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, Law, Rules and Regulations in Connection with the San Bruno Explosion and Fire on September 9, 2010.	I.12-01-007 (Filed January 12, 2012) (Not Consolidated)
Order Instituting Investigation on the Commission's Own Motion into the Operations and Practices of Pacific Gas and Electric Company with Respect to Facilities Records for its Natural Gas Transmission System Pipelines.	I.11-02-016 (Filed February 24, 2011) (Not Consolidated)
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REBUTTAL BRIEF OF THE DIVISION OF RATEPAYER ADVOCATES REGARDING FINES AND REMEDIES

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TABLE OF CONTENTS

I. INTRODUCTION 1

II. THE FINANCIAL CONSEQUENCES OF PG&E'S FAILURE TO OPERATE ITS GAS TRANSMISSION SYSTEM SAFELY SHOULD BE BORNE BY THE COMPANY TO THE EXTENT REASONABLY POSSIBLE 4

A. CPSD AND INTERVENORS AGREE THAT PG&E SHOULD PAY THE MAXIMUM IT CAN AFFORD AND REMAIN FINANCIALLY HEALTHY 4

B. OVERLAND *CONSERVATIVELY* ESTIMATES THAT PG&E CAN AFFORD AT LEAST $2.45 BILLION POST TAX 5

C. PG&E HAS NOT ARGUED THAT IT CANNOT ABSORB $2.45 BILLION IN FINANCIAL CONSEQUENCES 8

III. THE FINANCIAL CONSEQUENCES TO PG&E SHOULD INCLUDE A SUBSTANTIAL FINE PAID TO THE GENERAL FUND 11

IV. PG&E'S CONSTITUTIONAL CLAIMS HAVE NO MERIT 13

V. CALCULATION OF THE TOTAL FINANCIAL CONSEQUENCES TO PG&E 15

A. TO LIMIT CONFUSION AND FUTURE LITIGATION, THE COMMISSION MUST CLEARLY DEFINE WHAT EXPENDITURES MAY BE CREDITED AGAINST PG&E'S TOTAL LIABILITY 15

B. APPLICATION OF DRA'S PROPOSED RULES 18

VI. INDEPENDENT MONITORING AND AUDITING OF PG&E'S REMEDIAL WORK IS NECESSARY TO PROTECT PUBLIC SAFETY AND RATEPAYER DOLLARS 19

VII. CONCLUSION 20

TABLE OF AUTHORITIES

CASES

Alcoholic Beverage Control Appeals Bd., 151 Cal. App. 4th 1274 (2007) 16

Clark v. City of Hermosa Beach, 48 Cal. App. 4th 1152 (1996) 16

English v. City of Long Beach, 35 Cal.2d 155 (1950) 16

Pacific Bell Wireless, LLC v. Public Utilities Commission,
140 Cal.App. 4th 718(2006) 4

CPUC DECISIONS

D.98-12-075 13
D.01-09-058 13
D.02-02-027 13
D.02-10-059 13
D.04-09-062 14
D.08-09-038 13
D.12-12-030 ....16, 17, 18, 19

CALIFORNIA PUBLIC UTILITIES CODE

§ 2100..3
§ 2101..14
§ 2104..4
§ 2107...4, 5, 14
§ 2108...4, 5, 14
§ 2119..3

OTHER AUTHORITIES

Cal. Const. art. I § 17 14

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

I. INTRODUCTION

Pacific Gas and Electric Company (PG&E) claims to have "fully accepted moral and legal responsibility" for the San Bruno disaster (which it calls "a tragic accident") and to acknowledge that there should be penalties.[1] But in what sense does it accept responsibility? PG&E admits only a few violations, none of which, according to PG&E, contributed to the

[1] PG&E Fines & Remedies (F&R) Reply Brief (RB), p. 1.

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San Bruno explosion: "erroneous class location designations in the Class Location OII, failure to follow company procedures in creating a clearance for the Milpitas Terminal UPS replacement, [and] failure to timely perform alcohol testing."[2] Rather than confront the evidence of safety violations adduced in these proceedings, PG&E argues repeatedly that there is no evidence that violations were knowing or willful – deliberately overlooking the fact that the violations alleged in these proceedings do not require any showing of intent.[3] This posturing is not consistent with acceptance of responsibility.

PG&E's position on penalties is equally contradictory. PG&E argues that the $2.25 billion "penalty" recommended by the Director of the Consumer Protection and Safety Division (CPSD) is "grossly disproportionate." Contrary to many news reports, CPSD recommends no fine, but proposes to treat as a "penalty" unrecovered remedial costs up to $2.25 billion.[4] PG&E urges the Commission to "apply the unrecovered amounts that shareholders have spent and plan to spend on gas safety to any penalty"[5] and claims that those unrecovered amounts add up to $2.2 billion.[6] One barely needs to scratch the surface of the two proposals to see that PG&E's recommendations and CPSD's are actually very similar. CPSD proposes to treat as a "penalty" unrecovered costs up to $2.25 and is explicit about recommending no fine. PG&E says it has unrecovered costs of $2.2 billion and asks the Commission to take this into account in determining the penalty, and implicitly suggests that any fine on top of these unrecovered costs would be excessive. PG&E calls CPSD's no-fine proposal "grossly disproportionate" but the similarities between the CPSD proposal and PG&E's are more striking than the differences.

