constitutes a separate and distinct offense."); and SCE's Performance-Based Ratemaking OII, D.08-09-038, p. 111 ("Finally, a fine of $30 million is reasonable when viewed as an ongoing violation that should be subject to a daily penalty, as recommended by CPSD and used by the Commission in the case that was upheld in *Pacific Bell Wireless, LLC v. Pub. Util. Comm'n.* If SCE's violations are viewed as daily violations that continued for seven years, then a $30 million dollar fine equates to a daily penalty of just less than $12,000 ($30 million / 7 years / 365 days").

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PG&E made a related argument challenging continuing violations last year when it appealed a fine of $16.8 million for failure to perform gas leak surveys. In that appeal, PG&E argued that because the requirement to conduct a leak survey is once every five years, it could only be fined once every five years for missing the next leak survey.[33] The Commission affirmed the ALJ determination that PG&E was wrong: "The duty to conduct a leak survey does not expire for five years once a survey date has passed. … *Each missed day is a violation.* This view is consistent with state law, which provides that in the case of a continuing violation each day's continuance is a separate and distinct offense."[34]

Here, PG&E claims: "It is not enough to contend, as CPSD apparently does, that the continued absence of a record makes a violation continuing."[35] However, that is exactly the point. Section 2108 *requires* that the Commission consider fines for every day the record is absent. PG&E suggests that it may only be fined on a daily basis if the violation is "curable" and it claims that its records violations are not curable.[36] PG&E contends: "The Commission may not find a 'continuing' violation in the absence of proof that the utility could have cured the alleged violation, and failed to do so."[37] PG&E argues that absent an "ability to cure," daily fines would lead to "absurd results."[38] PG&E's argument culminates in the conclusion that it is entitled to both "notice and a meaningful opportunity to cure."[39]

PG&E's "notice and cure" argument makes no sense. As an initial matter, it is not true that PG&E's records violations are not curable. PG&E has spent over 250,000 person hours since the San Bruno explosion correcting and updating its pipeline records pursuant to NTSB recommendations and Commission orders.[40] It claims it "has retrieved, scanned and uploaded

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[33] Resolution ALJ-277, p. 3.

[34] Resolution ALJ-277, p. 4, *citing* § 2108 (*emphases added*).

[35] PG&E RK OB, p. 40.

[36] PG&E RK OB, p. 41.

[37] PG&E RK OB, p. 11.

[38] PG&E RK OB, p. 41.

[39] PG&E RK OB, p. 42.

[40] *See, e.g.,* D.11-06-017 and D.12-12-030, pp. 11-12. *See also,* January 31, 2013 letter from PG&E President Christopher P. Johns to Honorable Deborah A.P. Hersman, Chairperson of the National Transportation Safety Board and the PG&E Power Point Presentation entitled "PG&E Pipeline Safety Enhancement Plan (PSEP) Expedited Application Workshop", dated March 26, 2013. The Assigned ALJ in I.11-02-016 took official notice of these two documents via e-mail ruling on April 4, 2013.

more than 3.5 million paper documents dating back more than 50 years…"[41] Thus, PG&E's claim that its missing and/or inaccurate records cannot be "cured" contradicts the point of this effort, and its own reports that it has located some of the missing information.[42]

Second, assessing fines on a daily basis does not lead to absurd results because of other protections built into the statutory framework for assessing fines. While CPSD is obligated to consider daily fines pursuant to § 2108, as described in Section II.B.2 above, the Commission may adjust the fines by taking into account a combination of the factors listed in § 2104.5 and D.98-12-075, including: the severity of the offense; the conduct of the utility before, during and after the offense; the financial resources of the utility; and the totality of the circumstances in furtherance of the public interest; and the role of precedent.'

D.98-12-075 explains the important policy behind assessment of daily fines:

> The number of the violations is a factor in determining the severity. A series of temporally distinct violations can suggest an on-going compliance deficiency which the public utility should have addressed after the first instance. Similarly, a widespread violation which affects a large number of consumers is a more severe offense than one which is limited in scope. For a "continuing offense," Public Utilities Code § 2108 counts each day as a separate offense.[43]

Finally, nothing in the statutory framework mentions a requirement that a violation be "curable" or requires the Commission to provide notice and opportunity for cure before imposing daily fines. And this position is inconsistent with multiple Commission decisions that have imposed daily fines without first providing an opportunity to cure.[44]

The cases cited by PG&E in support of this claim do not establish that "the Commission has interpreted Section 2108 as applying only to violations that are curable."[45] If anything, one of the cases stands for the proposition that a utility may incur daily fines for failure to cure *after*

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[41] PG&E RK OB, p. 1.

[42] *Id.*

[43] D.98-12-075, 1998 Cal. PUC LEXIS 1016, * 56.

[44] *See, e.g.,* footnote 32 above.

[45] PG&E RK OB, 41.

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notice.[46] In this instance, inability to cure may be taken into consideration in establishing the amount of the fine, but as described above, there is no evidence that the violations are not curable. As PG&E is well aware as a result of its records validation efforts, where it has irretrievably lost documents, it has available to it opportunities to "cure" by recreating the relevant information contained within them by, for example, performing an assessment of the line.

Finally, PG&E argues that it is prejudiced by CPSD's "unreasonable delay" in identifying and citing it for records deficiencies such that the equitable doctrine of laches bars CPSD from asserting the violations now.[47] PG&E makes much of the fact that the Commission did not identify its records problems in previous audits and that it failed to perform specific audits for compliance with § 451.[48] The Commission is clearly at fault with regard to its lax oversight of PG&E's recordkeeping practices.[49] However, CPSD's inattention does not absolve PG&E of its continuing obligation to maintain complete and accurate records to ensure the safety of its gas pipeline system pursuant to § 451, nor does it protect PG&E from prosecution for its recordkeeping violations. As explained in DRA's Opening Brief in the Recordkeeping Investigation, PG&E has been on notice since at least the early 1980s that there were significant problems with the accuracy of the databases it relied upon to determine the schedule for maintenance and replacement of its gas pipeline system.[50] The Commission's failure to recognize this fact after superficial audits that focused primarily on PG&E's written procedures, rather than the data and actual practices behind them, does not absolve PG&E of the responsibility to mind its own house.

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[46] *See Strawberry Prop. Owners Ass'n v. Conlin-Strawberry Water Co., Inc.*, D.97-10-032, 1997 Cal. PUC LEXIS 954, *9 ("… [E]ach day any violation remains uncured constitutes a separate and distinct offense for the purposes of the penalty provisions of the Public Utilities Code from which any relevant statute of limitations may be measured.").

[47] PG&E RK OB, pp. 43-48.

[48] PG&E RK OB, pp. 43-45.

[49] *See, e.g.,* NTSB Report, p. 122 ("The CPUC, as the regulator for pipeline safety within California, failed to uncover the pervasive and long-standing problems within PG&E. Consequently, this failure precluded the CPUC from taking any enforcement action against PG&E. The CPUC lost opportunities to identify needed corrective action and to follow through and ensure that PG&E completed the prescribed corrective actions in a timely manner.")

[50] DRA RK OB, § V.B.1.

