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 to Determine Violations of Public Utilities Code Section 451, General Order 112, and Other Applicable Standards, Laws, Rules and Regulations in Connection with the San Bruno Explosion and Fire on September 9, 2010.	I.12-01-007 (Filed January 12, 2012)
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
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

REPLY BRIEF OF THE UTILITY REFORM NETWORK ON FINES AND REMEDIES (PUBLIC VERSION)

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REPLY BRIEF OF THE UTILITY REFORM NETWORK ON FINES AND REMEDIES

I. INTRODUCTION

The Utility Reform Network ("TURN") submits this reply brief relating to fines and other remedies for the violations by Pacific Gas and Electric Company ("PG&E") that have been demonstrated in Investigations (I.) 11-02-016 ("the Recordkeeping Investigation"), 11-11-009 ("Class Location Investigation"), and 12-01-007 ("San Bruno Explosion Investigation"). This brief focuses primarily on responding to PG&E's Coordinated Remedies Brief ("CRB") submitted May 24, 2013. In addition, TURN responds to the Reply Brief of the Consumer Protection and Safety Division ("CPSD") Director Hagen ("Director's Reply") that the CPSD Director chose to file on June 5, 2013.

As in its opening brief,[1] TURN uses the following nomenclature. The terms "fine" and "penalty" are used synonymously to refer to the per offense fines and penalties authorized by Public Utilities Code[2] Section 2100 *et seq* and that are typically paid to the state's General Fund. The term "remedies" refers to other actions or costs imposed upon PG&E pursuant to the Commission's equitable powers and includes disallowance of costs from rate recovery. TURN uses the term "total financial consequences" (or similar phrases) to refer to the cumulative financial impact on PG&E of: (1) fines and penalties and (2) disallowances and other remedies.

[1] TURN's Opening Brief on Fines and Remedies ("Fines/Remedies OB"), p. 1, fn. 1.
[2] In the remainder of this brief, all statutory citations are to the California Public Utilities Code unless otherwise indicated.

II. SUMMARY

A. Response to PG&E

The Commission will recall that the Report of its Independent Review Panel ("IRP") in the wake of the San Bruno explosion included some stinging criticisms of PG&E's corporate culture. The Panel found that PG&E suffered from "an elevated concern about the company's image," an "overemphasis on financial performance," and "a culture whose rhetoric does not match its practice."[3] Lamentably, PG&E's briefs in these cases, including its Coordinated Remedies Brief, demonstrate that, more than two years after the IRP Report, these criticisms apply with even greater force.

As was true of its testimony and previous briefs, the rhetoric in PG&E's CRB does not match its practice. Once again, PG&E strikes a contrite tone, professing to acknowledge that "a penalty is appropriate."[4] However, just as PG&E's repeated claims that it "accepts responsibility" for the San Bruno explosion ring hollow in light of the company's refusal to admit any violation related to the explosion, PG&E's professed acceptance of a penalty is also public relations spin, not substance. In fact, PG&E rejects the payment of any actual penalty or fine (as defined above) and instead asserts that whatever financial consequences its shareholders have already experienced or will experience render unnecessary disallowances or other remedies of any financial significance in these cases. In other words, in response to PG&E's violations that

[3] *Report of the Independent Review Panel, San Bruno Explosion, Prepared for California Public Utilities Commission*, Revised Copy, June 24, 2011 ("IRP Report"), pp. 16-17.
[4] CRB, p. 8.

destroyed a community and raised serious doubts about the safety of its entire gas transmission system, PG&E advocates that the Commission should impose no additional financial sanctions.

The Commission should not be fooled by PG&E's strategem. Instead, the widespread, numerous and longstanding violations demonstrated in these cases cry out for the imposition of *additional, incremental* financial consequences on PG&E's shareholders in a very large amount. Consistent with constitutional limitations and the below-listed five factors the Commission uses in enforcement cases, the financial consequences imposed by the Commission should be commensurate with PG&E's ability to pay.

Severity of the harm. There *should* be no dispute regarding this factor – the admittedly defective pipe installed by PG&E ruptured and exploded, causing the deaths of eight people and unprecedented destruction from a utility accident in a populated area. Disturbingly, PG&E still clings to the absurd defense that installing this pipe was not a violation, a view that hinges on PG&E's nonsensical claim that Section 451 imposes no safety obligations -- one that TURN, CPSD and all non-PG&E parties have thoroughly discredited in previous briefs.

Conduct of the utility. Contrary to PG&E's protestations, this is an aggravating, not a mitigating, factor. With respect to its conduct both before and after the explosion, PG&E omits discussion of several known examples of policies and practices that were antithetical to safety, including: the deadly Rancho Cordova explosion; the IRP Report findings that PG&E top management was overly focused on the bottom line and insufficiently focused on public safety; the findings of the Overland audit that, in the late

2000's, PG&E cut spending on numerous safety projects at the same time its overall gas operations were highly profitable; the $3 million fine PG&E paid in 2012 for failure to follow the Commission's directive to produce records to justify maximum allowable operating pressure ("MAOP"); PG&E's withholding, from a discovery response to TURN and CPSD, of relevant records showing geographic information system ("GIS") errors; and its general unrepentant stance in these enforcement proceedings. Even the pre-explosion CPSD audits do not present the clean bill of health that PG&E touts, but rather identify numerous practices that placed safety at risk. And most of the safety-related programs that PG&E has implemented since the explosion were not implemented voluntarily but in response to CPUC directives.

Financial Resources of the Utility. PG&E is one of the country's largest combined gas and electric utilities, with 2012 operating revenues of over $15 billion and earnings on operations of over $1.3 billion. The Overland Report calculated that PG&E could raise about $2.25 billion to fund Commission-imposed penalties and disallowances without impacting the company's financial health, its ability to issue dividends or its ability to raise capital. PG&E spends pages lamenting the potential impact of a large penalty on investors' perceptions, and arguing that a penalty would impair its ability to raise large amounts of equity for the massive capital expenditures planned for the next few years. But there is no basis for this fearmongering. PG&E's actual criticisms of the Overland Report lack substance, and analyst forecasts of total financial consequences are in line with Overland's analytical results.

In the end, PG&E resorts to claiming that Overland "did not dispute" that various categories of "unrecovered and unrecoverable costs" should count towards the penalty

amount. PG&E's argument relies on the use of late-presented and untested exhibits and entirely misrepresents the oral testimony of CPSD's witnesses. To the contrary, the Overland Report made clear that the $2.25 billion included only incremental penalties and disallowances ***imposed*** by the Commission, not various categories or past or future costs that PG&E had to spend as part of its response to the San Bruno explosion. The financial resources calculated by Overland are on top of any cost overruns in existing spending that may or may not have impacted PG&E's bottom line.

Role of Precedent. The Carlsbad and Allentown accidents on which PG&E heavily relies are not comparable, as PG&E's own witness has acknowledged.[5] Among other differences, the Carlsbad accident occurred in a rural location, not in the middle of a high consequence area ("HCA") in a densely populated neighborhood. Nor did the case against the Carlsbad pipeline operator include allegations of such numerous and widespread violations[6] affecting the entire gas transmission system – including deficient recordkeeping and an ineffective integrity management program -- as are present here. Likewise, among other differences, the Allentown accident involved a smaller diameter pipe, fewer deaths and injuries, less destruction, no programmatic violations, and a much smaller utility with much more limited financial resources than PG&E.[7] In light of these and other substantial differences, it is not surprising that PG&E's witness agreed these cases are "very different circumstances."[8]

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[5] Jt. Tr., Vol. 14, pp. 1584-1585 (Fornell/PG&E).
[6] *Id.*
[7] According to the UGI Corporation 2012 Annual Report (http://www.ugicorp.com/files/doc_financials/annual_reports/2012/ugi_cover_text_for_web_120512.pdf) p. 29, the 2012 net income for the utility subsidiary that was responsible for the accident was $80.5 million.
[8] Jt. Tr., Vol. 14, pp. 1584-1585 (Fornell/PG&E).

Totality of the Circumstances. In discussing this factor, PG&E once again ignores the requirements of California law, particularly Section 451 and the recordkeeping requirements in the General Order ("GO") 112 series. As TURN has showed, the supposedly expert witnesses on which PG&E relied had no experience with or understanding of the requirements of California law and, in fact, did not factor such requirements into their testimony.[9] Accordingly, as just one example of the many areas in which California regulations were stricter than federal rules, whether or not *federal* pipeline regulations required retention of pre-1970 pressure test records is completely irrelevant to these cases because *California* law clearly mandated keeping those records. The Commission's duty is to measure PG&E's actions against the obligations of all applicable law, including California law. The totality of the record in these cases shows that PG&E committed egregious violations that: caused unprecedented death and destruction, placed in doubt the safety of PG&E's entire gas transmission system, necessitated billions of dollars of remedial measures to achieve reasonable levels of safety, and resulted from a corporate culture that elevated profits over safety.

B. Response to the CPSD Director's Reply

In many respects, the Director's Reply is even more disturbing than PG&E's CRB, because CPSD is supposed to advocate for the public interest. Instead, the Director's Reply employs the same type of diversionary tactics[10] as PG&E – make it sound as if the Director is being tough on PG&E ("It is time to throw the book at

[9] TURN Op. Br. (I.11-02-016), pp. 13-16.

[10] TURN does not use the term "diversionary tactics" lightly. The CPUC's June 5, 2013 press release regarding the Director's Reply trumpets the supposed $2.25 billion "penalty" and never mentions the proposal to allow PG&E to offset the "penalty" with costs for which shareholders are already responsible.

PG&E"[11]), but then advocate that PG&E be allowed to offset the claimed $2.25 billion "penalty" with "any bona fide" expense PG&E's shareholders have allegedly incurred or may incur for pipeline safety.[12] The upshot of the Director's recommendation is that PG&E shareholders can escape any incremental financial consequences in these cases. Any costs that shareholders have already absorbed or will have to absorb because of directives or obligations that are independent of these cases (assuming it is even possible to show they were really shareholder costs) can be used to negate the supposed "penalty". Put another way, the proposal in the Director's Reply paves the way for PG&E's shareholders to be no worse off financially as a result of these three enforcement cases than they are now. It is beyond disappointing that a CPSD Director would make such a proposal.

To be clear, TURN's objection is most decidedly not that the Director's Reply advocates requiring PG&E to pay for system improvements instead of paying a fine to the General Fund. The problem with the Director's proposal is that he would not require additional, incremental shareholder funding of remedial work beyond the status quo costs PG&E has already incurred or plans to incur. If, instead, the Director were to insist that most of the $2.25 billion "penalty" take the form of an additional disallowance of pipeline safety implementation plan ("PSIP")[13] costs (e.g., shareholders pay for PSIP

[11] Director's Reply, p. 3.
[12] Director's Reply, pp. 3-4. The Director even invites PG&E to offset distribution expenses (top of p. 4) against the "penalty," even though these cases do not relate to the distribution system.
[13] The Commission's Decision 12-12-030 mandated the "Pipeline Safety Implementation Plan" ("PSIP"), though many parties continue to use PG&E's original nomenclature of the pipeline safety enhancement plan (PSEP). Phase 1 was intended primarily to address testing or replacement of transmission pipelines in populated (high consequence) areas, while Phase 2 (which has not been filed or yet defined) will presumably address transmission pipelines in non-HCA areas.

Phase 1 costs that are currently required to be paid by ratepayers and for future Phase 2 PSIP costs that would otherwise be imposed on ratepayers), that would be a reasonable proposal – albeit different from TURN's – and worthy of Commission consideration. Regrettably, that is not what the Director's Reply recommends.