PG&E makes a series of arguments about why a $2.25 billion penalty is excessive.[7] These arguments miss the mark completely because no party has proposed a $2.25 billion penalty. CPSD and the intervenors have proposed that PG&E shareholders bear $2.25 to

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[2] PG&E F&R RB, p. 37.

[3] PG&E F&R RB, p. 1.

[4] CPSD F&R Opening Brief (OB) p. 37: "CPSD does not recommend a fine, but a penalty in the form of remedies of $2.25 billion."

[5] PG&E F&R RB, p. 2, p, 103.

[6] PG&E F&R RB, pp. 12-17.

[7] PG&E F&R OB, pp. 21-33.

$2.45 billion of the costs of making PG&E's gas transmission system safe, minus any fine imposed. The non-PG&E parties are mindful of the fact that the total financial consequences of PG&E's decades of mismanagement of its gas transmission system brought to light by the investigations conducted by the National Transportation Safety Board (NTSB) and by this Commission, will far exceed $2.25 billion, and that remediation costs not borne by the company will be passed on to ratepayers. For this reason, the intervenors have all recommended as a remedy holding shareholders responsible for a substantial portion of the remediation costs that would otherwise be paid by ratepayers. But not all unrecovered costs can properly be characterized as a "penalty."

Each of the intervenors has recommended a statutory ***fine*** (also called a penalty in the Public Utilities Code)[8] ranging from $550 million (DRA) to $1.25 billion (City of San Bruno). As previously noted, CPSD recommends no fine, but that shareholders be required to pay $2.25 billion of remedial costs. CPSD characterizes this no-fine proposal as a "penalty" of $2.25 billion, but it is not a "penalty" within the meaning of the California Public Utilities Code. The relevant provisions of the Public Utilities Code that specifically authorize the Commission to impose statutory penalties, §§ 2107 and 2108,[9] use the term "penalty" to mean a fine payable to the state's General Fund.[10]

Although commentators may use the term "penalty" loosely, there are important legal and tax differences between a statutory penalty or fine payable to the state's General Fund, and cost disallowances or other remedies. For the sake of clarity, in this brief DRA refers to statutory penalties that may be imposed pursuant to Public Utilities Code §§ 2107 and 2018 as "fines." To describe the combined costs to PG&E of all the remedies, of all types, imposed by the Commission in these three investigations, we will use the more general term "financial consequences to PG&E." Further, we do not refer to all unrecovered costs related to San Bruno as "penalties." There are many types of costs bearing some relation to San Bruno or gas safety

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[8] *See, e.g.,* California Public Utilities Code §§ 2100-2119.

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

[10] *See, e.g.,* § 2104 which requires that certain "fines and penalties" (the terms are used interchangeably) be paid into the State Treasury to the credit of the General Fund. *Note also* that the Commission and the appellate courts have consistently read the use of the term "penalty" in §§ 2107 and 2108 to be synonymous with "fine." *See, e.g., Pacific Bell Wireless, LLC v. Public Utilities Commission,* 140 Cal. App. 4th 718, 737 (2006) (*Cingular Appeal*).

that PG&E would not be allowed to recover from ratepayers under any circumstances. It would make no sense to count such costs as a "penalty."

This rebuttal brief is organized as follows: In the next section we address why it is appropriate (and not excessive) for the Commission to require PG&E to absorb $2.45 billion of the financial consequences of its egregious failures related to gas transmission pipeline safety. In Section III we explain why it is important to impose a substantial fine as one of the remedies. In Section IV we briefly rebut PG&E's constitutional arguments about excessive fines. In Section V we respond to other parties' recommendations about what unrecovered costs should be credited to the financial consequences imposed on the company and clarify our own proposal. In the last section we reiterate the need for an independent monitor, which all of the intervenors have requested.

II. THE FINANCIAL CONSEQUENCES OF PG&E'S FAILURE TO OPERATE ITS GAS TRANSMISSION SYSTEM SAFELY SHOULD BE BORNE BY THE COMPANY TO THE EXTENT REASONABLY POSSIBLE

A. CPSD And Intervenors Agree That PG&E Should Pay The Maximum It Can Afford And Remain Financially Healthy

Every party, except PG&E, recognizes that PG&E faces minimum fines in the tens of billions of dollars, and maximum fines exceeding several hundred billion dollars, under the applicable penalty provisions of the Public Utilities Code (§§ 2107 and 2108).[11] In light of this fact, several parties, including CPSD, have advocated that "[i]n these unprecedented circumstances, where a utility's conduct merits a penalty large enough to put the utility out of

[11] CCSF F&R OB, p. 8; TURN F&R OB, pp. vii, 2, and 17; San Bruno F&R OB, p. 6; DRA F&R OB, p. 2. CPSD only expressly acknowledges that PG&E is liable for fines in the "tens of billions of dollars." However, CPSD's Opening Brief acknowledges multiple daily and per segment violations, which, when calculated, add up to hundreds of billions of dollars in fines, rather than fines in the tens of billions of dollars. *Compare* CPSD F&R OB, pp. 5 ("Imposing a fine for each violation for each ongoing day would result in tens of billions of dollars of fines, which is more than PG&E's net worth") *with, for example,* F&R OB, p. 14 ("CPSD has found a total of 55 violations, for a number of days exceeding 300,000 days, pursuant to Section 2108 which states that each day a violation is ongoing is a separate offense"), violations alleged at pp. 22-26, and specifically at p. 23 ("PG&E admits to thousands of failures to retain strength test records that are required by law"), p. 32 ("PG&E provided a list of more than 23,700 pipe segments, constituting approximately 435.7 miles, in the most heavily populated (Class 3 and 4) high consequence areas, for which PG&E has not located a valid [] strength test record"), and p. 34 ("PG&E admits that 843 pipeline segments were not accurately classified in violation of federal regulations …. PG&E admitted to 843 such violations in Data Responses for a total of 6,097,290 days").