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Most significantly, while PG&E cites a number of cases purportedly in support of its laches claim (and they are, consistent with PG&E's defense in these investigations, *not* in support), PG&E overlooks the cases holding that laches may *not* be asserted to prevent an agency's enforcement of an important policy adopted for the benefit of the public.[51] Those cases lay to rest PG&E's laches claim. In sum, they conclude that "neither the doctrine of estoppel nor any other equitable principle may be invoked against a governmental body where it would operate to defeat the effective operation of a policy adopted to protect the public."[52] CPSD's prosecution of PG&E here unquestionably concerns significant policies adopted to protect the public, including the Commission's ability to enforce safety requirements applicable to utility facilities. Thus, "as a matter of law, laches is not available as a defense."[53]

C. The Commission Has Equitable Authority To Order Refunds Or Disallow Utility Expenses

In addition to its authority to impose fines, the Commission may impose equitable remedies so long as they are designed to redress the harm committed by the violation and they are "cognate and germane" to the Commission's existing authority.[54]

As the California Supreme Court recognized, the Commission's equitable authority is extensive and has been used in many prior situations:

> The commission often exercises equitable jurisdiction as an incident to its express duties and authority. For example, the commission may issue injunctions in aid of jurisdiction specifically conferred upon it. [Citations omitted] It may direct that a trust fund be created to conserve potential refunds during a stay of an order lowering rates. [Citations omitted] Its power to reform contracts of public utilities to make them conform to the

[51] *See, e.g., San Francisco v. Ballard,* 136 Cal. App. 4th 381, 395 (2006) ("We are concerned with whether city's lawsuit concerns a public policy and therefore, as a matter of law, laches is not available as a defense."); *Kajima/Ray Wilson v. LA County Metro. Trans. Auth.,* 23 C. 4th 305, 316 (2000) ("[N]either the doctrine of estoppel nor any other equitable principle may be invoked against a governmental body where it would operate to defeat the effective operation of a policy adopted to protect the public." *quoting County of San Diego v. Cal. Water etc. Co.,* 30 Cal. 2d 817, 826 (1947)); *Feduniak v. Cal. Coastal Comm'n,* 148 Cal. App. 4th 1346, 1381 (2007) ("[L]aches is not available where it would nullify an important policy adopted for the benefit of the public."); and *Golden Gate Water Ski Club v. Contra Costa,* 165 Cal. App. 4th 249, 263 (2008).

[52] *Kajima/Ray Wilson v. LA County Metro. Trans. Auth.,* 23 C. 4th 305, 316 (2000) *quoting County of San Diego v. Cal. Water etc. Co.,* 30 Cal. 2d 817, 826 (1947).

[53] *San Francisco v. Ballard,* 136 Cal. App. 4th 381, 395 (2006).

[54] *Consumers Lobby Against Monopolies v. CPUC,* 25 Cal. 3d 891, 905-906 (1979).

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public interest has been recognized. [Citations omitted] And the commission itself has relied on equitable precedent in implementing its authority to issue cease and desist orders. [Citations omitted][55]

The Commission may also use its equitable authority to order refunds or disallowance of costs pursuant to § 451 when it finds that a rate or charge is not just and reasonable. Section 451 provides:

> All charges demanded or received by any public utility … for any product or commodity furnished or to be furnished or any service rendered shall be just and reasonable. Every unjust or unreasonable charge demanded or received for such product or commodity is unlawful.[56]

As a supplement to § 451, and consistent with the Commission's general ratemaking authority, § 463 specifically requires the Commission to disallow direct and indirect expenses where they are related to the unreasonable errors or omissions of a utility and add more than $50 million to the cost of providing service:

> [T]he 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) ….[57]

The Commission has relied upon § 463 and its general ratemaking and equitable authority on many occasions to disallow costs resulting from unreasonable utility errors and omissions, and should do so here.[58]

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[55] *Consumers Lobby Against Monopolies v. CPUC,* 25 Cal. 3d 891, 907 (1979).

[56] *See also* § 728 ("Whenever the commission, after a hearing, finds that the rates or classifications, demanded, observed, charged, or collected by any public utility for or in connection with any service, product, or commodity, or the rules, practices, or contracts affecting such rates or classifications are insufficient, unlawful, unjust, unreasonable, discriminatory, or preferential, the commission shall determine and fix, by order, the just, reasonable, or sufficient rates, classifications, rules, practices, or contracts to be thereafter observed and in force.").

[57] Pub. Utils. Code § 463.

[58] *See, e.g.*, *Re Pacific Gas and Electric Company* (1998) 83 CPUC 2d 208 (D.98-11-067, affirming disallowance of $100 million from recoverable Diablo Canyon nuclear plant sunk costs, based on an admitted error by contractors during the plant's construction); *Re Southern California Edison Company* (1994) 53 CPUC 2d 452 (D.94-03-048, disallowing costs associated with an accident and explosion at a coal slurry generating plant that killed six utility employees); *Re Pacific Gas and Electric Company* (1985) 18 CPUC 2d 700 (D.85-08-102, disallowing costs based on managerial imprudence and inadequate attention during construction of Helms Pumped Storage Project); *Re Southern California Edison Company* (1985) 17 CPUC 2d 470 (D.85-03-087, disallowing repair costs associated with

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The PSEP Decision approving PG&E's remedial gas pipeline safety plan expressly contemplated that such ratemaking issues would be addressed in these proceedings. The PSEP Decision expressly made the rate increases approved in that decision subject to refund based on "ratemaking adjustments … adopted in [the Commission's] investigations":

> Our upcoming decisions in Investigations (I.) 11-02-016, I.11-11-009, and I.12-01-007 will address potential penalties for PG&E's actions under investigation. We do not foreclose the possibility that further ratemaking adjustments may be adopted in those investigations; thus, all ratemaking recovery authorized in today's decision is subject to refund.[59]

Ordering Paragraph 3 of D.12-12-030 reinforces this finding:

> All increases in revenue requirement authorized in Ordering Paragraph 2 [of this decision, D.12-12-030] are subject to refund pending further Commission decisions in Investigation (I.) 11-02-016, I.11-11-009, and I.12-01-007.[60]

Even without these provisions in the PSEP Decision, or the authority set forth in § 463, the Commission has equitable authority to exercise its ratemaking powers to disallow all further PSEP costs to the extent those costs fund activities that will redress the violations in these proceedings. Because PSEP costs are unquestionably funding such activities – for example, pressure testing or replacing pipes for which PG&E has no records to support the pressure rating – the Commission may properly disallow *all* PSEP costs, not just the Phase I costs approved in D.12-12-030, but also Phase II PSEP costs for which PG&E will be seeking approval for in its next Gas Transmission and Storage rate case.

III. THE SCOPE OF PG&E'S VIOLATIONS IS MASSIVE AND PG&E'S LIABILITY IS SIGNIFICANT

The number of PG&E safety violations, and the possible fines involved are staggering. Taken together, the three San Bruno investigations allege thousands of daily violations spanning,

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defective steam generator equipment at San Onofre Nuclear Generating Station Unit 1); *Re Southern California Edison Company* (1986) 22 CPUC 2d 124 (D. 86-10-069, disallowing $344.6 million in construction costs of SONGS units 2 and 3 as a result of imprudence and unreasonable delays in completion of the project).

[59] D.12-12-030, p. 4.

[60] D.12-12-030, p. 126, OP 3.

in many instances, over 50 years. As a result of the Commission's obligation to consider each day of a continuing violation a separate and distinct offense,[61] the range of fines for these violations exceeds several hundred *billion* dollars. For example, in the Class Location Investigation (I.11-11-009) CPSD alleges over 2,000 different violations, which when calculated on a daily basis constitute over 15 million violations.[62] The maximum possible fine in that investigation alone is approximately $220 billion.[63] In the Recordkeeping Investigation (I.11-02-016), PG&E has identified over 23,000 pipeline segments in populated areas for which it does not possess records for testing or maintenance of its pipeline as required by state and federal law.[64] If violations from 1956 to 2010 are counted for only 1,000 of those segments, the maximum possible fine in that investigation also approaches $150 billion.[65] And this is only one set of violations of the 35 that CPSD has alleged in the Recordkeeping Investigation.

DRA does not argue that fines of this magnitude are appropriate – they are not. But these calculations *are relevant* to demonstrate the massive scope and timeframe of the violations at issue. The San Bruno explosion is not the result of a one time "mistake" by PG&E. It is the result of organizational dysfunction that has persisted for over 50 years. Further, PG&E's refusal to admit to any but a small handful of the violations asserted in the San Bruno Explosion and Recordkeeping Investigations lays bare its bad faith defense in these cases. For example, in the face of overwhelming evidence that PG&E records contain millions of errors and/or omissions, contributed to the San Bruno explosion and a dysfunctional integrity management program, and now require testing and/or replacement of over 950 miles of its gas pipeline system,[66] *PG&E admits to only one minor recordkeeping violation* regarding its clearance form for work in the

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[61] Pub. Utils. Code § 2108.