C. TURN's Recommendation Imposes Meaningful Financial Consequences That Will Deter Future Violations and Strikes the Right Balance Between Disallowances and Penalties

After reviewing all of the parties' recommendations, TURN is more convinced than ever that its proposal should be adopted. TURN's proposal begins with a $1 billion disallowance of the PSIP Phase 1 pipeline testing and replacement costs that, under Decision (D.) 12-12-030, PG&E is now authorized to recover from ratepayers.[14] Unlike the CPSD Director's recommendation, this disallowance would be an incremental financial consequence to PG&E's shareholders and would reduce all PG&E ratepayers' gas bills.[15]

In addition to this $1 billion disallowance, TURN recommends a $670 million fine to be paid to the General Fund. This fine amount would more than cover the lost revenue to the state General Fund resulting from PG&E's reduced tax liability for unrecovered costs. Finally, TURN recommends that PG&E shareholders pay for the costs of additional remedial recordkeeping and audits, specified in the Summary of

[14] As explained in TURN's Summary of Recommendations in its Opening Brief on Fines and Remedies (Item #4, p. viii), if the $1 billion of authorized ratepayer costs for PSIP Phase 1 were to decrease because of the required PSIP "update application," TURN's recommended fine should be increased commensurately.

[15] As noted in TURN's Opening Brief on Fines and Remedies (pp. vii, 9), the after-tax impact of TURN's proposed disallowance would be $744 million. TURN's proposal does not allow PG&E shareholders to obtain the benefit of this tax deduction, but rather increases the fine by the amount of the tax benefit.

Recommendations of TURN's Opening Brief,[16] which TURN estimates will cost a total of $50 million.[17]

The total, after-tax incremental impact of TURN's recommendations on PG&E's shareholders would be $1.46 billion. Total financial consequences of this magnitude are within PG&E's ability to pay without harming its ability to raise necessary capital and take into account costs that shareholders are already required to absorb as a result of previously-ordered Commission disallowances. Most importantly, such financial consequences are compelled by the record in these cases of numerous, sweeping, and longstanding violations and would send the right message that the Commission will truly "throw the book" at California utilities that violate their safety obligations.

III. THE STATUS QUO IS NOT A 'PENALTY'

Without citing to any supporting authority, PG&E argues that any unrecovered costs that it has incurred or may incur in the future "resulting from the San Bruno explosion" constitute a penalty.[18] Based on this specious assertion, PG&E claims that all such unrecovered amounts should be credited against whatever financial consequences the Commission may decide to impose on PG&E.[19] In light of the broad categories of unrecovered costs for which PG&E seeks credit (and which regrettably the Director's Reply appears to endorse), PG&E's recommendation would likely completely offset any financial consequences the Commission may order in these cases.

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[16] TURN Op. Br. on Fines and Remedies, pp. viii-x.
[17] TURN recommends adjusting the fine amount if the incremental shareholder costs from TURN's proposed remedies differ from $50 million. TURN Op. Br. on Fines and Remedies, pp. viii.
[18] CRB, p. 12.
[19] CRB, p.

In Section VI.C of this brief, TURN will fully explain why, in the analysis of PG&E's ability to pay, it would be wrong to give PG&E credit for most of the cost categories identified by PG&E and why the record does not even support the claim that these costs are "unrecovered." However, before turning to that detailed analysis, TURN urges the Commission to consider at the big picture level the import of what PG&E and the CPSD Director are advocating.

If this Commission never opened these three enforcement actions, PG&E shareholders would be subject to the exact same costs that PG&E now labels "unrecovered." Heretofore, the Commission has not described any of these costs as a "penalty" or otherwise indicated that they are a sanction for violations committed by PG&E. Any shareholder costs that PG&E has incurred or may in the future incur because of past CPUC decisions or other actions PG&E deems necessary are not an outcome of these enforcement proceedings. These are status quo costs, costs that shareholders will bear regardless of the disposition of these cases.

If, as PG&E advocates and the Director's Reply invites, the status quo costs are allowed to completely offset any financial consequences the Commission orders in these cases, then there will be no net financial consequences to PG&E. From the standpoint of sanctions against PG&E, the result would be no different than if these cases had never been pursued. In terms of impacts on PG&E shareholders, the Commission's decisions would not change the status quo at all.

It is difficult to find words to express how deeply wrong such an outcome would be -- words such as "travesty", "outrage" and "mockery" only begin to capture the injustice. After two years of arduous work in three cases to examine PG&E's operation

and management of its gas transmission system, the Commission for the first time has a record conclusively showing extremely serious violations not just with respect to Segment 180, but also with respect to broad policies and practices in critical areas such as integrity management, maintenance, and recordkeeping – violations that placed the public safety at risk and ultimately destroyed a community. With this record before the Commission, allowing PG&E to escape with little or no incremental financial consequences would send a very loud message that this Commission still does not take safety seriously and remains unwilling to impose the kind of sanctions necessary to deter safety violations.

In the end, no one would be fooled if the Commission adopted the "credit for time served" arguments of PG&E and the CPSD Director – not consumers or their representatives such as TURN and DRA, not the citizens of San Bruno or their leaders, not the members of the Legislature, and least of all the utilities, who would see that PG&E's bottom line escaped unscathed from these cases and would take comfort that even their worst safety violations will not result in any meaningful financial harm to shareholders. The real measure of the Commission's decision in these cases will be the incremental financial impact on PG&E shareholders – how much shareholders will be required to absorb beyond the status quo costs. Only a large incremental impact commensurate with PG&E's ability to pay will send the right message. TURN's recommendation – a new, incremental disallowance of $1 billion in PSIP costs, a $670 million penalty paid to the General Fund, and $50 million of shareholder payments for additional remedial oversight and audits – would impose the kind of financial consequences on PG&E that its violations warrant.

IV. PG&E'S VIOLATIONS CAUSED THE SAN BRUNO EXPLOSION

In its analysis of the "severity of the offense" factor, PG&E claims that it did not commit any violation that caused the San Bruno disaster.[20] It is no exaggeration to say that this is a ludicrous claim – that relies on PG&E's untenable interpretation of Section 451 and a misleading portrayal of the record in these cases.

A. PG&E's Admittedly Negligent Installation of the Defective Pup Segments Violated Section 451 And Caused the Explosion

PG&E has admitted that it installed the defective pipe that ruptured and exploded in San Bruno and that it never should have put that pipe into service.[21] It is therefore undisputed that PG&E's improper installation of Segment 180 caused the San Bruno disaster.

In the face of these facts, the only way PG&E can assert that none of its violations caused the explosion is to resort to the absurd legal argument that it did not violate Section 451 when it installed unsafe pipe that never should have gone into service. As TURN has shown, PG&E's claim that Section 451 imposes no pipeline safety requirements is groundless on its face and defies a host of CPUC decisions.[22] Section 451 explicitly requires utilities to "furnish and maintain such adequate, efficient, just and reasonable . . . equipment and facilities . . . as are necessary to promote the safety . . . of its patrons, employees, and the public." There can be no question that: (1) PG&E violated Section 451 by installing the dangerously defective pup segments and allowing

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[20] CRB, pp. 7-8, 36.
[21] PG&E Op. Br. (I.12-01-007), p. 48.
[22] TURN Reply Br. (I.12-01-007), pp. 5-7. See also D.11-11-021 (Rancho Cordova penalty decision, citing Section 451 and several CPUC decisions for the proposition that providing safe and reliable service is a basic principle of public utility service).

them to stay in service for 54 years,[23] and (2) that these violations directly caused eight deaths and grave destruction in San Bruno.

PG&E's persistence in claiming that it did not commit any violation when it installed the pup segments epitomizes PG&E's failure to truly accept responsibility for the devastation it caused.

B. PG&E's Depiction of the Record Regarding the Construction of Segment 180 Is Misleading

To further mask its culpability for the San Bruno explosion, PG&E's CRB spins a misleading depiction of the evidentiary record in these cases regarding the construction of Segment 180. PG&E claims that the record shows that PG&E believed it was installing "new" pipe that was "most likely" delivered to the job site with an external corrosion coating that masked the existence of the pup segments.[24] The impression PG&E attempts to create is that the pipe was fresh from the mill, where it had recently been tested and inspected and then wrapped in corrosion coating.[25]

The actual record – particularly the testimony of PG&E's own witness, Mr. Harrison –shows two key points that PG&E carefully chooses to omit from its CRB. First, PG&E does not know where all of the pipe used in Segment 180 actually came from.[26] In fact, Mr. Harrison admitted (in response to questions from ALJ Yip-Kikugawa) that PG&E does not know if Segment 180 came from re-used pipe.[27] Thus,

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[23] TURN Reply Br. (I.12-01-007), pp. 12-13.
[24] CRB, pp. 34-35, 87.
[25] CRB, p. 85.
[26] Ex. PG&E-1 (I.12-01-007) (Harrison/PG&E), p. 2-3, fn. 3 (PG&E's records do not show where all the pipe in Segment 180 originated from).
[27] Tr., Jt. Vol. 4, p. 599 (Harrison/PG&E)("Q: So for Segment 180 when you said reconditioned pipe, you don't know it it's new or used? A: Right")

contrary to PG&E's CRB, the record does not establish that Segment 180 was new pipe, but is rather inconclusive because PG&E's deficient records fail to show the source of the pipe. TURN has previously pointed out that PG&E made the same incorrect statement in its opening brief in I.12-01-007,[28] yet PG&E continues to misstate the record, in violation of Commission Rule of Practice and Procedure 1.1.[29]

Second, PG&E omits the testimony of Mr. Harrison that the pipe used in Segment 180 was likely sitting around for years before it was installed in Line 132 and, at a minimum, needed to be reconditioned before it could be made ready for service.[30] Specifically, Mr. Harrison testified that Segment 180 came from pipe in PG&E's "existing inventory" that included 30-inch pipe left over from pipe ordered from the manufacturer as early as 1948 and no later than 1953.[31] If the pipe came from this inventory, as Mr. Harrison believes, it would have been anywhere from three to eight years old before it was installed in Line 132. While the pipe may have been "new" in the sense that it was not previously used, it was hardly fresh from the mill. In fact, Mr. Harrison testified, based on comments he saw in the job file, that the pipe in Segment 180 would have needed to be "reconditioned" because the external corrosion wrap "deteriorated rapidly in the sun," necessitating the removal of this deteriorated wrap and the recoating of the pipe.[32]

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[28] TURN Reply Br. (I.12-01-007), p. 4.
[29] Rule 1.1 states, in relevant part: "Any person who signs a pleading or brief . . . agrees . . . never to mislead the Commission or its staff by an artifice or false statement of fact or law."
[30] This section summarizes TURN's discussion in TURN's Opening Brief in I.12-01-007 (pp. 9-12) of Mr. Harrison's testimony relating to the construction of Segment 180. In its Reply Brief in I.12-01-007, PG&E did not, and could not, challenge the accuracy of TURN's discussion, which was based on the testimony of PG&E's own witness.
[31] Ex. PG&E-1 (I.12-01-007) (Harrison/PG&E), p. 2-3.
[32] Tr. Jt. Vol. 4, pp. 599-600 (Harrison/PG&E).