business, *the Commission should impose the largest penalty the utility can reasonably bear*."[12] CPSD explains: "… [T]he Commission should provide the maximum penalty, which PG&E can afford to pay, in order to send the message to PG&E's management that it must ensure that its facilities will be safe in the future."[13] CPSD elaborates later: "A penalty level that is 'the cost of doing business' and causes merely a dent in PG&E's profits will do little if anything to restore the public trust."[14] DRA agrees with these statements. Even more important, a penalty level that "causes merely a dent in PG&E's profits" will not induce the change that is so badly needed and will not deter repeat violations.

B. Overland *Conservatively* Estimates That PG&E Can Afford At Least $2.45 Billion Post Tax

While nearly all of the parties, except PG&E, advocate that PG&E should pay the maximum amount that it can afford based on the Overland Financial Analysis, which is $2.45 billion, they all quantify their proposals based on Overland's initial number of $2.25 billion.

Overland's analysis is premised on the belief that "[a] financially healthy utility is in the best interests of all stakeholders, including the CPUC, PG&E customers, and the company's stockholders and creditors."[15] However, the amount that Overland finds that PG&E can afford, while remaining financially healthy, is $2.45 billion – not the $2.25 billion relied upon by CPSD and other parties in making their recommendations. As Overland explained, its analysis determined "the amount of incremental equity that could potentially be issued by [PG&E Corporation], aside from $200 million that [PG&E Corporation] had already incorporated into its forecasts."[16] Thus, Overland intended the $2.25 billion to be *incremental* to $200 million in equity that PG&E Corporation was in the process of raising at the time of Overland's initial report. CPSD and TURN similarly recognized that the $2.25 billion Overland estimate was

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[12] CCSF F&R OB, p. 1(*emphases added*). *See also* TURN F&R OB, p. vii ("Because the statutory minimum fine well exceeds PG&E's financial resources, the fine actually imposed in these cases should be constrained by the company's 'financial limit,' the fine that PG&E can sustain without impairing its ability to serve customers or increasing its cost of capital."); CPSD F&R OB, p. 4; DRA F&R OB, p. 3.

[13] CPSD F&R OB, p. 4.

[14] CPSD F&R OB, p. 55.

[15] Jt. Ex. 52, Overland Financial Analysis, p. 14.

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

incremental to equity already forecasted by PG&E. As CPSD stated: "Overland determined that PG&E could raise $2.25 billion in equity to pay fines and remedies. … *It is important to note that this is additional equity to the equity already raised by PG&E in 2012.*"[17] TURN explained: "Overland found that PG&E could issue up to $2.25 billion of new equity, without significantly impairing these key financial metrics. *This amount is in addition to the $200 million that PG&E has already included in its 2012 forecasts. Thus, the Overland Financial Analysis found that PG&E could raise equity to pay for up to $2.45 billion in penalties and all other remedies and disallowances.*"[18] Thus, it is appropriate for the Commission to use $2.45 billion as a starting point for any calculations based upon what PG&E can afford and remain financially healthy.

Further, any calculations based upon what PG&E can afford should recognize that the Overland's estimate is *post tax* and that PG&E has agreed that the tax benefit of costs that it can deduct is 37%. In sum, Overland takes into account that the total financial consequences to PG&E of the San Bruno explosion could be a combination of a fine paid to the general fund, which would likely not be tax deductible, and other unrecoverable costs, such as cost disallowances for safety-related infrastructure, which would likely be tax deductible. Overland addressed this issue by comparing its own analysis to a sensitivity analysis by International Strategy & Investment (ISI) released the same month as the Overland Financial Analysis. ISI is an equity analyst group quoted in the Wells Report.[19] The ISI analysis calculates, among other things, changes to PG&E's share price assuming a variety of non-tax deductible fine amounts combined with post-tax costs of $1.175 billion, assuming a 37% tax rate, and showing the pre and post tax costs of those various scenarios. Overland explains that "the Post-tax Exposure column [in the ISI analysis] should be used when making any comparisons between ISI's analysis to Overland's."[20] Thus Overland clarified that it intended for its $2.45 billion estimate to be post tax, and that it assumed a 37% tax rate.

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[17] CPSD F&R OB, p. 52 (*emphases added* and *omitting citation* to Jt. Ex. 52, Overland Financial Analysis, p. 13, *underline in original*).

[18] TURN F&R OB, p. 32 (*emphases added* and *citations omitted*).

[19] *See* Jt. Ex. 67, Wells Report, p. 19 and note 25.

[20] Jt. Ex. 53, Overland Rebuttal - Confidential, p. 25. It is best to review the confidential version of the Overland Rebuttal because review of Table 13, which is redacted in the public version (Jt. Ex. 54), is very helpful to appreciating the points made both by ISI and Overland.