[62] I.11-11-009, Class Location OII, CPSD Investigative Report, Table 12, p. 58.

[63] The maximum statutory fine before 1994 was $2,000. The maximum statutory fine between 1994 and 2011 was $20,000. CPSD's Table 12 alleges 5.3 million violations before 1994. Multiplied by $2,000, the maximum fine for these violations is approximately $10.6 billion. The 10.6 million violations after 1996 would be subject to a maximum fine of approximately $212 billion, for a total fine of over $222.6 billion.

[64] CPSD RK OB, p. 17, *citing to* TURN Exhibit 4, PG&E Response to Joint CPSD-TURN Data Request 01, Question 01, and Attachment GasTransmissionSystemRecordsOII_DR_Joint_001-Q01Atch01.

[65] Applying the maximum statutory fine, one violation spanning the period January 1, 1956 to September 9, 2010 would be subject to a fine of approximately $149 million. One thousand such violations would result in a maximum fine of $149 billion.

[66] D.12-12-030, p. 3.

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Milpitas Terminal on the day of the explosion.[67] Further, PG&E admits that "has not located a number of pressure test records that, by regulation, it should have."[68] However, there is no violation because "PG&E has not given up looking for these records and still hopes to find them."[69] This argument would be funny if it were a joke, but PG&E is serious, and it offers this as a defense in the Commission's Recordkeeping Investigation – a serious matter. In the San Bruno Explosion Investigation PG&E is similarly unrepentant. PG&E only acknowledges two violations, both unrelated to Segment 180: (1) failure to properly complete a "clearance form" for electrical work at the Milpitas Terminal – the same violation it admits to in the Recordkeeping Investigation; and (2) failure to promptly administer employee tests for alcohol consumption.[70]

IV. THE APPROPRIATE FINE AMOUNT

As set forth in Section II.B.2 above, the Commission considers five factors in determining whether a fine should be imposed:

- The severity of the offense;
- The conduct of the utility before, during, and after the offense;
- The financial resources of the utility;
- The totality of the circumstances in furtherance of the public interest; and
- The amount of the fine in the context of prior Commission decisions.

Examination of each of these factors demonstrates that PG&E's liability for the San Bruno Explosion and its related recordkeeping and class location violations should be no less than $2.25 billion, and could be more.

How this liability is divided between fines payable to the general fund and equitable remedies such as disallowances for PSEP work is within the discretion of the Commission. Given the magnitude of the misconduct, and PG&E's failure to acknowledge that misconduct, the fine portion of the penalty should be *well above* any fine imposed by the Commission to date.

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[67] *See* PG&E RK OB, p. 2, note 7.

[68] *See* PG&E RK OB, p. 2, note 7.

[69] *See* PG&E RK OB, p. 2, note 7.

[70] *See* PG&E RK OB, p. 5.

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However, DRA is also concerned that PG&E ratepayers not be required to pay for PG&E's errors and omissions and other imprudent actions that have led to the need for its PSEP. Consequently, the Commission must strike the appropriate balance between fines and the need for PG&E to perform billions of dollars in remedial work.

With this balance in mind, as well as consideration of the factors required by D.98-12-075 and § 2104.5, as discussed in more detail below, DRA recommends a fine, payable to the State's General Fund of $550 million, and disallowance of all remaining Phase 1 PSEP costs, which are currently capped at $1.169 billion pursuant to Table E-4 of D.12-12-030. This proposal takes into account the approximately $820 million in PSEP costs disallowed by the Commission in D.12-12-030,[71] so that the cumulative "penalty" of fines plus equitable remedies totals approximately $2.539 billion, not including the costs for the independent monitor addressed below.

This total penalty is consistent both with the Well Fargo Report's representation that the "market" expects a *fine* in the range of $500 million, and with *actual* market expectations, such as those reflected in PG&E's stock price reduction after the San Bruno explosion, that a *total penalty* – including both fines and disallowance of remedial costs – could be $2.5 to $2.7 billion.[72] As explained in the Overland Financial Analysis, PG&E can easily afford a total penalty of approximately $2.25 billion, incremental to the $200 million of equity already raised by PG&E.[73] Further, to the extent PG&E decides to finance its disallowed costs with equity, those equity offerings will primarily fund capital costs associated with improving PG&E's gas

[71] The Wells Report (Jt. Ex. 67) miscalculates the PSEP disallowance as $1.015 billion by simply subtracting the amount approved in D.12-12-030 from the amount requested by PG&E in its PSEP application. Wells Report, p. 21 and footnote 33. The Wells Report fails to recognize that PG&E's original PSEP request was highly inflated and included costs that PG&E will not incur, such as $380.5 million for contingency. The PSEP Decision recognized this and did not approve certain unjustified costs, including for contingency. D.12-12-030, p. 99. The decision *did* disallow specific costs that it determined should be borne by shareholders, such as $330 million for PG&E's records validation and database update projects. D.12-12-030, p. 87. DRA and TURN calculate the total disallowance of *actual* costs PG&E shareholders will be required to absorb pursuant to D.12-12-030 to be approximately $820 million. Any additional costs PG&E claims to have incurred are not supported by the record in the PSEP proceeding.

[72] *See* discussion in Section IV.C below.

[73] Jt. Ex. 54, Overland Rebuttal, p. 22 and footnote 22.

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infrastructure, and should not be vulnerable to the concerns expressed in the Wells Report associated with raising equity to pay a fine.[74]

A. The Severity Of The Offense

The San Bruno Explosion is the largest and most deadly utility disaster in California history. PG&E's mismanagement, including installation of the faulty pups in 1956, and failure to build a functional integrity management program in the decades that followed, killed eight people, wounded 66 others, and damaged or destroyed 38 homes. Had this been a true "accident" and PG&E had otherwise run an exemplary gas pipeline system, that factor would be a meaningful consideration here. However, that is not the case. In the months that followed the San Bruno explosion, every report found that PG&E's sub-standard installation practices, and abysmal recordkeeping practices contributed to the explosion. Looking at the totality of the circumstances, the NTSB deemed the San Bruno Explosion an "organizational accident" that might have been avoided if PG&E had applied lessons learned from earlier gas pipeline incidents:

> [M]any of the organizational deficiencies were known to PG&E, as a result of previous pipeline accidents in San Francisco in 1981, and in Rancho Cordova, California, in 2008. As a lesson from those accidents, PG&E should have critically examined all components of its pipeline installation to identify and manage the hazardous risks, as well as to prepare its emergency response procedures. If this recommended approach had been applied within the PG&E organization after the San Francisco and Rancho Cordova accidents, the San Bruno accident might have been prevented.[75]

Thus, it quickly became evident that the "offense" here was not just the San Bruno explosion, but that there were *multiple continuing violations by PG&E committed over many decades that led up to the accident*, and that these violations compromised the integrity of PG&E's *entire* gas pipeline system. This realization resulted in the NTSB's issuance of a number of urgent recommendations to ensure the safety of PG&E's pipeline system[76] and the Commission's subsequent pipeline safety rulemaking,[77] which ordered PG&E to undertake *massive* remedial efforts – including "pressure testing of 783 miles of pipeline, replacement of

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[74] *See, e.g.,* Jt. Ex. 67, Wells Report, pp. 15-16.

[75] NTSB Report, pp. 117-118 (*citations omitted*).

[76] Some of the NTSB safety recommendations are in the record at Jt. Ex. 44 and CPSD-94 I the SB OII.

[77] *See e.g.,* D.11-06-017 and D.12-12-030.