PG&E ignores this testimony from its own witness because it shows that PG&E had the responsibility to ensure that the pipe used in Segment 180 was properly reconditioned before it could be placed into service. Mr. Harrison testified that PG&E typically used a 10-step process for reconditioning pipe that included removing old coatings, visually inspecting the pipe (including longitudinal seams "inside and outside"), and re-wrapping the pipe.[33] He further testified that, had PG&E performed a visual inspection of Segment 180's seam welds inside and outside, PG&E would have seen the missing interior seam weld.[34]

Thus, the words of PG&E's own witness provide the best explanation regarding the construction of Segment 180 – one that PG&E wants the Commission to ignore: the most likely scenario is that the pipe used in Segment 180 remained in PG&E's inventory long enough that it needed to be reconditioned and that if PG&E had properly reconditioned the pipe, it would have discovered the defect and prevented the defective pipe from going into service. As TURN has previously explained, this failure to properly recondition the pipe used in Section 180 violated PG&E's Section 451 obligation to ensure safe facilities, a violation that ultimately caused the San Bruno explosion.[35]

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[33] Ex. PG&E-61 (I.11-02-016) (Harrison/PG&E), p. 3-29; Tr. Jt. Vol. 4, p. 481 (explaining that the document quoted on p. 3-29 of Ex. PG&E-61 was describing the reconditioning process that should have been used in the 1950s and 1960s). A 1960 PG&E standard practice document showed that reconditioning work would be performed at PG&E's Decoto Pipe Yard in Union City. Ex. PG&E-61 (I.11-02-016) (Harrison/PG&E), p. 3-29; *see also* Tr. Jt. Vol. 4, p. 580 (Harrison/PG&E) (at a minimum, cleaning and inspecting part of reconditioning process would be conducted at PG&E's Decoto Yard).

[34] Tr. Jt. Vol. 3, p. 394 (Harrison/PG&E)

[35] TURN Op. Br. (I.12-01-007), pp. 11-12. As TURN further explained in that passage of its brief, PG&E cannot escape responsibility for this violation by claiming that a third party was responsible. *Carey v. PG&E*, D.99-04-029, 1999 Cal. PUC LEXIS 215, 85 CPUC 2d 682, 690 (utilities may not escape by delegation to a third party the duty to provide safe gas service).

Finally, PG&E also misrepresents the record when it claims that "the evidentiary record establishes that there was no intentional misconduct or willful neglect on the part of PG&E that led to the rupture."[36] The record establishes no such thing, primarily because of PG&E's failure to locate records showing either the source of the pipe used in Segment 180 or the steps, if any, that were taken to ensure the pipe was properly reconditioned. If anything, the record shows that PG&E's failure to detect the defective pup segments during the reconditioning process that PG&E's witness agrees should have occurred was, at a minimum, a reckless omission constituting willful neglect.

V. PG&E'S EFFORT TO DEMONSTRATE THAT IT ACTED IN GOOD FAITH BEFORE AND AFTER THE EXPLOSION IS THOROUGHLY UNCONVINCING

In Sections IV.B and IV.C of the CRB, PG&E contends that its conduct before and after the San Bruno explosion shows that it was making good faith efforts to ensure compliance with its pipeline safety obligations. PG&E overlooks the considerable evidence that it paid insufficient attention to safety and relies on evidence that falls well short of demonstrating good faith. Far from being a being a mitigating factor, PG&E's conduct before and after the explosion is an aggravating factor that further justifies financial consequences commensurate with PG&E's ability to pay.

A. PG&E's Conduct Prior to the Explosion Is An Aggravating, Not Mitigating Factor, In Determining Appropriate Penalties and Other Financial Consequences to PG&E

1. PG&E Admissions

Even PG&E admits, albeit with inappropriate understatement, that prior to the San Bruno explosion its gas system operations "were not what the company, the

[36] CRB, p. 85.

Commission or PG&E's customers expect."[37] Likewise, PG&E acknowledges that its recordkeeping practices "have fallen short of expectations."[38] Although these carefully phrased statements fail to admit the violations that PG&E should be conceding, these statements hardly reflect a utility that was making concerted, good faith efforts to furnish the safe facilities required by Section 451.

2. Rancho Cordova

PG&E's attempt to demonstrate its pre-explosion good faith completely ignores the company's culpability with respect to the deadly Rancho Cordova gas explosion in 2008. In its decision fining PG&E $38 million in relation to that accident, the Commission observed numerous shortcomings including: using pipe in the 2006 repair that was not authorized for use in gas service and below required specifications, failing to pressure test the pipe used in the repair, and unreasonably delayed and ineffective response to the outdoor gas leak.[39] The Commission found that these shortcomings illustrated systemic problems at PG&E -- "a failure to emphasize to its employees that safety and reliability of its gas system must be of paramount importance" and "underlying problems" with promoting a "corporate culture of employee awareness of their responsibility for ensuring that PG&E's facilities and operations are safe and reliable."[40] After the lethal 2008 explosion, PG&E should have taken immediate and effective steps to remedy these systemic problems, but did not.

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[37] CRB, p. 47.
[38] CRB, p. 47.
[39] D.11-11-001, slip. op., pp. 38-39.
[40] D.11-11-001, slip. op., p. 39.

3. Independent Review Panel Findings

The June 2011 IRP Report identified many longstanding operational and cultural problems at PG&E that compromised safety, including: insufficient management focus on system safety; inadequate document management; failure to identify threats because of inaccurate and incomplete input data; failure to embrace the spirit of pipeline integrity regulations; insufficient engineering resources; inadequate quality assurance; failure to re-design its system to accommodate in-line inspection ("ILI") tools; focus on appearance over substance in strategy setting; and overemphasis on financial performance.[41]

4. Cost Cutting and Overearning on Gas Operations

The Overland Consulting audit of PG&E's pipeline safety-related expenditures from 1996 to 2010[42] documented numerous instances, starting in 2008 and continuing through 2010 (*i.e.*, even after the lethal Rancho Cordova explosion), in which PG&E deferred pipeline replacement and ILI projects in an attempt to reduce costs.[43] PG&E internal documents quoted by Overland show, for example, that: (1) limited resources provided by management forced higher cost (and more safety-effective) ILI projects to be changed to lower cost (and less effective) external corrosion direct assessment ("ECDA") projects;[44] and (2) a PG&E gas manager pleading with staff to come up with more

[41] IRP Report, pp. 7-13, 17-18.
[42] Ex. CPSD-168 (I.12-01-007) (Harpster/CPSD).
[43] Summarized in TURN's I.12-01-007 Opening Brief, pp. 34-37 and Reply Brief, pp. 38-40. As noted in those briefs, PG&E could not muster an effective response to this evidence because it was based on PG&E's own documents.
[44] Ex. CPSD-168 (I.12-07-007) (Harpster/CPSD), p. 7-8 (quoting from a PG&E 2008 Gas Transmission Expense Program Review document).

reductions – including deferring scheduled work -- after upper management "saddled" them with a "very low" 2009 budget.[45]

In addition, PG&E dramatically reduced the use of ILI as an assessment method after 2008. While PG&E used ILI to inspect an average of 123 miles of pipeline per year in 2005 to 2008, from 2009 to 2011, PG&E used ILI for only an average of 21 miles per year.[46] This dramatic change corresponded to a change in FERC accounting rules that led PG&E to account for ILI costs as an expense, rather than a capital cost.[47] As a result, ILI work no longer contributed to PG&E's rate base and profits.[48]

At the same time this cost-cutting was occurring, it is undisputed that PG&E was reaping returns on equity ("ROE") for its Gas Transmission and Storage Division that far exceeded authorized levels: for the period 1999-2010, the ROE averaged at least 14.3%, compared to the average authorized ROE of 11.2%.[49] Thus, PG&E's post-2008 cost-cutting was not a response to disappointing returns, but rather part of a drive to cut costs in all phases of operations, including pipeline safety.

5. CPSD Audit Findings

PG&E contends that CPSD audit results constituted "approval of PG&E's general practices" and somehow demonstrate PG&E's good faith efforts to comply with all regulatory requirements.[50] The record does not support this contention.

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[45] Ex. CPSD-168 (I.12-01-007) (Harpster/CPSD), p. 8-3 (quoting 0/28/08 e-mail from GT&E Expense Program Manager).
[46] Ex. TURN-1 (I.12-01-007) (Hawiger/TURN), p. 16.
[47] *Id.*
[48] TURN Op. Br. (I.12-01-007), p. 38.
[49] TURN Op. Br. (I.12-01-007), p. 32.
[50] CRB, p. 43.

As an initial matter, even PG&E concedes that CPSD audits are not comprehensive and cannot identify all instances in which company practices and records do not meet regulatory requirements.[51] As CPSD explained more fully in its testimony, CPSD audits are only able to examine a fraction of records and facilities, and CPSD cannot continuously monitor the thousands of PG&E designers, engineers, excavators and other employees associated with gas systems. CPSD correctly testified that, for this reason, the ultimate responsibility for compliance rests with the utility, which is accountable for its violations.[52] Thus, PG&E's argument starts from the wrong premise; a failure by CPSD to identify violations does not show that PG&E was making a good faith effort to meet its safety obligations under Section 451 and other regulations.

In any event, the audits PG&E chooses to highlight in its CRB contained many negative findings, including concerns that PG&E was not devoting sufficient resources to system safety. For example, the May 2010 integrity management audit underscored two significant problems with PG&E's integrity management practices. First, CPSD found that PG&E used an "exception process" that "diluted" the requirements of its program and appeared to be "allocating insufficient resources to carry out and complete assessments in a timely manner."[53] CPSD explained that exceptions appeared to be routinely granted, without following PG&E's written rules, and were used to avoid performing activities, such as ILI assessments and excavations, that PG&E had previously committed to doing to make its program "more robust in nature."[54] Second,

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[51] CRB, p. 43.
[52] Ex. CPSD-5 (CPSD/Stepanian), pp. 5-6.
[53] Ex. PG&E-7, Tab 4-14 (Oct. 21, 2010 Letter from M. Robertson, CPSD, to Glen Carter, PG&E), p. 1
[54] *Id.*, pp. 1-2.

CPSD found that, although PG&E had conducted its own internal audits related to Integrity Management, PG&E failed to act upon the recommendations for improvements in a timely manner.[55] For example, an October 2009 audit identified the need for improvements in PG&E's risk assessment methodology, but by May 2010, PG&E had not even formulated a position on its consultant's recommendations, let alone acted upon them.[56]

Similarly, findings from a 2005 CPSD integrity management audit that PG&E cites identified numerous safety issues, including a "severe violation" for failing to immediately reduce operating pressure in response to extensive corrosion in a pipeline.[57] Other problems called out in the audit included: failing to have a technical justification for eliminating from consideration threats for stress corrosion cracking and internal corrosion (finding C.01.d); failing to gather and analyze all available data and to ensure consistent collection and analysis of data on an annual basis (findings C.02.a and C.02.b); in risk assessment, failing to rank all facilities, which CPSD identified as an indication of employing inadequate resources (findings C.03.e); and failure to identify the highest threat for each HCA segment so that appropriate preventive and mitigation measures are identified (finding H.01.a).[58]

In sum, these 2005 and 2010 audit findings are critical of many aspects of PG&E's integrity management program. If anything, they show PG&E's persistent failure to take safety obligations seriously and to devote sufficient resources to safety. PG&E's view that these audit results demonstrate good faith on its part is yet another

[55] *Id.*, p. 1.
[56] *Id.*, p. 3.
[57] Ex. PG&E-7 (Tab 4-25), p. 79 of 138 (Finding E.04.d).
[58] *Id.*, pp. 32, 34, 40, and 101.

troubling indication that PG&E still does not fully appreciate that its obligations go beyond check-the-box compliance with specific safety regulations and extend to taking all reasonable steps to furnish the safe facilities required by Section 451.

B. PG&E's Conduct After the Explosion Is Also An Aggravating Factor

1. PG&E Fined for Failing to Comply With Record Search Directive

Nowhere in PG&E's lengthy discussion of its supposed good faith conduct after the explosion does PG&E mention the fact that it has already been fined $3 million in connection with its failure to comply with the Commission's January 2011 record search directive, Resolution L-410. In D.11-03-047, the Commission issued an order to show cause to PG&E after the utility failed to comply with the CPUC's two-part order with respect to pipeline segments for which PG&E could not locate pressure test records. Rather than "aggressively and diligently search" for as-built documentations and other source documents and use such records to validate MAOP, PG&E submitted a report to the Commission that showed "no evidence" that PG&E had complied with these requirements.[59] The order to show cause was ultimately resolved by PG&E's agreement to pay a $3 million "fine" to the General Fund.[60]

This recent history, ignored by PG&E, shows that, even in the face of a Commission order, PG&E was unwilling to perform the records search and validation work necessary to ensure the safety of its transmission system.