During its cross examination of Overland, PG&E acknowledged that it would likely be faced with a non-tax deductible fine as well as other unrecovered costs that would be tax deductible, and did not dispute Overland's use of a 37% combined tax rate to calculate post-tax liability. Among other things, during that cross examination, PG&E added to the record an exhibit (Joint Exhibit 59) showing that PG&E used the 37% tax rate for purposes of calculating its post-tax liability for its 2012 Annual Report:

> Q … [W]hile I don't think there is any dispute that fines paid to the State General Fund are not tax deductible, other categories of expense that The Company may have incurred or will be incurring that are not recovered, recoverable are in fact deductible for tax purpose; correct?
>
> WITNESS LUBOW: A Yes.
>
> Q So that for a tax deductible item, if The Company spends a dollar on an unrecoverable item, it gets to deduct that, and the after-tax impact is only about 63 cents; correct?
>
> WITNESS LUBOW: A Correct.
>
> Q So what Exhibit Joint 59 is, is it is two pages from the prior exhibits. It is, first, page 13 from the annual report that we just looked at in Joint 58 and it is also, behind that page 13 of the 2012 earnings slides that is Joint 57. And you'll see what we did on the first page of Exhibit Joint 59 was to take the unrecovered and unrecoverable costs incurred and forecast in the annual report, and we tried to tax effect them, that is, to recognize which ones are tax deductible and subtract the tax benefit savings and then add back the straight fines piece that is not deductible. Do you see that?
>
> A I do.
>
> Q Okay. And first, to be clear, the accrued penalties, which in PG&E's case is prospective fines, that you agree is not tax deductible.
>
> WITNESS LUBOW: A Correct.
>
> Q And when we took the other pre-tax costs and we adjusted them by subtracting 37 percent, that is the correct tax adjustment?
>
> WITNESS LUBOW: A I'm assuming that The Company's representing an accurate composite tax effect. I'm not familiar with the relationship of federal and state, but I'm assuming that this is a composite tax rate based on the federal and state rates.

Q And that is a rate that you mentioned in your own testimony.

WITNESS LUBOW: A Yes.[21]

Thus, from this cross examination, Joint Exhibit 59, and other record evidence, it is clear that PG&E understood that Overland's calculations considered a combination of both a non-tax deductible fine payable to the general fund and other adverse financial consequences, and that Overland's estimates were calculated based on a post tax basis, assuming a 37% tax rate for non-fine remedies. It is also clear that PG&E anticipated the possibility of such an outcome and agreed with the use of the 37% tax rate. These points are relied upon in Section V below to calculate PG&E's total financial consequence for these three San Bruno-related proceedings.

C. PG&E Has Not Argued That It Cannot Absorb $2.45 Billion in Financial Consequences

PG&E attacks Overland's analytical method claiming "Overland's 'threshold level' is in fact essentially a made-up number based on two financial metrics that have nothing to do with market capacity for equity to be used to fund a penalty."[22] PG&E is, in part, correct. Because there is no standard methodology for quantifying how much of a fine and other financial consequences a company such as PG&E can absorb and remain financially healthy, CPSD had to develop a methodology from scratch. For that purpose, CPSD turned to Overland and two analysts with over 70 years of cumulative experience providing financial consulting services to the electric, gas, telecommunications, and railroad industries.[23]

Further, while Overland might have considered a range of scenarios for PG&E to fund the remedies assessed to PG&E in these three San Bruno-related proceedings, Overland's analysis is intentionally premised on a key constraint set by PG&E.[24] PG&E has options about how to fund the adverse financial consequences of the San Bruno explosion. For example, PG&E could easily fund both a fine and other costs through a dividend adjustment for a limited

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[21] 14 Jt. RT 1390-1392, CPSD/Lubow.

[22] PG&E F&R RB, p. 64.

[23] Jt. Ex. 54, Overland Rebuttal, pp. 1-2.

[24] *See, e.g.,* Jt. Ex. 52, Overland Financial Analysis, p. 1 ("The company's senior management has consistently stated that it plans to fund potential fines by issuing equity. As such, we have primarily focused our analysis on the company's ability to raise capital through the equity markets.")

period of time.[25] However, PG&E insists on funding such costs through an external equity offering, which has higher costs than an internal offering, i.e. a temporary dividend adjustment.[26] Thus, Overland's analysis specifically sought to determine the total post-tax amount PG&E can afford to pay and remain financially healthy, assuming that PG&E will finance *all* of the excess costs related to the San Bruno explosion through an external equity offering, with no changes to its dividend policies. Absent these constraints, the Overland Financial Analysis may have looked very different.

Aside from its observations that Overland relies upon a "made-up number," which almost any analysis must do, PG&E's remaining criticisms of Overland and its approach have no merit.

PG&E claims that the Overland consultants lack "a real world perspective" because neither Mr. Lubow nor Mr. Malko "has any experience working for an underwriter of utility equity or debt securities."[27] PG&E then argues that this "lack of a real world perspective … undermines Overland's testimony as a basis from which to determine the amount of any penalty."[28] However, as described in detail in DRA's Opening Brief in these proceedings, and summarized below, PG&E's reliance on equity analysts failed to produce a better approach to the task set out for Overland – quantifying the most that PG&E can absorb and remain financially healthy, using the assumption that PG&E will pay all San Bruno costs with an external equity offering. Rather, the Wells Report PG&E offers in place of the Overland Financial Analysis simply asserts that that *any* amount of consequences to PG&E that are more than what the "market expects" will have additional adverse financial consequences to the Company. The Wells Report does not attempt to quantify those consequences, nor does it propose a methodology for doing so. Rather, as DRA described in its Opening Brief, the Wells Report provides *no* analysis in support of its claims, and the few facts it relies upon are

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

[26] *See, e.g.,* Jt. Ex. 52, Overland Financial Analysis, p. 7.