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186 miles of pipeline, installation of 228 automated valves, and upgrades to 199 miles of pipeline to allow for in-line inspection." [78]

These deficiencies in PG&E's operations were not news to PG&E's management. Every investigation into the causes of the San Bruno explosion and PG&E's recordkeeping practices revealed that PG&E was *on notice* for decades that it needed to make significant changes in its operations, but it did not. In 1981, the NTSB investigated a gas pipeline leak in San Francisco where PG&E took 9 hours and 10 minutes to stop the flow of gas because it could not locate one emergency valve due to inaccurate records.[79] As described in DRA's Opening Briefs, Bechtel advised PG&E in both 1984 and 1986 of the risk to its integrity management program caused by missing pipeline data, and the need for additional research to resolve these "uncertainties."[80] The NTSB reports on the incidents in San Francisco in 1981 and the 2008 Rancho Cordova gas explosion both put PG&E on notice that many of its practices were deficient, unsafe, and needed to be modified.[81] The NTSB goes so far as to suggest that San Bruno might have been avoided if PG&E had changed its ways.[82] And a 2009 PG&E-commissioned audit of its integrity management risk algorithm put PG&E on notice that its risk assessment methodology suffered from "significant weaknesses"[83] causing the safety of its system to be compromised.

The amount of PG&E malfeasance revealed by the investigations into the San Bruno explosion, and PG&E's prior notice of these problems, multiplies the "severity of the offense" beyond calculation. The San Bruno explosion revealed that PG&E's gas pipeline transmission system is a ticking time bomb and that, absent the safety controls now being put in place, and perhaps additional measures, such as close monitoring of PG&E's operations, another explosion could happen anywhere and at any time.

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[78] D.12-12-030, p. 3.

[79] NTSB Report, p. 81.

[80] DRA SB OB, pp. 15-17, DRA RK OB, pp. 26-27.

[81] NTSB Report, pp.117-118 (*footnotes omitted*).

[82] Report, pp. 117-118.

[83] Jt. Ex. 48, Review of Pipeline IMP Documents, Oct. 20, 2009, by WKMC, LLC, pp. 3-4.

B. The Conduct Of The Utility Before, During, And After The Offense To Prevent, Detect, Disclose And Rectify A Violation

It is not an overstatement to say that PG&E has the contrition of Charlie Manson – that is to say, it has *none*. And the penalties the Commission imposes on it for the violations proven in these investigations should reflect that. PG&E's management, and the opening paragraphs of its briefs in these investigations all claim "regret" for the San Bruno explosion, that PG&E is "morally and legally responsible for this tragic accident," and that it has "learned many lessons."[84] However, *actions speak louder than words.*

PG&E's words of "regret," "responsibility," and "lessons learned" ring hollow in light of PG&E's conduct in these investigations. At the earliest stages of the investigations, PG&E did not cooperate with CPSD investigators, and even destroyed evidence.[85] More recently, PG&E has offered not merely an aggressive defense, but outlandish positions and baseless legal arguments that belie PG&E's claims that it "accepts responsibility for the Line 132 rupture and is a *better company now and forever* due to the lessons learned from this accident."[86] For example, as described in Section III above, notwithstanding the mountains of unrebutted evidence against it (including the thousands of boxes filled with records for sorting at the Cow Palace), PG&E claims CPSD has proven only one recordkeeping violation, and that for records still missing, PG&E claims that no violation has been proven, because it is still looking for them.[87]

Similarly, PG&E's legal defense includes so many misrepresentations of law that the Commission should consider issuing an order to show cause why PG&E should not be

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[84] PG&E RK OB, p. 1 ("PG&E deeply regrets the loss of life and injuries and the effect on the San Bruno community caused by the September 9, 2010 rupture and explosion on Line 132. PG&E is morally and legally responsible for this tragic accident and has acknowledged liability to those injured. As a result of the accident, PG&E – along with the industry as a whole – has learned many lessons, and the company has committed to making real and lasting changes to enhance the safety of its gas system."); see also PG&E SB OB, p. 4 ("PG&E deeply regrets the accident of September 9, 2010, and acknowledges its practices could have been better but, at the time, its gas operations were in line with common practice and regulatory requirements.") and p. 9 ("PG&E accepts responsibility for the Line 132 rupture and is a better company now and forever due to the lessons learned from this accident.").

[85] CPSD RK OB, pp. 73 and 75 ("Within a day of the San Bruno event, the Commission and PG&E directed that all evidence relevant to the San Bruno incident be preserved. Despite these directives, the evidence proves that PG&E destroyed highly relevant eviden[ce].").

[86] PG&E SB OB, p. 9 (*emphases added*).

[87] RK OII, PG&E OB, p. 2 and footnote 7.

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sanctioned for Rule 1.1 violations.[88] Contrary to well-established legal principles coupled with uncontroverted facts, PG&E asserts that:

- Public Utilities Code Section 451, the law that in various versions has required it to operate its system safely since 1909, is not a safety statute, notwithstanding its plain language regarding safety and decades of Commission decisions applying it as a safety statute;[89]

- The Commission may not assess penalties to PG&E on a daily basis, notwithstanding clear statutory language requiring daily assessments and decades of Commission decisions that have done so;[90] and

- PG&E's constitutional due process rights have been violated because it had no notice that it could be fined for gas safety violations pursuant to § 451, notwithstanding the fact that at least three Commission decisions have sought fines for safety violations pursuant to § 451, and two of those decisions involved PG&E.[91]

In sum, PG&E accepts *no* responsibility for the San Bruno explosion, or the corporate culture that permitted it to happen. Instead, PG&E claims the CPSD allegations that it has no safety culture "were mistaken and did not withstand scrutiny."[92] PG&E explains that it is "no

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[88] Rule 1.1 of the Commission's Rules of Practice and Procedure provides:

> Any person who signs a pleading or brief, enters an appearance, offers testimony at a hearing, or transacts business with the Commission, by such act represents that he or she is authorized to do so and agrees to comply with the laws of this State; to maintain the respect due to the Commission, members of the Commission and its Administrative Law Judges; and never to mislead the Commission or its staff by an artifice or false statement of fact or law.

PG&E's Opening Briefs in both the San Bruno Explosion and Recordkeeping Investigations contains arguments that seek to mislead the Commission "by an artifice or false statement of fact or law." PG&E's pleadings, and its entire defense of these two investigations, has lacked the candor the Commission expects from the utilities it regulates. *See e.g.,* D.04-04-065, pp. 35-36 ("In D.94-11-018 … the Commission recognized that a line of prior decisions held that situations involving a failure to correctly cite a proposition of law, a lack of candor or withholding information, and a failure to correctly inform and to correct mistaken information are potential Rule 1 violations, and clarified that a Rule 1 violation can result from such conduct if it is reckless or grossly negligent.").

[89] *See, e.g.,* PG&E RK OB, pp. 11, 24-29; and PG&E SB OB, pp. 28-35.

[90] *See, e.g.,* PG&E RK OB, pp. 39-43.

[91] *See, e.g.,* PG&E RK OB, pp. 11, 34-37; and PG&E SB OB, pp. 35-39.

[92] PG&E SB OB, p. 7.

different" than any other natural gas utility and that its actions "do not represent violations of law or regulations applicable at the time."[93]

These are not the arguments of a utility intending to address its well-documented safety failures in an effective and pro-active manner. To address problems, one must first acknowledge them. PG&E could acknowledge that CPSD did in fact identify many unsafe practices – but it has chosen not to. This is the same utility that knowingly allowed corporate malfeasance to reign unchecked for decades, and that is now expected to rebuild its gas transmission system to redress its systemic shortcomings. PG&E's conduct before, during, and after the San Bruno explosion demonstrate that PG&E's corporate culture and practices will not change absent a penalty of unprecedented proportions.

C. The Financial Resources Of The Utility

1. PG&E Is A Large And Profitable Utility With Substantial Financial Resources

PG&E is one of the largest distribution utilities in the country, with significant financial resources. PG&E serves approximately 4.3 million natural gas customers and 5.1 million electric customers in a northern California service territory that covers 43% of the state.[94] Most of these customers are captive ratepayers paying regulated rates. PG&E's currently Commission-authorized rate of return on equity is 10.4%;[95] it projects that its authorized rate base will grow to $26 billion in 2013.[96] For 2012, PG&E reported revenues from operations of $1.367 billion and profits ("earnings on a GAAP basis") of $816 billion – even after incurring over $500 million of unrecovered costs related to the San Bruno explosion and environmental liability.[97] Despite incurring hundreds of millions of dollars of unexpected and largely unrecoverable expenses related to the San Bruno explosion and dangerous conditions throughout

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[93] *See, e.g.,* PG&E RK OB, p. 3.