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[59] D.11-03-047, slip op., pp. 9-11.
[60] D.12-04-047, slip op., p. 8 (Ordering Paragraph 2).

2. Withholding Evidence in Discovery

CPSD's opening brief on fines and remedies correctly pointed out that PG&E's withholding of evidence in discovery in I.11-02-016 reflected poorly on PG&E's actions to disclose and rectify its violations.[61] At issue is PG&E's initial response to Joint CPSD-TURN Data Request 1-2 (issued July 19, 2012), which followed up on PG&E's testimony stating that the company was aware of data errors in GIS by asking PG&E to identify the errors "or data inaccuracies" of which PG&E was aware, and, among other things, asking PG&E to provide a list of GIS data inaccuracies that PG&E had updated and corrected since the San Bruno explosion.[62] PG&E's initial response, dated August 1, 2012, did not identify any errors or data inaccuracies or provide the requested list, stating that the requested data could not be "readily extracted" from GIS and that PG&E had "no comprehensive effort to validate the data" in GIS or tally errors contained in GIS.[63] Two months later on October 3, 2012, near the close of the I.11-02-016 evidentiary hearings, PG&E provided a "supplemental response" to the data request, in which it informed TURN for the first time that PG&E all along had been maintaining an "audit change log" in which PG&E was tracking "discrepancies" between GIS entries and data gained from other sources.[64]

In its CRB, PG&E contends: (1) that the audit change log was not responsive to the data request because it is not a "list of errors" in that it also reflects other changes; and (2) the two-month delay in producing the audit change log did not hinder CPSD's

[61] CPSD Fines/Remedies Op. Br., pp. 50-51.
[62] Ex. TURN-10 (I.11-02-016).
[63] *Id.*
[64] Ex. CPSD-64 (I.11-02-016).

investigation because PG&E had mentioned the existence of the log to CPSD representatives in a PG&E site visit.[65] Neither response holds water.

First, the audit change log is clearly responsive to the data request. The request sought identification of not just errors, but also any "data inaccuracies" of which PG&E had become aware. As PG&E's response acknowledges, the audit change log, at a minimum, includes all instances or errors or data inaccuracies PG&E had found. The fact that the log may include other changes that do not constitute errors or inaccuracies (and this is debatable since the distinction between an "inaccuracy" and a "discrepancy" is unclear) does not make the log unresponsive to a request a list of inaccuracies. PG&E merely needed to explain in its response that the log may be overinclusive.

Second, whether or not CPSD knew about the log prior to October 3, 2012, TURN certainly did not, and TURN was hindered in its ability to prepare for evidentiary hearings and to probe the issue of the nature and quantity of errors in PG&E's GIS system. PG&E's obvious instinct was to withhold information that could be used to investigate key issues in the recordkeeping case. Just as CPSD contended in its opening brief, this episode is evidence of a utility that was not up front about disclosing information relating to its violations.

3. PG&E Programs In Response to CPUC Directives

PG&E challenges the statements in the opening briefs of CPSD and TURN demonstrating that most of the key initiatives that PG&E has undertaken since the San Bruno explosion are in response to directives or recommendations of the CPUC, NTSB,

[65] CRB, pp. 45-46.

or PHMSA.[66] PG&E now says that the fact that PG&E was ordered to take these actions is not important; what matters is that, in implementing them, PG&E "embraced the spirit of change rather than grudgingly accepting a mandate."[67]

As an initial matter, the Commission should reject the premise of PG&E's response. Implementing steps a regulator directs a utility to perform is hardly evidence of good faith that warrants mitigating financial consequences.

In any event, in key situations after the San Bruno explosion, PG&E certainly has not "embraced the spirit of change." As noted above, in response to the record search requirements of Resolution L-410 in early 2011, PG&E had to face an order to show cause before it accepted that it needed to search for as-built documentation and source records for all pipe segments without a pressure test record. In addition, as shown by PG&E's initial response to CPSD-TURN data request 1-2, PG&E saw no reason, even for its own internal use, to flag or "tally" errors in GIS.[68] It would seem that PG&E was more concerned about avoiding the creation of evidence that might be used against it in litigation than finding out the extent to which GIS errors had corrupted its integrity management analysis.

Even the examples of supposed good faith to which PG&E calls attention are incorrect or overstated. It is simply not true that PG&E "went beyond what was required" in extending the MAOP validation process beyond HCA segments to its entire transmission system.[69] In D.12-12-030, the Commission explains that it was the CPUC that "expanded on" the NTSB's original recommendations that were limited to HCA

[66] CPSD Fines and Remedies Op. Br., p. 49; TURN Fines and Remedies Op. Br., pp. 27-28.
[67] CRB, p. 63.
[68] Ex. TURN-10 (I.11-02-016).
[69] CRB, p. 52.

areas.[70] PG&E also claims that CPSD approved of PG&E's PSIP plan "with few objections" but does not note that those objections including pointing out that PG&E was improperly trying to recover from ratepayers the costs of pressure tests that were required under GO 112.

4. PG&E's Unrepentant Stance in These Cases

As CPSD, TURN and all the other intervenors have pointed out in virtually every brief responding to PG&E's arguments, PG&E has adopted a remarkably unrepentant stance in these proceedings. TURN will not restate here the ample evidence supporting this point. Instead, we will simply note that, by denying that the records of these cases show any significant violations, PG&E shows that, at the highest levels, it still does not understand or accept its pipeline safety obligations.

VI. TURN'S ANALYSIS IS CONSISTENT WITH OVERLAND'S METHODOLOGY, WHILE PG&E'S CONTENTION THAT IT HAS "ALREADY PAID IN FULL" IS BASED ON A MISREPRESENTATION OF THE RECORD EVIDENCE AND IS INCONSISTENT WITH OVERLAND'S ANALYSIS

A. Summary of Issues Concerning PG&E's Resources and Proper Structure of Financial Penalties and Disallowances (Financial Consequences)

The testimonies and briefs of CPSD and intervenors show that potential penalties for violations and disallowances for imprudence could well exceed PG&E's financial resources. The Commission must thus evaluate the following three key issues in determining how PG&E's financial resources impact the size and structure of the total financial consequences that the Commission will determine in these enforcement proceedings:

[70] D.12-12-030, slip op., p. 93.

- PG&E's financial ability to issue equity to cover the financial consequences imposed by the Commission;
- Any amounts that should be subtracted (i.e. credited to PG&E) to determine total financial consequences; and
- The tax consequences for PG&E and the State due to the imposition of penalties and/or disallowances.

The CPSD and intervenors all relied on the analysis conducted by CPSD's expert witnesses from Overland to quantify PG&E's financial resources. That analysis showed that PG&E could issue more than $2.25 billion in equity to cover Commission imposed penalties and disallowances. PG&E disputes the appropriateness of $2.25 billion as a reasonable measure of its ability to pay for remedies imposed by the Commission, but PG&E does not offer any alternative number.

The CPSD opening brief recommended that all of the $2.25 billion be used to fund safety work ordered as part of the PSIP Phase 1, and planned to be continued in PSIP Phase 2. Intervenors generally proposed that the money be apportioned between paying for pipeline safety work ordered in PSIP Phase 1, paying for other remedies, and paying a penalty to the General Fund. PG&E embraced wholeheartedly the recommendation of the CPSD that all penalties be used to pay for pipeline safety work ordered in PSIP Phase 1 and Phase 2.

However, there was considerable disagreement, and also a lack of specificity, concerning what categories and amounts of past or future spending should be credited against the $2.25 billion. CPSD stated in its *opening* brief that PG&E should be given credit only for PSIP Phase 1 and 2 spending, but CPSD provided no quantification, presumably requiring some future process to keep track of such spending and determine

appropriate offsets.[71] For its part, PG&E sought to use untested and extra-record evidence to suggest that its shareholders have already paid, or will pay in the future, costs in a variety of categories that threaten to fully offset the $2.25 billion proposal of CPSD. Regrettably, the Director's Reply appears to completely change CPSD's position and goes even further than PG&E, explaining that PG&E should get credit for any past or future shareholder funding of any "bona fide safety enhancements" on the natural gas transmission or distribution systems. As explained below, this vague and unworkable proposal could leave PG&E in absolutely the same position as if the Commission had never instituted these enforcement proceedings.

TURN relied on record evidence provided by PG&E to properly and conservatively (*i.e.*, in PG&E's favor) calculate the Commission-imposed disallowance that should be subtracted from the $2.25 billion. TURN's recommendation leaves approximately $1.46 billion that should be used to pay for remedial activities and a penalty to the General Fund.[72] TURN's recommendation is entirely consistent with Overland's analysis, relies on record evidence in these proceedings, and offers a clear and final resolution that promotes market certainty for the coming years.

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[71] CPSD Opening Brief, May 6, 2013, p. 6. CPSD further specified that the penalty "is not recoverable from ratepayers nor are the capital expenditures paid for by these amounts to be included in the rate base." Furthermore, CPSD stated that "PG&E can not underspend in any other areas of their operations that affect safety to offset any of these expenditures," implying some balancing account treatment.

[72] As explained in below, TURN failed to adjust the PSIP disallowance to calculate the proper after tax treatment, thus underestimating the after-tax amount remaining to pay for penalties and remedies.

B. TURN's Proposal Is Consistent With the Overland Analysis, Relies on Record Evidence, Gives PG&E's Shareholders Proper Credit for Past Disallowances and Costs Borne by Shareholders, and Provides a Clear and Final Resolution of the Enforcement Proceedings

1. The Overland Report Provides A Clear Standard for Determining Any Offsets Due to Commission-Imposed Penalties and Disallowances

A key issue in dispute concerns the quantification of costs that should be included within the $2.25 billion of financial capacity calculated by Overland. This issue is properly resolved by understanding what types of costs were considered by Overland when it developed its threshold figure of $2.25 billion. In its original August 2012 Financial Analysis report, Overland explained that the goal was to provide an estimate of PG&E's "ability to raise equity capital sufficient to fund a *CPUC imposed fine*."[73] The emphasis of Overland's analysis was on "disciplinary actions *imposed by the CPUC*."[74] Overland explained that CPUC action could result in "fines" imposed by the CPUC which would not be tax deductible, or disallowances of "PSEP expenses/capital" that would be tax deductible.[75]

In CPSD's rebuttal testimony, submitted in February 2013, witnesses Lubow and Malko explained even more directly that the purpose of the original report was to provide a benchmark of "the financial capacity of PG&E to absorb potential fines or penalties *associated with the outcome of proceedings arising from the San Bruno incident.*"[76] The CPSD witnesses further explained that CPSD's recommendations are intended to guide

[73] Ex. Jt. 51, p. 1 (emphasis added). Overland clarified that it had assumed all 2012 PSEP expenses (forecast at $376.8 million) to be unrecoverable, and that third-party liability claims were not relevant to its calculations due to insurance coverage. Ex. Jt. 51, p. 5-6.
[74] Ex. Jt. 51, p. 6.
[75] Ex. Jt. 51, p. 13.
[76] Ex. Jt. 53, p. 3:1-3 (emphasis added).

regulatory action and provide "a reasonable framework for the commission to consider financial outcomes that also preserve PG&E's financial integrity."[77]

CPSD witnesses Lubow and Malko provided a clear and practical standard, namely that only penalties or disallowances "***imposed***" by this Commission count towards the $2.25 billion.