[27] PG&E F&R RB, p. 73.

[28] PG&E F&R RB, p. 73.

misrepresented.[29] In fact, DRA identified no less than 9 material flaws in the Wells Report, not one of which PG&E has rebutted.[30]

In a misleading statement about Overland's testimony, PG&E states: "Even Overland cautioned that '[t]he actual amount of equity that the company could issue might be materially different than' Overland's 'threshold level' of $2.25 billion."[31] PG&E omits the clarification that follows this "caution" from Overland: "However, based on the information provided by the company we believe this amount is a reasonable estimate of external equity available to the company that allows it to stay within its dividend payout policy as well as maintain a price to book ratio comparable to its utility peers." Further, PG&E ignores the clarification repeated throughout the Overland Report that it is a "conservative" estimate in PG&E's favor. Instead, PG&E repeats criticisms made in the Wells Report that were soundly rebutted by Overland.

For example, PG&E claims that the Overland analysis "fails to take into account PG&E's need to issue large amounts of equity to fund planned capital improvements during the same time that it would need to fund the penalty."[32] This is not accurate. The Overland Rebuttal explains that had it ignored PG&E's need to raise significant equity in the future, "our threshold analysis would look considerably different."[33] Overland lists the capital expenditures PG&E has planned through 2016 and observes that "almost half of these costs will be funded with internally generated funds."[34]

PG&E also claims that Overland did not consider the impact of an equity offering made to finance a fine, rather than capital expenditures, or an acquisition that will add to the earnings of the company.[35] But as explained in the Overland Rebuttal, this consideration was embedded in Overland's highly conservative approach:

> The analysis provided in Table 10 at page 12 of our August 2012 Report (and updated in the "Updated Estimate of Available Equity Capital Through Equity

[29] DRA F&R OB, pp. 27-34.

[30] DRA F&R OB, pp. 27-28.

[31] PG&E F&R RB, p. 64.

[32] PG&E F&R RB, pp. 64-65.

[33] Jt. Ex. 54, Overland Rebuttal, p. 17.

[34] Jt. Ex. 54, Overland Rebuttal, p. 17.

[35] PG&E F&R RB, pp. 69.

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> Issuance" section of this testimony) considers the implications of various levels of equity issuance on stock price and other relevant metrics. Our analysis makes a conservative assumption regarding how investors would view these funding levels – it assumes zero incremental earnings and a 100% dilution effect on incremental shares issued. In reality, our analysis is overly conservative, as much of the penalty effects on the stock price have already been absorbed in the market price of the stock. More specifically, our "No Additional Equity Raise" price of $43.41 from our August 2012 Report ($42.67 in our updated analysis) already considers the adverse effects of San Bruno priced by the market.[36]

In sum, Overland has effectively rebutted every criticism raised by PG&E. For all of these reasons, the Overland Financial Analysis constitutes important evidence that is well-supported, whereas the Wells Report and PG&E's Reply Brief criticisms based on that report fall apart under scrutiny and should be given little or no weight. The only analysis in the record that addresses what PG&E can afford is the Overland Financial Analysis. As discussed in DRA's Opening Brief, that analysis is solid and conservative. As the Overland Rebuttal explains: "…[W]hen compared to a valuation study performed by one of [PG&E Corporation's] own equity analysts [ISI], Overland's results actually produced a more conservative result. Inconsistencies between Overland's methodology and that of 'standard' practices, to the extent they exist, appear to be in [PG&E Corporation's] favor."[37]

III. THE FINANCIAL CONSEQUENCES TO PG&E SHOULD INCLUDE A SUBSTANTIAL FINE PAID TO THE GENERAL FUND

The only way the Commission can send a clear message to PG&E that the company's longstanding, pervasive disregard of public safety will not be tolerated any longer is to impose financial consequences that reduce the company's profits for a finite period of time. For this reason, among others, all of the intervenors have argued that a significant fine is not only warranted, but also necessary, for purposes of deterrence. In this case that means a fine that must be unprecedented. CPSD states: "… the Commission should provide the maximum penalty, which PG&E can afford to pay, *in order to send the message to PG&E's management that it must ensure that its facilities will be safe in the future*."[38] CPSD also explains that "[a] penalty

[36] Jt. Ex. 54, Overland Rebuttal, p. 9.

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

[38] CPSD F&R OB, p. 4 (*emphases added*).

level that is 'the cost of doing business' and causes merely a dent in PG&E's profits will do little if anything to restore the public trust."[39]

Surprisingly, however, ***CPSD's Director has recommended that the Commission impose no fine at all on PG&E***.[40] Instead, in light of the significant cost of the remedial work that is needed on PG&E's gas transmission system, he proposes that "PG&E be ordered to spend $2.25 billion on remedies to make its gas transmission system safe."[41] Specifically, he recommends that "[t]his $2.25 billion should be directed toward paying for Phase I and Phase II costs and expenses of PG&E's PSEP, which the Commission had mandated in D.12-12-030, prior to collecting any money from the ratepayers."[42] As to the ratemaking treatment of these payments, he specifies: "This penalty is not recoverable from ratepayers nor are the capital expenditures paid for by these amounts to be included in the rate base. PG&E can not underspend in any other areas of their operations that affect safety to offset any of these expenditures."[43]

DRA shares CPSD's concern regarding the costs of fixing PG&E's gas transmission system. We have argued in these proceedings that PG&E is responsible for much of those costs pursuant to Public Utilities Code §§ 451 and 463. But a fine is also necessary to send the unequivocal message to PG&E that further violations on the scale revealed by these three proceedings will not be tolerated. As DRA noted in its Opening Brief,[44] the Commission has

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[39] CPSD F&R OB, p. 55.