[94] Jt. Ex. 52, Overland Financial Report, p. 1.

[95] Jt. Ex. 57, PG&E Corporation Fourth Quarter Earnings Call presentation (February 21, 2013), slide 3. PG&E's FERC-authorized rate of return for its transmission system is closer to 9%.

[96] Jt. Ex. 57, PG&E Corporation Fourth Quarter Earnings Call presentation (February 21, 2013), slide 6.

[97] Jt. Ex. 57, PG&E Corporation Fourth Quarter Earnings Call presentation (February 21, 2013), slide 4.

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its natural gas operations, PG&E continues to pay dividends at its customary rate.[98] That rate is slightly higher than the median of comparable gas company peers and roughly the same as the median of electric company peers.[99] In 2012, despite the widely reported fact that PG&E is facing potential fines and disallowances related to its gas system that may exceed $2 billion, PG&E had no trouble raising approximately $775 million of new equity.[100] PG&E plans to raise even more equity capital in 2013: between $1 billion and $2 billion.[101]

In short, a fine of $800 million represents less than a year's profit for PG&E.

2. PG&E Can Absorb Over $2.25 Billion In Penalties And Still Remain A Financially Healthy And Profitable Company

a) The Overland Financial Report

Given the massive scale of the potential penalties – easily in the tens of billions of dollars – CPSD realized early in these investigations that the measure of the penalties would be constrained by PG&E's ability to pay them and remain financially healthy. Thus, CPSD retained Overland Consulting (Overland) to prepare a financial analysis of PG&E's[102] financial health, including an estimate of its ability to raise enough equity to fund a Commission-imposed fine (Overland Financial Report or Overland Report).[103] The Overland Report provides solid evidence to support the conclusion that PG&E can absorb over $2 billion in fines and other penalties and still remain a financially healthy and profitable company – assuming it takes the necessary action to avoid another San Bruno.

Overland prepared its financial analysis "based largely on the company's own financial projections."[104] For purposes of its analysis, Overland took as a given PG&E management

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[98] See Jt. Ex. 57, PG&E Corporation Fourth Quarter Earnings Call presentation (February 21, 2013), slide 10.

[99] Jt. Ex. 52, Overland Financial Report, p. 2.

[100] Jt. Ex. 57, PG&E Corporation Fourth Quarter Earnings Call presentation (February 21, 2013), slide 9.

[101] Jt. Ex. 57, PG&E Corporation Fourth Quarter Earnings Call presentation (February 21, 2013), slide 9.

[102] For purposes of this discussion, "PG&E" may also refer to PG&E Corporation, also known as "PCG," PG&E's holding company. The PG&E utility is the holding company's primary asset. The Overland Financial Report analyses the financial health of the holding company.

[103] Jt. Ex. 52, Overland Financial Report, p. 1.

[104] Jt. Ex. 52, Overland Financial Report, p. 1.

representations that PG&E plans to fund fines and other unrecoverable costs by issuing equity.[105] Although Overland observed that PG&E could also raise a portion of the equity needed internally (and at less cost) merely by temporarily reducing the dividend level to the low end of the payout ratio targeted by company policy,[106] for purposes of its financial analysis Overland assumed all of the equity would be raised externally consistent with PG&E's plan.

Overland concluded, among other things, that:

- PG&E stock prices already reflect an expected cost for San Bruno penalties, which one bank quantified as a $2.5 billion discount for potential penalties;[107]

- $2.25 billion is the "threshold level" of equity capital available to PG&E which would allow it "to maintain a premium of market value above its book equity value" and comply with its dividend policy, which PG&E projected to be $1.82 per share at the time of the analysis.[108]

- "The threat of a credit rating downgrade as a result of CPUC sanctions is unlikely within a large range of potential penalties."[109]

- "The rating agencies have made clear that they expect the disciplinary action imposed by the CPUC will likely be a material one-time cost but not a chronic drag on earnings."[110]

The Overland Financial Report was prepared before the Commission issued its final PSEP Decision. Prior to issuance of the Overland Financial Report, PG&E adjusted its forecasts for PSEP costs to recognize that the Commission might disallow all 2012 PSEP expenses, which it ultimately did.[111] Overland noted that even with these adjusted forecasts PG&E was still profitable, "earning roughly $3 per share."[112]

Overland also considered PG&E's liability to third parties for personal injury and property damage but did not separately analyze the impacts because PG&E's various insurance

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[105] Jt. Ex. 52, Overland Financial Report, p. 7.

[106] Jt. Ex. 52, Overland Financial Report, p. 7.

[107] Jt. Ex. 52, Overland Financial Report, p. 6.

[108] Jt. Ex. 52, Overland Financial Report, pp. 10-11.

[109] Jt. Ex. 52, Overland Financial Report, p. 3.

[110] Jt. Ex. 52, Overland Financial Report, p.6.

[111] The PSEP Decision did however allow PG&E to earn a return on most of the 2012 capital investments beginning in 2013.

[112] Jt. Ex. 52, Overland Financial Report, p. 5.

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policies providing nearly $1 billion in coverage were more than adequate to cover the $600 million in liability estimated by PG&E.[113]

b) The Wells Fargo Report Is Little More Than A Compendium of Guesses, Rumors, and Gossip Among Investment Analysts

PG&E hired Eric Fornell, Vice-Chairman of Investment Banking for Wells Fargo Securities (Wells), who submitted a critique of the Overland Financial Report ("Wells Report").[114]

First it must be said what the Wells Report is not. Although the report takes pot shots at Overland's analysis, it provides no alternative analysis of what PG&E can afford to pay in penalties and still remain financially healthy. [115] It does not overtly address what the fine *should* be – Mr. Fornell stated he was not qualified to assess that.[116]

The Wells Report focuses on equity analyst reports (in newsletters circulated among investors and investment analysts) trying to predict the size of the fine the Commission is likely to impose for San Bruno. Based on their comments, he warns of dire consequences should the Commission impose a fine larger than what the "market" expects.

Mr. Fornell, purporting to speak for the "investment community," represents that the "market" expects a range of fines with a mean of $477 million. The Wells Report describes a parade of horribles that will result if the Commission assesses a fine significantly larger than what the "market" expects, including a reduced credit rating for PG&E resulting in a higher cost of capital passed through to PG&E ratepayers, and ultimately all California utilities.

The Commission should give no weight to the Wells Report. It is full of analytical and factual errors and employs inappropriate scare tactics intended to mislead the Commission. For example, the Wells Report:

1. Fails to recognize that market expectations about the potential penalty amount have already been realized in PCG's reduced stock prices;
2. Confuses "market expectations" with the guesses of a handful of equity analysts who know little if anything about how the Commission determines fines;

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[113] Jt. Ex. 52, Overland Financial Report, p. 6.

[114] Jt. Ex. 67, Wells Report.

[115] Jt. 14 RT 1448-1449; Jt. 15 RT 1559.

[116] Jt. 14 RT 1448-1449.

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3. Ignores all evidence of "market expectations" that are substantially higher than those Mr. Fornell considered to reach the conclusion that the mean of the range of fines that the "market" expects is $477 million;
4. Fails to clarify that some of its own equity analysts have projected penalties as high as $2.225 billion dollars;
5. Fails to clarify that the alleged "market expectation" of a fine amount, which is based on a selection of equity analyst opinions, only includes the "fine" portion of the total penalty potentially imposed on PG&E and does not consider disallowances or other remedies available to the Commission;
6. Threatens that PG&E's credit will be downgraded if the fine is not consistent with market expectations, but fails to recognize that the rating agencies have anticipated a fine much larger than its $477 million mean, and overall unrecovered costs that could exceed $2 billion;
7. Threatens a parade of horribles resulting from a temporary suspension or reduction of dividends – a red herring given that the Overland Financial Report assumes no such reductions or disallowances;
8. Incorrectly asserts that the Overland Financial Report failed to consider the negative impacts of an equity offering made to fund a fine and its consequences on later offerings; and
9. Ignores the financial benefits of investing in safety, even at shareholder expense.