The Commission imposed disallowances in the PSIP I decision, D.12-12-030, amounting to $634.6 million.[78] The Commission can impose penalties or additional disallowances in these enforcement cases. Any of these financial consequences could count against the $2.25 billion in financial capacity calculated by Overland.

2. PG&E's Position Is Inconsistent with Overland's Analysis and Relies on an Unprincipled Standard that Would Make the Utility Better Off than Under Standard Ratemaking

PG&E agrees with CPSD's recommendation that any penalty should be "directed to safety investments."[79] However, PG&E proposes that the Commission offset any penalty by past and future spending on system safety. PG&E's proposal for "time served" is so broad and expansive that it would threaten not only to eliminate any financial consequences to shareholders, but actually to make the utility *better off* than it would be under standard ratemaking treatment. In addition, PG&E's proposal would eviscerate the ratepayer protections provided by the cost caps imposed in D.12-12-030.

a. PG&E's "Standard" Is Contrary to Overland's Analysis and Lacks Any Principled Basis

PG&E argues at various points that it should get credit for:

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[77] Ex. Jt. 53, p. 8:15-23.
[78] See, TURN Fines and Remedies Op. Br., p. 44.
[79] PG&E CRB, p. 8.

- "the amounts that PG&E has already spent and will spend on system safety,"[80] including PSEP costs and other GT&S costs;
- "all PG&E's unrecovered gas pipeline safety costs";[81]
- "all unrecovered and unrecoverable costs," including "unrecoverable operating costs outside gas transmission."[82]

PG&E goes as far as to assert that it should get credit for "unrecoverable costs to be borne by shareholders in 2013 and beyond **in other operational areas** of the utility."[83] When combined with PG&E's other testimony and statements, it appears that the term "unrecovered" equates with "cost overrun" for spending on certain activities, such as, for example, integrity management. PG&E's proposed standard can be paraphrased as: any costs above authorized levels for any utility operations, plus any future costs we believe will be shareholder costs, should be deducted from the penalty. In other words, PG&E is asking the Commission for a blank check to shield shareholders from cost overruns for any utility "safety" spending, including spending in "other operational areas." This is a recipe for an outcome to these cases that imposes no additional financial consequences whatsoever.

PG&E's standard that any cost overruns should be counted towards fulfilling the penalty amount bears no relation to Overland's attempt to quantify PG&E's financial capacity to pay for CPUC-imposed penalties. PG&E claims in its brief that Overland "did not disagree" that various categories of spending should be counted against the $2.25

[80] PG&E CRB, p. 10.
[81] PG&E CRB, p. 12.
[82] PG&E CRB, pp. 81 and 84.
[83] PG&E CRB, p. 82 (emphasis added).

billion. But as detailed below, PG&E's claim misrepresents Overland's oral testimony and should be roundly dismissed.

b. PG&E's Position Violates Normal Ratemaking Principles and Eviscerates the Ratepayer Protections Imposed in D.12-12-030, Because "Cost Overruns" Do Not Equate to Shareholder Funding

PG&E's position is that cost overruns for safety activities, including integrity management and right of way encroachments, automatically represent "shareholder funding." The Director's Reply appears to endorse this view. This position is directly at odds with basic ratemaking principles.

Under traditional ratemaking in California, the Commission authorizes a total revenue requirement. The utility controls actual spending and has flexibility to reallocate spending between activities as it sees fit, unless the Commission has ordered balancing account treatment for an identified category of spending.[84] If total actual utility spending is less than the total revenue requirement, the utility may earn more than its authorized rate of return, and vice versa. This traditional ratemaking paradigm generally applies to PG&E's gas pipeline spending, including its Gas Transmission and Storage operations.[85]

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[84] See, for example, D.04-05-055, *mimeo.* Sec. 9.3 ("A fundamental tenet of forecast test year ratemaking is that the utility retains the discretion between the test years to manage its revenues and activities as it sees fit, consistent with its obligations to provide safe, reliable, environmentally sound utility service.")
See, also, I.12-01-007, PG&E Opening Brief, March 11, 2013, p. 137. A one-way balancing account, such as adopted in the PSIP decision, precludes the utility from shifting underspent funds to other activities.

[85] The Commission adopted additional reporting requirements for pipeline capital and expense spending in the last Gas Transmission and Storage (GT&S) decision in order to better monitor PG&E's budget allocations based on risk assessments. D.11-04-031, p. 58 and Ordering Paragraph 5, p. 72. Additionally, parties agreed to one-way balancing account treatment for integrity management as part of the adopted Settlement, due to the fact that parties did not seek to lower PG&E's request for integrity management. D.11-04-031, Attach. A, Section 7.3.1.

Any utility expenditures above those forecast for a particular activity (and thus "embedded in rates") can be offset by cost savings due to lower spending for other activities. If not offset, such increased costs could result in lower rates of return. It is almost impossible to determine whether cost overruns in any one area are specifically matched by cost savings in other areas absent a careful accounting of company-wide spending and returns. Such accounting would also have to adjust for complex cash-flow changes associated with, for example, federal tax and depreciation impacts.

An example of the difficulty in evaluating what constitutes "shareholder funding" fills much of the record of I.12-01-007. A huge volume of paper in the exhibits to I.12-01-007 (most entered into the record by PG&E) was devoted to detailed analyses of costs and revenue requirements for the Gas Transmission and Storage (GT&S) line of business during the 2007 through 2010 time period, with the intent of showing whether PG&E over- or under-spent when comparing recorded to actual costs. The exercise was extremely complicated. PG&E's position on these issues was that: 1) PG&E did not underspend on GT&S activities, especially with respect to safety, 2) even if there was any "underspending," such underspending was likely made up for by spending on other lines of business, and 3) nothing can really be concluded from looking at over- or under-spending for individual activities without considering company-wide financial performance.[86] And what is perhaps most remarkable in all this is that PG&E readily agreed that, *even if it overspent* on gas transmission and storage operations, it still earned

[86] See, I.12-01-007, PG&E Opening Brief, March 11, 2013, p. 142 ("("As Mr. O'Loughlin testified, there is no connection between GT&S earnings above-authorized returns and any underspending by PG&E – PG&E in fact spent more than the imputed adopted O&M and capex amounts from 1997 to 2010."), p. 143 ("The Commission therefore should consider PG&E's overall returns before drawing any conclusion based solely on the success of GT&S's storage business."); See, also, PG&E Reply Brief, April 25, 2013, pp. 116, 118, 133-134.

more than its authorized returns![87] In other words, overspending on these activities in no way resulted in "shareholder funding."

The results for GT&S as a whole partly reflect the "at-risk" operations of storage revenues. But such a result will continue to apply to GT&S operations under Gas Accord V. Moreover, the fact that overspending on a particular activity does not equate to shareholder funding is true when looking at any individual account or activity on a stand-alone basis. Simply put, overspending on "safety" does not at all require shareholder funding and lower shareholder profits.

It would be an extremely complicated auditing task to determine whether PG&E shareholders *actually contributed* to overspending on a particular activity. For example, Ms. Yura's testimony alleges "shareholder funding" of $74 million on integrity management in 2011-2012, an area funded in the GT&S rate case, presumably due to overspending of amounts embedded in rates.[88] But Ms. Yura presents no data for total GT&S spending and earnings. Without knowing whether total spending (and revenues) were more or less than authorized, it is impossible to know whether shareholders actually contributed out of net earnings.[89]

In sum, PG&E is asking the Commission to deduct overspending for all "safety activities" from any Commission requirement to fund remedial work. Under normal ratemaking, such overspending could be offset by other cost reductions, or *could* impact

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[87] See, for example, I.12-01-007, PG&E Opening Brief, March 11, 2013, p. 138.
[88] I.12-01-007, Ex. PG&E-1A, p. 13-16 and ch. 13, Appendix C (Yura/PG&E). See further discussion below in the Reply to the Director's Reply Brief.
[89] The company can charge certain spending "below the line." Such is the case for identified categories of spending, such as charitable donations and political lobbying. Such spending is not included in any accounts that are used to forecast a revenue requirement, and spending for these items comes from net earnings. But this does not appear to be at all what is being proposed by PG&E.

shareholder earnings. PG&E's proposal would make such overruns automatically count against a penalty, thus making the utility better off than if the Commission simply imposed a one-time fine.

Even more troubling, PG&E is asking the Commission to credit future cost overruns for PSIP spending against the financial consequences ordered by the Commission in these cases. In D.12-12-030, the Commission modified the standard ratemaking for all costs associated with the Pipeline Safety Implementation Plan (PSIP). The Commission ordered PSIP costs to be included in a one-way balancing account, so that PG&E is not free to shift any under-spending to other areas of business.[90] Moreover, the Commission required that PG&E complete the entire scope of work within the approved forecast costs, or else reduce the authorized budgets if it removes projects from the work scope.[91] Under normal ratemaking, PG&E could simply do less work if actual costs exceeded forecasts. However, for the PSIP, D.12-12-030 mandated PG&E to perform all the work without raising rates, even if there are cost overruns, thus ensuring that there would be no impact on rates due to cost overruns.

Nevertheless, PG&E now requests that any PSIP cost overruns be deducted dollar for dollar against any potential financial consequences. This would make PG&E *better off* than if the Commission did nothing in these cases. As things stand now, PG&E shareholders would have to absorb the cost overruns, unless PG&E cut costs in other

[90] D.12-12-030, p. 107-108 and Ordering Paragraph No. 5, p. 127.
[91] D.12-12-030, Ordering Paragraph No. 6, p. 127.

areas.[92] However, under the proposal PG&E makes here, shareholders would not suffer any adverse effects from PSIP cost overruns, even if PG&E did not cut costs elsewhere.

c. PG&E Used Untested Exhibits and Misrepresented Overland's Testimony

PG&E relied on late-presented and wholly untested exhibits to attempt to justify the types of past and future costs it seeks to use as offsets. As explained in more detail below, the Commission should give no weight to PG&E's arguments, and PG&E's proposed "credit amounts" should not be deducted from the $2.25 billion calculated by Overland. The Commission should find that PG&E's position is inconsistent with ratemaking principles and would fundamentally undermine the objectives to be served by imposing financial consequences on shareholders for violations.

3. TURN's Proposal Is Consistent with the Overland Analysis and Is Based on PG&E's Own Testimony Concerning Shareholder Costs in 2011 and 2012

TURN proposed that the $2.25 billion be offset by all forecast PSIP disallowances, totaling $634.6 million.[93] Additionally, TURN relied on the testimony of Ms. Yura to calculate a credit of $150.2 million due to PSIP costs overruns in 2011-2012.[94] The total offset calculated by TURN on a pre-tax basis was thus $748.8 million.

In at least two respects, TURN'S proposal represents a conservative estimate in PG&E's favor. First, TURN started with $2.25 billion, while Overland explained that this number already included a $200 million charge that PG&E expected to take. In

[92] Indeed, TURN already benefitted PG&E shareholders by crediting them the 2011-2012 cost overruns for hydrotesting. However, at least that was a known cost, based on the testimony of Ms. Yura. It is a different level altogether to request offsets for any future cost overruns. Such a mechanism would eviscerate any cost containment incentive provided by the cost cap.
[93] TURN Fines and Remedies Op. Br., p. 44-45.
[94] TURN Fines and Remedies Op. Br., p. 46.

addition, by oversight, TURN's proposal failed to deduct the tax benefit to PG&E for operational spending. Appropriately adjusting the $748.8 million by the 37% tax impact would result in an *after-tax* offset of less than $500 million.[95]

TURN's recommendation that the Commission give PG&E credit for $748.8 million due to PSIP disallowances and cost overruns is completely consistent with Overland's analysis, since it calculates as an offset Commission disallowances in the PSIP case. The Commission disallowed PSEP 2011 and 2012 expenses on a forecast basis. PG&E claimed that its actual expenses were higher than forecast. Such a cost overrun does not represent a cost "imposed" by the Commission, and under standard ratemaking treatment it is a risk borne by shareholders. However, in our opening brief TURN did credit PG&E with $150 million for 2011-2012 cost overruns. In this respect, TURN was again conservative in PG&E's favor (perhaps unduly so) by including this cost as a credit towards the $2.25 billion.