[40] The many press reports that announced that CPSD had recommended a $2.25 billion fine were incorrect. In fact, he recommended a fine of zero. CPSD Opening Brief pp. 6, 37. As explained earlier, in the Public Utilities Code the words "penalty" and "fine" are frequently used interchangeably. That is also true of Commission and Court decisions addressing the Commission's statutory authority to impose fines. *See, e.g.* Public Utilities Code Sections 2100 to 2119. CPSD's Opening Brief filed on May 6, 2013, uses the word "penalty" to mean something other than a fine.

[41] CPSD F&R OB, p. 6.

[42] CPSD F&R OB, p. 6; *see also* p. 58 ("This is justified by the billions of dollars it would take for PG&E to meet acceptable safety standards without putting the entire burden on ratepayers.").

[43] CPSD F&R OB, p. 6.

[44] DRA F&R OB, p. 9.

repeatedly acknowledged the deterrent purpose of fines.[45] Here a fine is absolutely necessary for deterrence purposes. What message would it send to PG&E if the only financial consequence imposed by the Commission is to make the company pay for part of the cost of fixing its neglected and mismanaged gas system? What message would it send to the other California public utilities regulated by this Commission?

For all of these reasons, DRA stands by its initial proposal that PG&E be fined $550 million. Further, DRA recommends that the Commission set the fine at an appropriate amount that will remain fixed and not vary depending upon what other gas-related expenses PG&E is allowed to "count" as a remedy. It is important that the message delivered by the imposition of a fine be clear, and that it be imposed as promptly as possible consistent with due process.[46] Adjusting the fine to account for other expenses, which will potentially be determined at a later date, is likely to dilute this message and cause unnecessary delay.

IV. PG&E'S CONSTITUTIONAL CLAIMS HAVE NO MERIT

PG&E suggests that the $2.25 billion in total financial consequences the CPSD and other parties have proposed is unconstitutionally excessive.[47] PG&E explains: "The California

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[45] *See, e.g.,* D.98-12-075, 1998 Cal. PUC LEXIS 1016, *53-54:

The purpose of a fine is to go beyond restitution to the victim and to effectively deter further violations by this perpetrator or others. For this reason, fines are paid to the State of California, rather than to victims.

Effective deterrence creates an incentive for public utilities to avoid violations. Deterrence is particularly important against violations which could result in public harm, and particularly against those where severe consequences could result. To capture these ideas, the two general factors used by the Commission in setting fines are: (1) severity of the offense and (2) conduct of the utility. These help guide the Commission in setting fines which are proportionate to the violation.

See also, Decision 08-09-038 (SCE PBR), pp. 107 ("We expect this penalty to be a deterrent to SCE and to other utilities"); D. 02-10-059 (Qwest), p. 48 ("However, we do not agree with Qwest that its mitigation efforts warrant either no fine, or a minimal fine, because of the other factors that we balance, and because that outcome would not deter further violations by Qwest or others.") and p. 65, COL 16 ("The purpose of a fine is to effectively deter further violations by the perpetrator or others."); D.04-09-062 (Early Termination Fees), p. 62 ("As the Commission has stated before, 'The primary purpose of imposing fines is to prevent future violations by the wrongdoer and to deter others from engaging in similar violations. Fines should, therefore, be set at a level within the range permitted by § 2107 that is sufficient to achieve the objective of deterrence without being excessive in light of the offending utility's financial resources'" citing *UCAN v Pacific Bell,* D.01-09-058, *mimeo,* p. 80, 2001 Cal. PUC LEXIS 914**,** *limited rehearing granted in* D.02-02-027).

[46] *See* Public Utilities Code §2101 (requiring the Commission to promptly prosecute violations of the law by public utilities and collect penalties).

[47] PG&E F&R RB, p. 24.

Constitution prohibits 'excessive fines.' Cal. Const. art. I, § 17. This prohibition aims to limit the state's power to punish and therefore imposes a substantive constitutional limit on the state's power to extract civil penalties."[48] PG&E then cites a string of cases and a Commission decision in support of this claim.

PG&E's argument fails, among other reasons, because no party in these proceedings has proposed a $2.25 billion "civil penalty" or "statutory penalty" of the kind considered in the cases cited by PG&E. "Civil" and "statutory" penalties are the types of fines authorized by the Public Utilities Code, which must be paid to the state's General Fund. Public Utilities Code, § 2107 sets upper and lower limits for these fines. *CPSD proposes no such penalty.* Rather, it proposes an alternative remedy of disallowance of various costs that would otherwise be paid for by ratepayers. DRA proposes a $550 million statutory penalty pursuant to §§ 2107 and 2108. The remainder of the financial consequences DRA has recommended are primarily disallowances. A statutory fine of $550 million is well within the range of reason given PG&E's size and the circumstances of these proceedings. As the Commission has observed:

> With respect to the financial resources of the utility, the Commission considers both the need for deterrence and constitutional limitations on excessive fines. Consideration of the totality of the circumstances requires the Commission to look at the unique facts of each case, which may mitigate or exacerbate the degree of wrongdoing, in the furtherance of the public interest.[49]

PG&E's repeated attempts to compare five decades of unprecedented systemic gas transmission pipeline mismanagement to other accidents are unconvincing. As the City of San Bruno observed in its Opening Brief, PG&E's own penalty witness acknowledged that the "precedent penalties" he cited in the Wells Report are not comparable. After San Bruno's cross examination took him through the facts of four of those five incidents, Mr. Fornell admitted they were "very different circumstances" from the San Bruno explosion.[50]

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[48] PG&E F&R RB, p. 24.