(1) Market Expectations Regarding A Penalty Amount Are Embedded In PG&E's Stock Price

Market expectations regarding the possible penalty amount (not just the fine, but all remedies combined) have already been realized in the stock price reduction that occurred in the immediate aftermath of the San Bruno explosion. As described above, Overland observes that at least one bank calculates that PG&E's stock price reduction reflects investor expectations that the penalty will be over $2.5 billion.[117]

(2) Wells Fargo Confuses "Market Expectations" With Speculation By A Handful Of Equity Analysts And Ignores More Relevant Market Indicators

Wells confuses *real* market or investor expectations, which are reflected in stock prices, with equity *analyst* hopes or expectations, and it ignores all evidence inconsistent with its conclusions regarding its opinion of "market" expectations. Overland's Rebuttal cites more

[117] Jt. Ex. 52, Overland Financial Report, p. 9.

credible sources indicating that "expectations" regarding the penalty are well above the $477 million mean that Wells claims the "market" expects:

- PG&E stock prices reflect an expected cost of San Bruno penalties in the range of $1.6 to $2.0 billion.[118]
- The rating agencies have anticipated the CPUC imposition of significant fines and penalties, potentially exceeding $1.7 billion.[119]
- PG&E has estimated that fines and penalties could be in the range of $1.5 to $2.0 billion.[120]

These expectations of potential penalties in the range of $1.5 to $2.0 billion are fundamentally inconsistent with the Wells Report's representations that the "market" expects a much lower penalty amount. Evidently the "market" does not include expectations reflected in PG&E's stock price, or the expectations of PG&E and rating agencies. Wells would have the Commission ignore those sources but treat as evidence speculation by a group of equity analysts.

Mr. Fornell testified that the analysts whose penalty estimates he cited "based their estimates in large part, on discussions with the CPUC, comparisons to the Rancho Cordova case, and the consensus of other analysts."[121]

Mr. Fornell, who wrote the Wells Report, does not claim to know anything about the San Bruno Investigations. Mr. Fornell admitted that he had read *none* of the reports into the causes of the San Bruno explosion.[122] He does not claim to know anything about the root causes of the San Bruno explosion.[123] He does not know the factors that the Commission considers when assessing the amount of the fine.[124] And there is no indication in the record that any of the equity analysts whose guesses he relied on are any better informed.

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[118] Jt. Ex. 54, Overland Rebuttal, pp. 10 and 26-27.

[119] Jt. Ex. 54, Overland Rebuttal, pp. 26-27.

[120] Jt. Ex. 54, Overland Rebuttal, pp. 26-27.

[121] Jt. Ex. 67, Wells Report, p. 20.

[122] Jt, 14 RT 1440 and 15 Jt. RT 1554-1555, PG&E/Fornell.

[123] Jt. 15 RT 1555: 6-12, PG&E/Fornell.

[124] Jt. 14 RT 1440, PG&E/Fornell.

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(3) Were The "Market Expectations" Formed By Improper *Ex Parte* Communications?

Mr. Fornell conceded on cross examination that many of the investment analysts whose opinions he cited in his report have financial interests in PG&E.[125] Among the analyst reports he cited are reports from JP Morgan, Bank of America/Merrill Lynch, Morgan Stanley, and Barclays.[126] Bank of America/Merrill Lynch, Deutsche Bank Securities, and Morgan Stanley, among others, all report having met with Commissioners and/or their advisors and discussed the San Bruno proceedings.[127] All three came away from these visits expecting a fine of about $500 million.[128] Given that *ex parte* communications with decisionmakers are prohibited in adjudicatory cases,[129] that some of the investment analysts who reported discussing the investigations with Commission offices have a financial interest in PG&E Corporation,[130] and that the size of penalties are a substantive issue in these three investigations, it appears that "market expectations" may have been shaped in part by improper *ex parte* communications in violations of Public Utilities Code § 1701.2 and the Commission's ex parte rules.[131] On cross-examination Mr. Fornell agreed that published reports like Morgan Stanley's October 4, 2012 report entitled "California Visit Takeaways,"[132] cited in the Wells Report, are widely read in the investment community and likely have a ripple effect on expectations.[133] The Commission should consider the possibility that the source of the rumor among investor

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[125] Jt. 14 Rt. 1535-1536.

[126] Jt. Ex. 67, Wells Report, pp. 19-20.

[127] Jt. DRA Exs. 80, 81, 82.

[128] Jt. DRA Exs. 80, 81, 82.

[129] Pub. Utils. Code § 1701.2 (b).

[130] Wells, and the other companies opining on what the "market" expects for a fine amount all have financial interests in PG&E and the outcome of these proceedings. *See* Jt. 14 RT 1443: 23-24 ("… Wells Fargo owns about $28 million worth of PG&E shares."); Jt. 14 RT 1535-1536 and Jt. 14 RT 1536:14-20 (a number of investment companies estimating the expected fine have disclosed a financial interest in PG&E and other California utilities).

[131] Commission Rules of Practice and Procedure, Article 8.

[132] Jt. Ex. DRA-82.

[133] Jt. 14 RT 1531.

analysts that the fine will be in the neighborhood of $500 million is communication with Commission offices in violation of the *ex parte* rules. [134]

(4) The Wells Report Misrepresents The Market Expectations It Relies Upon

In a related mischaracterization, the Wells Report does not even properly represent the equity analysts' positions that it relies upon. Mr. Fornell focuses on the $477 mean as the amount of the fine that the "market" expects. However, the Wells Report fails to disclose that the analyst reports that Wells relied upon identified a *large range* of expected fines and penalties, with some of those estimates as high as $2.225 billion dollars.[135] Thus, even if these fine "expectations" came from a reliable source which represented a market, which they do not, Wells' quantification of the $477 mean is meaningless. Some of Wells' equity analysts "expect" a fine as high as a billion dollars.

The Wells Report also fails to clarify that its equity analysts were only estimating a possible fine in the opinions he cites. Their estimates do not include projected disallowances or other remedies that the Commission may impose.[136] As discussed earlier, many other sources cited in the Overland Financial Report indicate that the rating agencies and investment analysts expect substantial unrecoverable costs that greatly exceed the amount of the fine.

(5) The Wells Report Employs Baseless Scare Tactics Regarding PCG's Credit Rating And Dividend Cuts

Employing scare tactics, Wells asserts that PCG's credit rating is vulnerable to a downgrade, and implies this will occur if the Commission's fine exceeds "market" expectations.[137] Wells represents that a downgrade "would likely increase their costs and potentially negatively affect PG&E's customers …."[138] Wells even invokes the spectre of the California energy crisis and further suggests a downgrade could "impact PG&E's ability to

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[134] Further, if any decisionmakers expressed opinions on the likely size of the fine, the question arises whether those decisionmakers may have prejudged the outcome of these cases.

[135] Jt. 14 RT 1446:6-22, 1471-1479 (generally), 1472:24-28 ($2.225 billion), and 1479:5-25.

[136] Jt. 14 RT 1522-1523:18-6.

[137] Jt. Ex. 67, Wells Report, p. 11.

[138] Jt. Ex. 67, Wells Report, p. 13.

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procure electricity and gas on behalf of its customers, potentially limiting PG&E's ability to provide service."[139]

Wells offers these inflammatory predictions evidently *unaware* or in spite of the fact that *Standard and Poors (S&P) has already anticipated penalties of* at least *$1.7 billion and has opined that an upgrade is more likely than a downgrade*.[140] As the Overland Rebuttal explains, S&P made the following statements in its December 2012 report:

> *"…we believe there is a high probability that the CPUC will issue a material fine…In total, we assume that the company will incur at least $1.7 billion in out-of-pocket costs and fines not recoverable in customer rates. The company recently estimated that total unrecoverable pipeline safety costs and regulatory penalties related to the San Bruno pipeline explosion could range from $1.5 billion to $2 billion." (emphasis added)*[141]

Overland adds: "S&P affirmed this rating and outlook assuming that PCG will '*pay significant penalties and out-of-pocket costs resulting from the San Bruno incident*.' (emphasis added) The S&P report also stated that an upgrade was more likely than a downgrade."[142]

The Wells Report unleashes more scare tactics by suggesting that there will be a further stock price adjustment in the event of "unanticipated" cuts in utility dividends.[143] This is a red herring. Overland's analysis assumes no change in the dividend payout. Overland did note that PCG could easily raise additional internal equity by temporarily reducing its dividend payments, or even just keeping them flat, at lower cost than raising external equity.[144] But Overland's analysis is in no way contingent upon any change in PG&E's dividend policy. Thus, the Wells Fargo focus on the dividend issue is a distraction.