In sum, TURN's proposal is based on record evidence presented in PG&E's testimony. It provides a reasonable and clear calculation. And it allows the Commission to set a penalty without the need for any future audits and adjustments, thus promoting market certainty concerning PG&E's financial liability.

C. PG&E's Arguments Concerning Offsets Misrepresent the Testimony of CPSD Witnesses and Rely on Late-Presented and Untested Exhibits That Should be Given No Weight

As explained above, PG&E's contention that any cost overruns should be counted as offsets does not comport with Overland's standard that only CPUC-imposed penalties and disallowances count towards the $2.25 billion.

[95] TURN Fines and Remedies Op. Br., p. 46. 63% of $748.8 million equals $494.4 million.

PG&E's last section in its brief concerning its financial ability to pay claims that Overland's "threshold level" of $2.25 billion includes "all unrecovered and unrecoverable costs."[96] PG&E identifies four categories of costs that are supposedly "unrecovered and unrecoverable costs," including PSIP disallowances, spending above rate case amounts in gas transmission "and other lines of business," right of way management costs, and contributions to the City of San Bruno.[97] PG&E then cites to its cross examination of Messrs. Lubow and Malkow to conclude that Overland "**did not dispute**" that these four categories should be "counted towards the 'threshold level' of equity."[98]

PG&E's claim that Overland agreed with their analysis misrepresents the testimony of CPSD's witnesses and relies on the use of untested exhibits that should be given no weight.

1. PG&E Used Exhibits That Had No Evidentiary Support in the Record

PG&E engages in semantic sophistry when it uses the term "did not dispute." The only reason CPSD witnesses did not "dispute" some of these categories is that they were never asked to voice their opinion of them. On the last day of evidentiary hearings, PG&E's counsel, Mr. Malkin, introduced three exhibits (Joint 57, 58 and 59) consisting of an excerpt from PG&E's 2012 annual report and a slide deck from an investor presentation. These exhibits quantified various categories of allegedly "unrecovered" costs. Mr. Malkin did not ask the Overland witnesses any questions concerning their

[96] PG&E CRB, p. 81.
[97] PG&E CRB, p. 82.
[98] PG&E CRB, p. 82.

opinion of the categories or numbers in these exhibits.[99] Mr. Malkin repeatedly described the various contents of the exhibits and asked Mr. Lubow "Do you see that?"[100] At no time did Mr. Lubow offer any substantive opinion about the exhibits; he simply responded "I do," based on the fact that he saw the exhibits placed before him. It is entirely inappropriate to represent such answers as evidencing any opinion, positive or negative, concerning the contents of those exhibits.

Mr. Malkin asked absolutely no substantive questions about these exhibits. It was only during the confidential portion of the hearing when Commissioner Florio asked Mr. Lubow whether he would "accept and agree with that number,"[101] and Mr. Lubow replied:

> Well, this is exactly the problem I'm referring to. Of course, I've never seen these estimates. I don't know -- I have no basis to be able to rely upon them; I'm not sure the Commission does, and maybe it does. But, you know, there is a $500 million item in here for right of way encroachment that I assume is some estimate based on the time frame of future costs that are going to incur or may incur. I don't know where that comes from.
>
> So this is an accumulation of everything. In my view -- and the Commission, of course, will ultimately sort this out, but my view is some of these costs are recovered, have been -- there is certainly, to the extent that they've been incurred as we're sitting here today going backwards, **some component of those costs are recovered in -- from existing rates**, not because they were specifically identified as recoverable, **but they're simply embedded in a cost of service** that the Commission is fully aware that specific and unique costs from period to period may change. **But what's important is that the overall revenue level either does or does not result in the intended earnings and other financial metrics as a result of the regulatory process**.[102]

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[99] This issue was likewise addressed in the CPSD Motion to Strike, which explained why the Commission should give no weight to Exhibit Joint 57. CPSD Motion to Strike, May 29, 2013, p. 5.

[100] 14 Jt. RT 1391-1394, Lubow/CPSD.

[101] 14 Jt. RT 1427: 10-22. By "that number" Commissioner Florio was referring to the total claimed shareholder costs identified in Ex. 59.

[102] 14 Sealed Jt. RT 1427:23 – 1428:23, Lubow/CPSD (emphasis added). By email dated June 5, 2013, counsel for PG&E stipulated that those portions of the sealed transcript that do not address

When Mr. Malkin subsequently asked Mr. Lubow whether he had conducted any specific analysis to determine whether "some level of these costs were in fact recovered because they are embedded in rates," Mr. Lubow readily agreed he had not conducted a specific analysis, but he reiterated that he had looked "at the ultimate earnings results and comparing to that the authorized return."[103] And as explained below, such a comparison, at least for 2012, indicates that most costs were indeed covered in rates.

2. PG&E Misrepresents the Testimony of CPSD Witnesses Concerning the Four Categories of Claimed Unrecovered Costs

Each of PG&E's citations to the record concerning the four categories of "unrecovered" or "unrecoverable" costs misrepresents the statements of Mr. Lubow and Mr. Malkow. Due to the importance of this issue, TURN separately analyzes each of the four "categories" identified by PG&E.

First, PG&E claims Overland did not dispute that the PSIP disallowance should be counted towards the $2.25 billion; but even PG&E admits in footnote 396 that Mr. Lubow specifically "questioned whether the disallowed contingency should be counted."[104] However, Mr. Lubow more than just "questioned" the contingency. He explained that the rejection of the contingency in D.12-12-030 was not a penalty, but rather an "adjusted rate base" analogous to any determination in a rate case that costs

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the issue of PG&E's forecasts of earnings per share are not confidential and may be quoted in full. PG&E cited to these portions of the transcript in the public version of their brief.

[103] 14 Sealed Jt. RT 1430:21 – 1431:5, Lubow/CPSD.

[104] PG&E CRB, p. 82.

should be less than forecast by the utility.[105] TURN specifically credited PG&E with the PSIP disallowance excluding the contingency costs, consistent with Overland's position.

Second, with respect to "spending above rate case amounts in gas transmission and other lines of business," PG&E correctly cites to Overland's explanation that "some of these amounts might have been recovered in rates and, in its view, the test would be whether PG&E earned more than the authorized rate of return."[106] However, PG&E then claims that Overland "admitted that it has not analyzed this issue and *has no reason to believe* that any costs PG&E identified as costs over rate case amounts were recovered elsewhere in rates."

By using the phrase "has no reason to believe" PG&E engages in the same type of misrepresentation as when it used the phrase "did not dispute." Overland addressed this issue several times during oral cross examination, and made clear that the available evidence indicates that some of these costs were actually "covered in rates."[107] Overland agreed that it had not conducted a specific analysis of all individual costs; however, Overland made clear that it drew its conclusions based on "looking at the ultimate earnings results and comparing to that the authorized return from the Commission's existing rates and how the Company performed as a result of that."[108]

PG&E's contention that spending for a particular account or activity "over amounts implicit in adopted rates" inherently results in unrecovered costs is incorrect. PG&E has discretion to reduce costs and reallocate budgets as it see fit. Just because a

[105] 14 Sealed Jt. RT 1425:7-16, Lubow/CPSD.
[106] PG&E, p. 82, fn. 397.
[107] 14 Jt. Sealed RT 1428:6-23, Lubow/CPSD.
[108] 14 Jt. Sealed RT 1431:1-5, Lubow/CPSD.

particular activity resulted in higher costs does not at all mean those costs were not "recovered" in rates.

As Mr. Lubow explained on the stand, and as PG&E acknowledges in footnote 397 of its brief, the "ultimate test" of whether a particular cost "might have been recovered in rates" is whether the company has earned more or less than its authorized return. And indeed, Mr. Lubow testified that "even in 2012, plus or minus, [PG&E] did earn its authorized rate of return."[109] PG&E did not dispute or question this conclusion. The only way PG&E could have earned close to its authorized rate of return was if it was able to include any cost overruns in rates, likely through reductions in other costs.

The fact that Overland did not have sufficient data to conclude for sure that all the costs were covered in rates cannot be turned into an admission, as PG&E tries to do, that there was "no reason to believe that any costs … were recovered elsewhere in rates." Overland had reason, based on reviewing overall company financial performance, to believe that some of these costs were recovered in rates. PG&E had the opportunity to provide credible evidence to the contrary. It did not do so.

Indeed, PG&E actually did provide exactly this type of evidence on the record in this proceeding in the *revised* direct testimony of Ms. Yura, which was served on January 7, 2013. Ms. Yura's testimony claimed PSIP shareholder spending of $603 million for 2011-2012, and claimed shareholder non-PSIP spending of $179 million in 2011-2012.[110] TURN credited PG&E with most of the PSIP overruns, as discussed previously. The

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[109] 14 RT 1425:23-25, Lubow/CPSD.

[110] I.12-01-007, Ex. PG&E-1A, p. 13-16 and ch. 13, Appendix C (Yura/PG&E). Ms. Yura used recorded
spending through 2012 Q3 to forecast the totals for 2011-2012. The non-PSIP spending included $74 million for integrity management work, which is a category funded in the GT&S rate case.

other spending, including cost overruns for GT&S integrity management, should not be credited against a penalty. Not only are they not appropriately counted towards the $2.25 billion, but there is no evidence that these costs were not "included in rates."

Third, PG&E claims "right of way management costs" as another category of unrecoverable costs; and PG&E alleges that Overland "did not disagree that such costs should count toward the 'threshold level.'" For support, PG&E cites to the cross examination of Mr. Lubow by Commissioner Florio, which was reproduced in full above. Mr. Lubow certainly did not "agree" that this category of costs should count toward the threshold, and he specifically stated that "some of these costs … are recovered in existing rates."

CPSD counsel asked Mr. Lubow on redirect whether he knew about the $500 million of supposedly unrecovered costs for right of way encroachment, and Mr. Lubow responded:

> Did not know. And as we're sitting here today, still do not know enough about it to be able to comment on some future cost that hasn't been really subject to review by this Commission and that I've never seen any documentation of to date.[111]

PG&E's claim that Mr. Lubow "did not disagree" is at best technically correct only to the extent that Mr. Lubow did not categorically state that he "disagreed" with PG&E. It is difficult to know how he could have agreed or disagreed, however, as Mr. Lubow explained that he knew nothing of these numbers and had "no basis to be able to rely upon them."

[111] 14 Jt. RT 1435:15-20, Lubow/CPSD.

Fourth and last, PG&E identifies the "contributions to the City of San Bruno" as the last category of unrecoverable costs that Overland "did not dispute." PG&E provides no citation to any record evidence for this point; most likely because Overland never actually addressed this issue at all.[112]

VII. PG&E'S CRITICISM OF OVERLAND'S METHODOLOGY FAILS TO DEMONSTRATE MEANINGFUL WEAKNESS

PG&E claims that Overland's analysis of financial ability lacks "both theoretical and practical support."[113] But PG&E's criticisms fail to demonstrate that Overland's analysis is anything but a conservative estimate of PG&E's financial resources, especially when one considers that the results of Overland's financial modeling are fully supported by analyst estimates of expected financial consequences.