[49] D.04-09-062 (Early Termination Fees), p. 63.

[50] *See* San Bruno F&R OB, pp. 39-40 and 14 Jt. RT 1575-1585.

V. CALCULATION OF THE TOTAL FINANCIAL CONSEQUENCES TO PG&E

In considering the total financial consequences to PG&E for the San Bruno explosion and PG&E's other violations, PG&E urges the Commission to "give full credit and consideration to PG&E's ongoing capital needs, the realities of the equities market in which PG&E would need to sell stock to fund a penalty *and, most important, the more than $2.2 billion of unrecovered and unrecoverable gas transmission safety-related costs that PG&E's shareholders already have incurred or will incur.*"[51]

This $2.2 billion assertion is the crux of this phase of these proceedings. As described in Sections II.B and II.C above, PG&E's first two concerns – its ongoing capital needs and the equity markets it operates within – are incorporated into the Overland Financial Analysis. Taking these and other factors into consideration, Overland conservatively estimates that PG&E can absorb total post-tax financial consequences of $2.45 billion to the extent PG&E insists on covering those costs through equity issuances.

Once a specific fine amount is determined – and DRA acknowledges but disagrees with CPSD's no-fine recommendation – the remaining issue is what PG&E expenditures should count as a "credit" towards PG&E's remaining San Bruno explosion liability. In other words, if the fine is set at $550 million, as DRA proposes, and the Commission determines that the total post-tax financial consequences to PG&E should be $2.45 billion, what will count as a credit toward the $1.9 billion remaining ($2.45 billion minus $550 million) after the fine is deposited in the state's General Fund?

A. To Limit Confusion And Future Litigation, The Commission Must Clearly Define What Expenditures May Be Credited Against PG&E's Total Liability

It is critical that the Commission address the issue of what counts as a "credit" in a simple and straightforward manner in order to avoid confusion and future litigation.

PG&E claims that it has already spent or committed $2.2 billion related to gas transmission safety,[52] and it repeatedly referred in its brief filed May 24, 2013 to expenditures, and communications regarding such expenditures, which are not in the record of any of these

[51] PG&E F&R RB, p. 65 (*emphases added*).

[52] PG&E F&R RB, p. 65.

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proceedings.[53] Such assertions cannot be considered here, as acknowledged in an Administrative Law Judge (ALJ) Ruling of June 3, 2013.[54] However, D.12-12-030 – which may be considered – provides an ideal road map for the Commission to consider the "credits" that PG&E should receive for gas-safety expenditures already incurred or committed to.

Rather than re-litigate issues of reasonableness already decided by the Commission in D.12-12-030, DRA proposes that the Commission adopt the following "rules" to define and calculate which PG&E expenditures qualify as a "credit" toward PG&E's total San Bruno liability ordered in these proceedings:

1. Any "credit" calculations should be based on the existing record in these proceedings, and the findings of D12-12-030.

2. All PG&E expenditures qualifying as "credits" toward the total financial consequences ordered in these proceedings shall be calculated post-tax based upon a 37% tax rate.[55]

3. All "credit" calculations should discourage inefficiency and cost overruns; consequently, no "credits" may include cost overruns.

4. PG&E shall receive a post tax credit of $399.735 million for the $634.5 million in PSEP expenditures disallowed by D.12-12-030 (Disallowed PSEP Costs) and described in more detail below.

5. All remedial capital expenditures authorized in PSEP Phase 1 by D.12-12-030, within the limits of the cost cap adopted in that decision, shall count towards the credit. This would currently be a credit of $551.124 million post tax,[56] but could be adjusted downward based on the PSEP "Update

[53] *See, e.g.,* PG&E F&R RB, pp. 10, 13-18, 82-83, and 103.

[54] On June 3, 2013, CPSD's Motion to Strike PG&E's references to facts outside the record of these proceedings was granted and PG&E was ordered to "re-file its opening brief to redact the portions of its brief that refer to extra-record material as described in the CPSD Motion to Strike" no later than June 5, 2013. As the June 3 ALJ Ruling recognized: "The Commission must base its decisions on evidence of record, and briefs that refer to extra-record evidence are not to be filed." PG&E's use of evidence outside the record of these proceedings, if allowed, would violate the other parties' right to a fair hearing. Adjudicators who are required to decide a case after a hearing may not consider evidence that was not introduced at the hearing, and of which parties were never given notice. *English v. City of Long Beach* (1950) 35 Cal. 2d 155, 158; Rondon *v. Alcoholic Beverage Control Appeals Bd.* (2007) 151 Cal. App. 4th 1274, 1289; *Clark v. City of Hermosa Beach* (1996) 48 Cal. App. 4th 1152, 1173.

[55] A fine should not be tax adjusted.

[56] These authorized capital expenditures are currently reflected in Table E-3 of D.12-12-030. Assuming valve automation costs are not remedial, such authorized expenditures total $874.8 million, which is $551.124 million post tax.