(6) The Wells Report Mischaracterizes The Overland Financial Report

Wells also incorrectly suggests that the Overland Financial Report failed to account for the negative impact of the fact that PG&E Corporation would be raising equity offering to pay a

[139] Jt. Ex. 67, Wells Report, p. 14.

[140] Jt. Ex. 54, Overland Rebuttal, p. 7.

[141] Jt. Ex. 54, Overland Rebuttal, p. 7.

[142] Jt. Ex. 54, Overland Rebuttal, p. 7.

[143] Jt. Ex. 67, Wells Fargo Report, pp. 7-9.

[144] *See, e.g.,* Jt. Ex. 54, Overland Rebuttal, pp. 18-21 and 27.

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fine, rather than for capital investment, and that the company will be seeking billions more in equity from the capital markets in the next few years.[145] Wells argues that both factors will reduce the demand and thus the prices received for PG&E's equity offerings. However, Wells overlooks the fact that both considerations were taken into account in Overland's highly conservative analysis. As the Overland Rebuttal explains: "…[W]hen compared to a valuation study performed by one of PCG's own equity analysts, Overland's results actually produced a more conservative result."[146] PG&E Corporation's analyst produced a sensitivity analysis that included a range of outcomes up to $2.7 billion in a post-tax exposure to fines and penalties. Its "most likely range of outcomes" included an exposure of up to $1.740 billion.[147]

(7) In A "Favorable Regulatory Environment" Safety Laws Are Enforced

Wells appears oblivious to the role of safety in a "good regulatory environment." The basic message of the Wells Report is that investor perceptions of the regulatory environment matter, and if the Commission were to impose a fine larger than investors are expecting, investors may no longer perceive California to be a "favorable regulatory environment." Investors perceive California to be a "marvelous" regulatory environment since the energy crisis, according to Wells.[148] Marvelous for whom? For the people of San Bruno? What of the NTSB and IRP findings that the Commission failed to detect dangerous practices affecting PG&E's gas operations for years? Don't investors rely on regulators to ensure that public utilities operate safely?

Understandably, investors are focused on earning the best possible return on their investment. But surely safe operations are in the long-term financial interest of PG&E as well as the public. A responsible regulator holds companies accountable for the financial consequences of safety violations.

In sum, PG&E's "expert" testimony regarding "market" expectations for a fine in these proceedings is anything but "expert" and has no credibility. The Overland Financial Report

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[145] *See, e.g.,* Jt. Ex. 67, Wells Report, pp. 14-16.

[146] Jt. Ex. 54, Overland Rebuttal, p. 26.

[147] Jt. Ex. 54, Overland Rebuttal, pp. 26-27.

[148] Jt. 14 RT 1483.

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commissioned by CPSD is solid, and it is conservative. It demonstrates that PG&E can easily raise the funds necessary to pay a total penalty of more than $2.25 billion primarily through stock issuance, possibly supplemented by a temporary dividend adjustment.[149] Shareholders will protest, but hopefully penalties of this magnitude will be large enough to force PG&E to make safety a priority.

D. The Totality Of The Circumstances In Furtherance Of The Public Interest

The totality of the circumstances in furtherance of the public interest require that the harshest punishment available be applied to PG&E. As set forth in Section IV.A above, the severity of the offense – the most deadly utility disaster in the state – is compounded by PG&E's pervasive malfeasance that contributed to the explosion, as well as the fact that PG&E was on notice for decades before that its system was not safe.

As Section IV.B chronicles, PG&E's conduct before, during, and after the explosion has lacked any contrition. Among other things, in an effort to mislead the Commission in violation of Rule 1.1., PG&E has misrepresented laws and facts throughout its briefs in the San Bruno Explosion and Recordkeeping Investigations. Further, despite extensive unrebutted documentation to the contrary, PG&E asserts that it has no safety culture issues.[150] If PG&E cannot acknowledge its safety culture issues, it cannot change them.

As shown by the Overland Audit, PG&E has been an extremely profitable utility for over a decade, earning a minimum of $460 million *over* its authorized rate of return from its gas transmission and storage operations between 1999 and 2010.[151] As described in Section IV.C, the record shows that PG&E can raise at least $2.25 billion, and potentially more, to cover fines and other penalties.

Not *one* of these circumstances speaks favorably for PG&E – with the exception of PG&E's ability to raise capital. Individually, these circumstances mandate the harshest penalty possible; together they leave no room for doubt. The public interest requires that PG&E must be fined until it hurts, and it must be required to pay for all of the work necessitated by its errors,

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[149] Jt. Ex. 51, Overland Financial Report, p. 11.

[150] PG&E SB OB, p. 7 ("CPSD's assertions regarding PG&E's … overall safety culture were mistaken and did not withstand scrutiny by PG&E's expert.").

[151] SB OII, Ex. CPSD-168, Overland Audit, p. 1-3.

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omissions, and imprudence. PG&E has demonstrated its contempt for the Commission in every step it has taken since Segment 180 of Line 132 was installed. Only by applying significant penalties, and by putting PG&E "on probation" with the assistance of an independent third party monitor will the Commission and the public have any assurance that PG&E will change its ways.

E. The Amount Of The Fine In The Context Of Prior Commission Decisions.

The Commission has issued numerous enforcement decisions over the years. However, nothing approaches the penalties being considered in these investigations. *Rancho Cordova* is the most similar to this proceeding, and while its logic is appropriate, its scale is inapposite to the issues faced in these proceedings. In *Rancho Cordova* PG&E faced fines of approximately $97 million, and the Commission fined PG&E $38 million. In imposing that fine, the Commission looked at prior enforcement decisions with total penalties ranging from $12 to $30 million, but found that "the facts and circumstances of Rancho Cordova are distinguishable from those other decisions and justify a higher penalty."[152] The same point is relevant here. Nothing compares to the extent or level of utility malfeasance the Commission faces in these proceedings, including evidence of thousands of violations, many committed over a fifty year time frame.

In short, we are faced with an unrepentant utility that is responsible for the most destructive utility accident in California history. Further, when investigators scratched only the surface, it became immediately evident that the utility did not know where its gas pipelines were located, how they were constructed, or what condition they were in. These deficiencies necessitated a massive effort to identify accurate records for every pipeline and to test and/or replace over 950 miles of pipeline for which records could not be found.

While the Commission should be consistent with its enforcement decisions, prior fines assessed by the Commission provide no context for this matter. Misconduct on the scale shown by the evidence in these investigations constitutes uncharted territory. Here, the Commission should look to the other four factors articulated in § 2104.5 and D.98-12-075, including: the severity of the offense; the conduct of the utility before, during and after the offense; the financial resources of the utility; and the totality of the circumstances. Given that there are no

[152] D.11-11-001, p. 41.

mitigating circumstances, the highest penalty the company can absorb should be imposed on PG&E.