PG&E claims that the two metrics used by Overland – the price to book and dividend payout ratios– are not the measures "typically used by investment banks to determine the market's capacity for an equity offering."[114] But PG&E has created an artificial strawman only tangentially related to the issue at hand.

The Overland modeling exercise uses standard financial benchmarks. Rather than being a precise measure of "market capacity," the price to book and dividend payout ratios are key metrics used to measure financial health. PG&E does not dispute that these are precisely the metrics that reflect future shareholder value as used in standard valuation models.[115] If these metrics remain unharmed by a level of equity issuance that

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[112] This appears to be one of the few issues where CPSD disagrees with PG&E in its reply brief.
[113] PG&E CRB, p. 75.
[114] PG&E CRB, p. 75.
[115] As explained in TURN's opening brief, shareholder value is generally based on expected dividends and stock price appreciation. TURN Fines and Remedies Op. Br., p. 37.

does not yield incremental returns, the logical conclusion is that shareholders will continue to purchase the stock.

How such a stock sale is structured may need to reflect investor expectations, so that, for example, PG&E would likely not issue $2.0 billion worth of stock in one offering strictly for the purpose of paying money to the General Fund. However, if PG&E increases its issuances of stock over the next two years to raise money for capital expenditures, some of which would be disallowed from rate base, there is no fear that investors will not buy the shares at a reasonable price.

PG&E criticizes Overland's analysis because the model is "very sensitive to the earnings per share assumption used in the calculation."[116] This is a correct statement, though is not a reflection of any shortcoming of the model, but actually reinforces the fact that Overland's model appropriately weighs shareholder profitability (as measured by EPS) as a key determinant of the possibility of issuing dilutive shares to fund penalties and disallowances.

PG&E explains that if Overland had used PG&E's most current EPS guidance for 2013, this would have produced a much lower threshold level of possible equity issuance. PG&E would have smaller profits, so it could not continue paying dividends while staying within its dividend payout target.

[116] PG&E CRB, p. 76.

But PG&E admits that it "is projecting that 2013 will be a comparatively low earnings year, XXXXXXXXXXXXXXXXXXXXXXXXXXX."[117] Indeed, PG&E's attempt to discredit Overland by XXXXXXXXXXXXXXXX fails precisely because the XXXXXXXXXXXXX XXXXXXXXXXXXXXX. PG&E's confidential "2012-2016 Financial Outlook" shows that PG&E forecasts XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXX for both the "base case" and the "pessimistic case" scenarios.[118] During cross-examination, Mr. Lubow explained that the 2013 number XXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXX."[119] Using the low 2013 EPS number does not reflect the long-term financial health of the company. Moreover, given the timing of this proceeding, it is more likely that any equity issuances to account for potential disallowances or penalties will occur in Q4 2013 or, more likely, in 2014. The EPS forecasts XXXXXXXXXXX are similar to the numbers used by Overland in its financial analysis.

[117] PG&E CRB, p. 77.
[118] Ex. Joint-65 at 3. PG&E already disclosed this information in its opening brief, so has presumably waived confidentiality at least with respect to the general trend of its EPS forecast.
[119] 14 Confidential Jt. RT 1422:12-25, Lubow/CPSD.

VIII. PG&E'S DIRE WARNINGS ABOUT THE IMPACT OF A PENALTY ON CAPITAL SPENDING AND FINANCIAL HEALTH MISSTATE THE TESTIMONY OF ITS WITNESS AND ARE BASED ON AN INFLATED WISH LIST FORECAST OF FUTURE CAPITAL EXPENDITURES

PG&E claims that the expert testimony of its witness Fornell shows that a large penalty will impair PG&E's financial health and imperil its ability to fund future capital expenditures.

However, Mr. Fornell's "real world" testimony simply indicates that market capacity for dilutive shares is less than for shares intended for profitable investments. This is not new news, and PG&E was undoubtedly aware of this issue when it decided to fund any penalty through equity issuances. Mr. Fornell's warnings about the potential need to postpone future capital expenditures are based entirely on PG&E's wish list forecasts of future capital spending. PG&E's financial capacity is sufficient to sell enough equity to support reasonable penalties and capital expenditures.

A. Issuing Equity to Fund Penalties or Disallowances Will Not Imperil PG&E's Financial Health or Its Ability to Raise Equity for Reasonable Capital Expenditures That Are Not Based on PG&E's Wish List Forecast

PG&E argues at length that a penalty that exceeds investor expectations would will imperil PG&E's ability to fund its massive capital expenditures planned for 2014-2016.[120] But PG&E's testimony shows that a large penalty will <u>not</u> undermine PG&E's ability to raise sufficient capital to finance a reasonable level of capital expenditures.

PG&E's conclusions and assertions in its CRB go beyond the actual testimony of its expert witness. Mr. Fornell was asked about the potential to issue equity to pay $2 billion in penalties *in addition* to PG&E's large forecast of equity needs for capital

[120] PG&E CRB, p. 67-73.

expenditures in 2013-2016.[121] Mr. Fornell testified that "to the extent a fine exceeds investor expectations the more challenging it will be to raise that equity," and that issuing such additional equity would result in a stock price reduction and the need to "postpone as much capex as possible going forward."[122] He did not testify that issuing additional equity would put PG&E's long-term financial health at risk.

Most importantly, what is entirely missing from PG&E's argument is the fact that its forecast equity issuances and capital expenditures are based on its wish list of future spending, and most likely overestimate actual capital expenditures for 2012-2016. PG&E's forecast of capital spending, on which Mr. Fornell's entire analysis is based, includes the following:

> The total capital expenditure forecasts in Figure 7 [of Mr. Fornell's testimony] assume PG&E's requested 2014 GRC capital expenditures are authorized in full. They also include capital expenditure forecasts not in the 2014 GRC request, including the Pipeline Safety Enhancement Plan, the 2015 Gas Transmission and Storage Rate Case, Transmission Owner Rate Cases, and certain separately funded expenditures such as the Oakley Generation Facility.[123]

Mr. Fornell's expectations of future capital expenditures[124] and projected equity issuances[125] are based on the assumption that *all* of PG&E's requested GRC capital spending will be authorized in full;[126] *all* of PG&E's yet-to-be requested 2015 GT&S capital spending will be authorized in full;[127] that PG&E's forecast electric transmission

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[121] PG&E CRB, p. 66.
[122] PG&E CRB, p. 71; See, also, 14 Jt. RT 1620:15-20, Fornell/PG&E.
[123] Ex. Jt. 76, p. 9, PG&E Response to TURN DR 006-020.
[124] As reflected in Figure 7 on p. 17 of Ex. Jt. 66.
[125] As reflected in Figure 9 on p. 17 of Ex. Jt. 66.
[126] Ex. Jt. 76, p. 10, PG&E Response to TURN DR 006-021.
[127] See Confidential Ex. Jt. 78 for specific details of PG&E's capital forecast for 2012-2016.

capital spending will be authorized in full; and that PG&E's forecast for the Oakley power plant, which has been challenged by TURN and other parties in court, will likewise occur in full.

These forecasts are based on PG&E's actual and future requests for capital spending. There is no precedent for assuming the PG&E's capital request in the GRC will be approved without any reduction. There is no precedent for assuming that the yet unseen GT&S capital forecast will be approved in full. It is entirely reasonable to conclude that PG&E's actual capital needs, as determined by the Commission, will be significantly less than the forecast amounts embedded in Mr. Fornell's testimony. Thus, "postponing" some of these capital expenditures may prove to be an illusory problem.

Mr. Fornell's dire warning that some capital expenditures may need to be postponed is based on an unrealistic assumption about future capital expenditures and capital needs. The Commission should place little weight on PG&E's scare tactics that it will not be able to fund necessary capital spending.

B. PG&E's Testimony Shows That PG&E Can Issue Equity to Fund Penalties and Disallowances

PG&E touts its witness, Mr. Fornell, as the only expert witness who brought a "real-world perspective to analyze the equity capacity for PG&E to fund a large penalty."[128] PG&E contends that it is not possible to perform a "theoretical calculation" of the ability of PG&E to issue equity, claiming that the market does not work that way, and PG&E warns that a large penalty will imperil its ability to fund future capital expenditures.

[128] PG&E CRB, p. 71.

Mr. Fornell's actual testimony, and the "real world experience" of PG&E's equity issuances in 2012 and 2013, indicate that PG&E will be able to sell equity to investors. During cross examination, PG&E's witness Fornell agreed that PG&E could issue equity to pay a penalty of $2 billion, even though such an issuance would be challenging and would best be done in tranches, rather than "all at once."[129] Messrs. Lubow and Malkow agree with Mr. Fornell that PG&E will likely need to issue equity in tranches over some time period to raise money for penalties and other purposes.[130]

PG&E already sold significant numbers of shares in two issuances in March of 2012 and February of 2013.[131] Both times, PG&E's prospectus specified that the equity was for "general corporate purposes."[132] PG&E intends to issue significant amounts of new equity in the coming years. It is not likely that PG&E will separately issue equities *only* to fund a penalty. Rather, PG&E will issue equities both to support normal capital expenditures as well as capital expenditures and/or penalty costs that will dilute shareholder value. In either case, it appears there is significant investor appetite for PG&E stock.

PG&E refused to provide the Commission with any useful estimate of financial resources to pay penalties and disallowances based on investor expectations. Indeed, the evidence in the record established that equity analysts have forecast 1) total financial consequences in the range of $2.0 to $2.5 billion, and 2) a 'penalty-only' component in

[129] 14 Jt. RT 1587-1588 and 1637-1638, Fornell/PG&E. See, also, City of San Bruno Op. Br., p. 29-31.
[130] 14 Jt. RT 1383-1384, Lubow/CSPD.
[131] 15 Jt. RT 1572;
[132] See, for example, PG&E Press Release of Feb. 27, 2013, at http://www.pgecorp.com/news/press_releases/Release_Archive2013/130227press_release.shtml

the range of $200 million to $1.0 billion.[133] These "investor expectations" entirely confirm Overland's conclusion that PG&E could issue equity to support financial consequences of $2.25 billion.

Ultimately, Mr. Fornell maintains that the Commission must issue a penalty within "investor expectations." PG&E claims that the lack of "artificial precision" in Mr. Fornell's testimony is a virtue,[134] but Mr. Fornell's recommendation not only lacks "precision," it lacks any actionable guidance at all. TURN already addressed Mr. Fornell's testimony extensively in our opening brief,[135] where we cautioned that the Commission should not base its policy decision regarding the appropriate fine based on meeting "investor expectations." The Commission cannot accept the premise of PG&E's argument, which is that a penalty can be no larger than that forecast by equity analysts.

IX. RESPONSE TO THE DIRECTOR'S REPLY BRIEF

Regrettably, the Director's Reply appears to dovetail all too closely with PG&E's proposal that the utility be given credit for any and all past and future spending that might impact shareholders in any way. In this way, the CPSD completely gives back to PG&E with one hand what it purportedly took with the other. Furthermore, although it does not explain this at all, the CPSD recommendation apparently envisions a lengthy and complex process of auditing PG&E's past and future expenditures to determine when PG&E has finally spent the required $2.25 billion of shareholder money.

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[133] TURN Fines and Remedies Op. Br., p. 40-41. The analyst estimates are on the record in numerous exhibits, including public exhibit Jt. 79.
[134] PG&E CRB, p 71.
[135] TURN Op. Br. On Fines and Remedies, p. 33-40.