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Application" ordered by D.12-12-030.[57] The credit should not be adjusted upward because D.12-12-030 places a cap on authorized PSEP costs, and requires PG&E shareholders to absorb cost overruns.[58] Consequently, costs over the cap should not count toward the credit.

6. All further credits – totaling approximately $950 million – shall be for remedial gas transmission safety-related capital expenditures authorized by future Commission decisions in ratesetting proceedings.

7. Capital expenditures paid for by any credit shall not be included in rate base.[59]

8. Any PG&E expenditures that do not fall within these parameters – such as costs related to PG&E settlements of third party litigation, or expenditures not authorized by the Commission in a ratesetting proceeding, or authorized but already funded through rates – shall not count as a credit towards the total financial consequences ordered in these proceedings.

With regard to the Disallowed PSEP Costs, D.12-12-030 expressly disallowed PG&E's requested funding for its Pipeline Records Integration Program[60] and to strength test lines installed after 1955.[61] DRA calculates this disallowance as proposed by TURN in its Opening Brief.[62] However, DRA does not propose to give PG&E "credit" for cost overruns of $150.2 million, as proposed by TURN.[63] DRA calculates the Disallowed PSEP Costs as follows:

1. Start with the amount PG&E requested for PSEP - $2.184 billion

2. Subtract the contingency that D.12-12-030 found unreasonable - $380.5 million[64]

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[57] D.12-12-030, p. 115.

[58] D.12-12-030, pp. 56, 98-99.

[59] CPSD F&R OB, p. 6.

[60] *See, e.g.,* D.12-12-030, p. 87 (disallowing PG&E's requested funding for its MAOP Validation and for its Gas Transmission Asset Management program (GTAM), which is now referred to as "Project Mariner" by PG&E. Together these programs constitute PG&E's disallowed Pipeline Records Integration Program or "PRIP.").

[61] *See, e.g.,* D.12-12-030, p. 61, FOF 18, and COL 15.

[62] *See, e.g.,* TURN F&R OB, pp. 44-46.

[63] *See, e.g.,* TURN F&R OB, p. 46.

[64] *See, e.g.,* D.12-12-030, pp. 98-99.

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3. Subtract the amount authorized to be spent at ratepayer expense by D.12-12-030 - $1.169 billion[65]

4. The remaining amount is the disallowance for the PRIP and post-1955 strength testing - $634.5 million

It is important to note that the resulting $634.5 million in Disallowed PSEP Costs is inflated in PG&E's favor and does not reflect actual shareholder costs. This is because the $634.5 million is the remainder of PG&E's *forecasted* costs for the PSEP program. D.12-12-030 did not find these forecasted costs reasonable. Rather, it found all of PG&E's forecasts "generous"[66] and ultimately, the decision simply disallowed these specific forecasted costs. As such, any "credit" for Disallowed PSEP Costs using PG&E forecasted costs is likely inflated and does not reflect actual costs to be incurred by PG&E. However, for purposes of simplicity and compromise, DRA is willing to accept that the calculation of the credit for these disallowances be based on PG&E's forecasted costs.

B. Application Of DRA's Proposed Rules

Following DRA's proposed "rules" described above, DRA provides the following calculation of PG&E's total liability for these investigations:

- $2.45 billion Overland determination of what PG&E can conservatively afford
- Minus $550 million fine
- Minus $399.735 million tax adjusted credit for Disallowed PSEP Costs
- Minus $551.124 million tax adjusted credit for remedial work authorized in D.12-12-030
- $2.45 billion less a total of approximately $1.5 billion[67] equals approximately $950 million remaining to be applied to other remedial gas transmission safety-related capital expenditures authorized by the Commission.

[65] D.12-12-030, p. E3, Table E-4, line 7.

[66] *See, e.g.,* D.12-12-030, pp. 98-100.

[67] $550 million + 399.735 million + $551.124 million = $1,500.859 million or approximately $1.5 billion.

VI. INDEPENDENT MONITORING AND AUDITING OF PG&E'S REMEDIAL WORK IS NECESSARY TO PROTECT PUBLIC SAFETY AND RATEPAYER DOLLARS

Several parties express concern that more oversight is needed to monitor PG&E's PSEP activities and to ensure that PG&E is performing work consistent with NTSB, PHMSA, and CPSD recommendations.[68] These recommendations are generally consistent with DRA's own proposal for an independent third party monitor in order to (1) comply with the NTSB recommendation to "verify that all corrective actions are completed"; (2) restore public confidence in the Commission's ability to supervise PG&E; and (3) provide the expertise necessary to ensure that PG&E's compliance work is implemented in a timely and competent manner.[69] DRA proposes that this level of oversight should be maintained until the Commission has found that PG&E has fully complied with its orders regarding testing, replacement, and database upgrades relative to its gas transmission system.

All of the proposals for an independent monitor are grounded in the need for the Commission to move forward in a public and transparent manner to ensure that PG&E properly performs the PSEP remedial work. Absent an independent third party monitor, the public has no assurance that PG&E will do what is required, and that the Commission will hold PG&E accountable.

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[68] *See, e.g.,* TURN F&R OB, pp. 47-50; San Bruno F&R OB, pp. 43-49; DRA F&R OB, pp. 36-40.

[69] DRA F&R OB, p. 38.

VII. CONCLUSION

For all the reasons set forth herein, the Commission should adopt the recommendations summarized in Section I.B of DRA's Opening Brief, as modified herein with regard to Recommendation 4.

Respectfully submitted,

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