V. OTHER EQUITABLE REMEDIES

A. Safety Requires An Independent Third Party Monitor

PG&E's lack of quality control and quality assurance procedures have been extensively noted and criticized by both the NTSB and the IRP Reports. The NTSB Report blamed the installation of the defective segment in Line 132 on PG&E's lack of quality assurance and control in 1956:

> …. the probable cause of the [San Bruno explosion] was the Pacific Gas and Electric Company's (PG&E) (1) inadequate quality assurance and quality control in 1956 during its Line 132 relocation project, which allowed the installation of a substandard and poorly welded pipe section with a visible seam weld flaw that, over time grew to a critical size, causing the pipeline to rupture during a pressure increase stemming from poorly planned electrical work at the Milpitas Terminal…[153]

The NTSB found that PG&E's poor quality control was also a factor in the Rancho Cordova installation that resulted in an explosion in 2008, and in PG&E's inadequate emergency response after that explosion:

> … the NTSB notes that several of the deficiencies revealed by this investigation, such as poor quality control during pipeline installation and inadequate emergency response, were also factors in the 2008 explosion of a PG&E gas distribution line in Rancho Cordova, California.[154]

The IRP Report noted the importance of quality assurance, which in data projects includes systematic checks for accuracy at multiple stages after data entry has been performed under quality control requirements. It recognized that PG&E's failure to have any quality assurance of its pipeline records after the initial data entry (which was obviously not subject to quality control) allowed the misinformation about Line 132 to persist in the database for decades:

> Data management is important, but it is just one process in the chain. *Quality assurance is the framework that runs throughout the entire process. A review by experienced piping engineers who question*

[153] NTSB Report, p. xii.

[154] *See, e.g.,* NTSB Report, p. 116.

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> *assumptions and demand substantiation should be a part of the quality assurance for the threat identification and risk ranking process.* At any number of process steps in PG&E's threat identification and ranking processes, a casual review by an experienced piping engineer should have flagged the mischaracterization of the pipe seam type for the Line 132 segments that are the subject of this investigation.[155]

This theme of PG&E's lack of quality control and quality assurance runs throughout the IRP Report.[156]

In light of PG&E's quality assurance and quality control failures, which are pervasive and long-standing, and PG&E's refusal to acknowledge that it has committed any but the most minor of violations,[157] or that it does not have a safety culture,[158] it is unrealistic to expect PG&E to change its culture and develop these programs successfully overnight because of a partial change in management. The Commission must adopt a qualitatively different type of oversight of PG&E's gas operations. And it must maintain this stepped-up oversight until PG&E has demonstrated that it can operate its gas transmission system safely.

The Commission cannot provide this oversight in a vacuum, nor can it provide it by itself. The IRP Report identified the Commission's failure to oversee PG&E's gas operations effectively and opined that the Commission as well as PG&E "must confront and change elements of their respective cultures to assure the citizens of California that public safety is the

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[155] IRP Report, p. 62 (*emphases added*).

[156] *See, e.g.,* IRP Report, p. 8 ("The lack of an overarching effort to centralize diffuse sources of data hinders the collection, quality assurance and analysis of data to characterize threats to pipelines as well as to assess the risk posed by the threats on the likelihood of a pipeline's failure and consequences.") and p. 62 ("PG&E lacks robust data and document information management systems and processes. These hinder the collection, quality assurance/quality control, and analysis of data to fully characterize threats to pipelines as well as assess the risk posed by the threats on the likelihood of a pipeline's failure.") and p. 72 ("The fact the line pipe DSAW seam type was incorrectly recorded as 'seamless' is symptomatic of PG&E's inadequate quality control and quality assurance management. The failure to properly document the seam type designation as DSAW, rather than seamless is not sufficient in itself to have prevented this incident, but had the records been more complete and the characterization been part of a more refined threat identification process, then the tragedy might have been avoided. Without a quality assurance program embedded in the integrity management process– and a feedback loop when anomalies are uncovered or pipelines do fail, mistakes happen. Unheeded lapses in the end-to-end process of pipeline integrity can lead to accidents like San Bruno.").

[157] *See* discussion in Section III above.

[158] PG&E SB OB, p. 7 ("CPSD's assertions regarding PG&E's … overall safety culture were mistaken and did not withstand scrutiny by PG&E's expert.").

foremost priority."[159] The NTSB report found that the Commission's "failure to detect the inadequacies of PG&E's pipeline integrity management program" contributed to the San Bruno Explosion.[160] The NTSB made the following finding regarding the Commission's ability to evaluate or assess the integrity of PG&E's pipeline system:

> Because PG&E, as the operator of its pipeline system, and the California Public Utilities Commission, as the pipeline safety regulator within the state of California, have not incorporated the use of effective and meaningful metrics as part of their performance-based pipeline safety management programs, neither PG&E nor the California Public Utilities Commission is able to effectively evaluate or assess the integrity of PG&E's pipeline system.[161]

The NTSB followed this conclusion with the recommendation that the Commission take steps to require PG&E "to correct all deficiencies identified as a result of" the San Bruno explosion "as well as any other deficiencies identified through a comprehensive audit" and "verify that all corrective actions are completed."[162]

In order to (1) comply with the NTSB recommendation to "verify that all corrective actions are completed"; (2) restore public confidence in the Commission's ability to supervise PG&E; and (3) provide the expertise necessary to ensure that PG&E's compliance work is implemented in a timely and competent manner, the Commission should establish a method of oversight that employs independent monitors who will actively monitor PG&E's remedial work and report publicly on their findings. This level of oversight should be maintained until the Commission has found that PG&E has fully complied with its orders regarding testing, replacement, and database upgrades relative to its gas transmission system.

Independent third party monitors are routinely used on large scale public works projects, including the recent retrofits to the Golden Gate Bridge and the current construction of a new Bay Bridge. There, independent monitors are on site, inspecting all aspects of the work being

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[159] IRP Report at 8 and 18-22.

[160] NTSB Report at xii.

[161] NTSB Report, p. 126, Finding No. 25.

[162] NTSB Report, p. 130, Recommendation to the Commission.

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performed on a daily basis as an additional check to ensure the public is getting what it is paying for.

Similarly, it is not uncommon for independent monitors to be employed in response to destructive oil and gas pipeline incidents, including the 2006 British Petroleum oil spills in Alaska[163] and the 1999 rupture of a Shell and Olympic Oil Company pipeline.[164] An independent monitor with expertise in risk assessment, pipeline integrity management, and data management systems was employed to review the implementation of remedial plans agreed to by El Paso Natural Gas Company as part of a 2007 Consent Decree resolving an action brought by the federal government against the company after a pipeline explosion that killed twelve people.[165]

To establish an independent monitor process, the decision resolving these investigations should direct the parties to meet and confer and invite them to file joint comments proposing an independent monitor process acceptable to the majority of them. At a minimum, the decision should require the parties' joint proposal to include these elements:

- A hiring process for the independent monitors that ensures their independence;
- PG&E will hire and pay for the independent monitors;
- The independent monitors will conduct and present all analyses and recommendations publicly and independently of any suggestions or conclusions of PG&E, the Commission, or other interested parties;
- Quarterly public reporting by the independent monitors to a joint meeting of PG&E, the Commission, and other interested parties;
- The independent monitors will notify PG&E, the Commission, and other interested parties in writing within 10 days of discovery of any potential non-compliance with the requirements of the PG&E's gas safety implementation plan or that presents a potential, but not immediate, threat to public safety;

[163] See pp. 30-31 of British Petroleum's consent decree with the U.S. Environmental Protection Agency at http://www.epa.gov/compliance/resources/decrees/civil/cwa/bpnorthslope-cd.pdf.

[164] See http://www.epa.gov/compliance/resources/cases/civil/cwa/olympicshell.html.

[165] Consent Decree in US v El Paso Natural Gas Co. (Dist. Ct. New Mexico) at 12 and *et seq.,* available at http://emerginglitigation.shb.com/Portals/f81bfc4f-cc59-46fe-9ed5-7795e6eea5b5/r_El_Paso_Natural_Gas_Consent_DecreeFinal.pdf

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- The independent monitors will notify PG&E, the Commission, and interested parties in writing within 24 hours of any condition that poses a potential and immediate threat to public safety; and
- PG&E's contracts with independent monitors shall prohibit an independent monitor from accepting work from PG&E while performing the duties of an independent monitor.

Proposed Findings of Fact and Conclusions of Law necessary to implement this third party independent monitor proposal are set forth in the appendices to DRA's Opening Briefs in both the Recordkeeping and San Bruno Explosion Investigations.

VI. CONCLUSION

For all the reasons set forth herein, the Commission should adopt the recommendations summarized in Section I.B above.

Respectfully submitted,

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