A. The Director's Proposal Is Practically Unworkable Due to Its Vagueness

The Director's Reply summarizes the Director's penalty proposal at pages 3-4. The Director states that he "supports a flexible apportionment of the penalty, so long as funds are used exclusively to improve the safety of PG&E's gas transmission *or distribution* systems."[136] The Director further explains that "[a]ny bona fide safety enhancement to PG&E's gas transmission or distribution system made at shareholder expense may be eligible to satisfy the $2.25 billion penalty." The Director provides several examples of spending that would satisfy the $2.25 billion penalty requirement, including:

- Any costs of PSIP Phase I and Phase II
- Shareholder-funded safety improvements related to GT&S rate case spending
- The development of safety management systems
- Remediation of gas pipeline right-of-way encroachments.

The Director's Reply explains that these examples are "illustrative but not exhaustive." The Director does not even attempt to explain what qualifies as "safety enhancements" to the gas distribution system. Moreover, PG&E's gas distribution is not at issue in any of these enforcement proceedings.

The Director does provide a few examples of costs that would not count towards the $2.25 billion. These include payments made to compensate victims or the City of San Bruno. They also include administrative costs, customer notification costs, legal fees, and "expenses previously approved for rate recovery."

[136] CPSD Reply Brief, June 5, 2013, p. 3 (emphasis added).

The Director's Reply does not adequately define "bona fide safety enhancements." Given the sweeping language of the brief, it appears that the Director intends a broad and expansive definition that would essentially allow PG&E to determine what would qualify as safety enhancement dollars. In essence, it is similar to PG&E's proposal, except perhaps for the exclusion of PG&E's $70 million contribution to the City of San Bruno.

Likewise, the Director's Reply does not define what qualifies as "shareholder funding." TURN is concerned that the Director has the same intention as PG&E, to allow any cost overruns to count as shareholder funded. This is especially true since the Director excludes "expenses approved for rate recovery" but then includes "shareholder-funded" spending related to the GT&S rate case. There is absolutely no principled way to determine what portion of GT&S spending might be funded by "shareholders." TURN already addressed this issue above and further discusses our concerns in the following section.

B. The Director's Reply Would Give PG&E Credit for Any and All Spending on Transmission and Distribution Safety, Making a Mockery of the Purported 'Penalty'

Perhaps unintentionally, the Director's Reply makes a mockery of the notion of a "penalty," since it would simply put PG&E in exactly the same position as the *status quo.* There are at least three ways in which this would result.

1. Any "Safety Related Spending" Above Authorized Levels Does Not Necessarily Mean Shareholder Funding

First, the proposal would give PG&E credit for any safety spending "funded by shareholders," on either the transmission or distribution system. However, the phrase

"funded by shareholders" is not as simple as the Director's Reply implies. The Director's examples assume there is a clear demarcation between expenses for the same activity that are "approved for rate recovery" versus those that are funded by shareholders. CPSD appears to envision that any spending above the amount used to set the revenue requirement is automatically a shareholder expense. Absent specific ratemaking mechanisms and strict cost separation of different activities, this is simply false.

There are two key aspects that apply to true "below the line shareholder expenses," such as political lobbying costs, that are not authorized to be collected in rates. First, such costs must be recorded in accounts that are not used to forecast revenue requirements in rate cases. In other words, actual historical spending for lobbying must be kept entirely separate from any account that forms the basis of a rate case request, so as not to increase future rates. This is not the case for any of the spending examples cited in the CPSD brief. There is absolutely no technical or practical basis on which to separate spending on "integrity management" (part of the GT&S rate case) into "shareholder" versus "ratepayer" accounts.

Second, below the line costs must be funded out of net earnings, not out of any revenues made available by cost reductions in other accounts and fund shifting. This is essential to ensuring that costs are actually deducted from net earnings, rather from the overall revenue requirement.

As explained above, absent specific ratemaking mechanisms (such as a one-way balancing account), the utility is free to allocate costs in any way it sees fit. In practice this means that a cost overrun in one area does not at all signify a "shareholder contribution," if the utility is able to reduce costs elsewhere. This was the crux of the

explanations given by Mr. Lubow as to why certain costs that PG&E characterized as "unrecovered" could have easily been included in rates.

Two examples illustrate this problem. Ms. Yura claims in her testimony that PG&E shareholders spent $74 million on integrity management in 2011-2012. Integrity management is an account in the GT&S revenue requirement. Presumably, Ms. Yura meant that PG&E overspent this account by $74 million in those two years. However, there is absolutely no evidence concerning PG&E's *total spending* for GT&S activities as compared to the total revenue requirement.[137] PG&E shareholders may or may not have contributed any funds for the integrity management overrun.

As previously noted, the Commission need look no further than to the lengthy dispute concerning historical GT&S spending on the record in I.12-01-007. Hundreds of pages of testimony from Overland and PG&E all went to demonstrate whether PG&E overspent or underspent in certain accounts within GT&S. But, in that debate, PG&E never alleged that overspending automatically resulted in "shareholder funding." E*ven if* one accepts PG&E's version (that it overspent on safety), the undisputed fact remains that actual GT&S returns were higher than authorized.[138] This means there was no impact on the bottom line, and thus no "shareholder funding" for the overspending.

In sum, to the extent that the Director, like PG&E, envisions that any spending in a particular account or activity above the amount used to set the revenue requirement is automatically a shareholder expense, the Director is ignoring basic ratemaking principles.

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[137] An even further complication is the fact that, since a portion of GT&S revenues are not decoupled, it would also be possible that actual revenues exceeded forecast revenues.
[138] For GT&S, this impact reflected some lower costs combined with higher revenues from storage sales. See, for example, PG&E Opening Brief in I.12-01-007, p. 142.

2. Credit for Distribution System Overspending Means PG&E Would be Better Off Than Without This Fictitious Penalty

The Director's misapprehension of ratemaking principles is compounded by the fact that the Director's Reply consistently refers to safety spending on "transmission *and distribution.*" This opens up a ratemaking hole through which PG&E can drive its armored truck of utility profits. There is absolutely no explanation of what is meant by the term "distribution" or why it was included in the Director's Reply. The Commission can certainly take official notice of the commonly known fact that PG&E has had two distribution line explosions in 2011 on Aldyl-A platic distribution pipe.[139] As a result, one can surmise that PG&E has probably "overspent" on at least some categories of gas distribution spending related to plastic pipe. That overspending may or may not be cause for higher rate requests in the ongoing general rate case, A.12-09-011. There is no recourse for this overspending in normal ratemaking, and PG&E has never filed any application concerning this matter. It would be ironic indeed if PG&E were now given credit for this overspending to reduce any fictitious "penalty" levied in these proceedings.

3. The CPSD Reply Fails to Account for Any Tax Benefits of Utility Spending

Both the PG&E and CSPD expert witnesses agreed that a disallowance of utility costs has tax benefits for PG&E, as compared to a penalty payment to the General Fund. This issue is explained in detail in Overland's financial report.[140] During the cross examination by PG&E's counsel the CPSD witnesses confirmed that any dollar of

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[139] See, for example, "PG&E to replace more than 1,200 miles of faulty gas piping across California," October 14, 2011, at http://www.garp.org/risk-news-and-resources/risk-headlines/story.aspx?newsId=36131

[140] Ex. Jt. 51, p. 13.

spending on utility activities disallowed by the Commission would result in only a 63-cent reduction in profits due to the tax impacts.[141]

The Director's Reply purports to recommend a $2.25 billion fine, but would appear to give PG&E dollar-for-dollar credit for any "shareholder funding" of utility activities. Even if one could possibly determine that shareholders actually funded a particular activity, the after-tax impact of these deductions would mean that the actual financial impact on shareholders would be only 63% of the total, $1.418 billion.

C. Conclusion

TURN supports that apparent intent of CPSD's original recommendation in its opening brief, that PG&E, rather than utility ratepayers, should fund the safety expenditures made necessary by PG&E's decades of neglect and mismanagement. However, TURN cannot support the blank check proposed in the Director's Reply, which allows PG&E to write its own penalty credit. TURN strongly suggests that the Commission look to TURN's analysis, based on record evidence, to find that the $2.25 billion should be properly reduced to a $1.46 billion outstanding amount. That amount should be used to order PG&E to pay for most of the remaining PSIP work, as well as to fund a penalty to the General Fund and certain other remedial activities.

[141] 14 Jt. RT 1390-1392, CPSD/Lubow. Indeed, after rereading the testimonies, TURN realizes that we under-calculated the tax benefit to PG&E from our recommended disallowance of authorized PSIP costs, by disaggregating capital and expense, though PG&E apparently intends to "expense" any capital disallowance. Likewise, TURN neglected to adjust the tax benefit of the disallowed 2011-2012 PSIP expenses.

X. PG&E'S OBJECTIONS TO TURN'S PROPOSED RECORDKEEPING AND AUDITING REMEDIES ARE WITHOUT MERIT

In its opening brief, TURN proposed that the Commission order focused recordkeeping and auditing remedies to address specific violations and deficiencies shown in the record of these proceedings. PG&E objects to TURN's remedies on various grounds, none of which have merit.

First, PG&E contends that the Commission should not order audits in its decision on these cases, but should rather leave it to CPSD's discretion to decide what audits are needed.[142] TURN strongly disagrees. Because of PG&E's serious safety deficiencies, these cases have come before the full Commission for resolution. The record of these cases provides the Commission an opportunity to exercise sorely needed leadership in ensuring that PG&E fully remedies its many recordkeeping and other safety problems. Although CPSD of course should have the flexibility to undertake audits as it deems necessary, the audits TURN recommends – of PG&E's MAOP validation efforts and the critical Project Mariner – are clearly necessary based on the record of this case and should be baseline audits ordered by the Commission.

Contrary to the statements in PG&E's Appendix B, TURN's recommended recordkeeping and audit remedies do not duplicate remedies proposed by CPSD or other parties:

TURN #1 (CRB, p. B-39). PG&E claims this remedy duplicates CPSD 4.C.18 and 4.C.19. Although there is some overlap, TURN's remedy addresses important problems that are not dealt with by CPSD's proposals. In particular, CPSD only addresses salvaged and re-used pipe, but does not address pipe that is otherwise

[142] CRB, pp. 101-102 and fn. 476.

reconditioned. As noted in Section IV above, key problems with Segment 180 were that PG&E failed to ensure that it was reconditioned properly and PG&E's records failed to show even that the pipe was reconditioned. Thus, PG&E's centralized database should track not just re-used pipe but also pipe that has not been previously used but that needed to be reconditioned. As TURN recommends, the database should show whether PG&E has records showing that the pipe was properly reconditioned so that appropriate attention can be given in integrity management to reconditioned pipe that lacks such records. If PG&E had such a system in place earlier, it is likely that it would have recognized that Segment 180 was suspect pipe. TURN would have no objection if TURN #1 were merged with CPSD 4.C.18 and 4.C.19, as long as the content of TURN's recommendation is reflected in the merged remedy.

TURN #2A (CRB, p. B-39): PG&E claims that this proposal duplicates CPSD 4B.4. TURN notes that the Director's Reply would incorporate TURN's language in 4B.4, which TURN agrees is appropriate.

TURN ##2B and 3 (CRB, p. B-40): PG&E incorrectly claims that these remedies duplicate the independent monitor proposal by the City of San Bruno ("San Bruno"). PG&E overlooks the substance of TURN's remedies. The key need (not reflected in the San Bruno proposal, but with which TURN otherwise agrees) is that the Commission needs to order comprehensive independent audits (funded by PG&E shareholders), under the Commission's direction, of both PG&E's MAOP validation results and the new recordkeeping systems to be created in Project Mariner. In addition, to promote much needed transparency in the oversight of PG&E's remedial safety efforts, the Commission needs to make clear that the audit reports will be made available to all interested parties.

XI. CONCLUSION

For the reasons set forth in this reply brief and in TURN's opening brief on fines and remedies, TURN urges the Commission to adopt each of the recommendations summarized in TURN's Summary of Recommendations in its opening brief.

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Respectfully submitted,

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