

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the
Commission's Own Motion to Adopt
New Safety and Reliability Regulations
for Natural Gas Transmission and
Distribution Pipelines and Related
Ratemaking Mechanisms.

Rulemaking 11-02-019
(Filed February 24, 2011)

**NON-PARTY COMMENTS OF SENATOR JERRY HILL ON THE SAFETY AND
ENFORCEMENT DIVISION'S WORKSHOP AGENDA FOR THE GAS
CITATION AND SELF-IDENTIFIED VIOLATION REPORTING WORKSHOPS
ON AUGUST 1ST AND 2ND**

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I appreciate the continued effort by the Safety and Enforcement Division (SED) to address the weaknesses in oversight of gas pipeline operators brought to light by the Independent Review Panel, the National Transportation Safety Board, and others in the aftermath of the pipeline rupture in San Bruno. As the Senate Subcommittee on Gas and Electric Infrastructure Safety (under the Standing Committee of Energy, Utilities, and Communications), which I chair, will be addressing the issue of enforcement at the CPUC, and as author of pending legislation on gas and electric safety enforcement (SB 291), I would like to offer these initial thoughts regarding my and the subcommittee's direction of inquiry for consideration by CPUC management, the Safety and Enforcement Division (SED), and the parties of R.11-02-019.

These comments address the importance of considering the CPUC's gas safety program as a whole and not just focusing on self-reported violations.

One cannot address self-reported violations in a vacuum. To demonstrate this, I will use a simple economic model of enforcement, as described in "The Economic Theory of Public Law Enforcement."¹ Self-reporting is valuable to the state for a number of reasons: it lowers enforcement costs, and it can allow for faster mitigation, as self-reported violations necessarily would be brought to the regulator's attention before the regulator would otherwise learn of the violations. It can incentivize a utility to more diligently search for violations and remedy them before the regulator finds them. Also, lowering the sanction amount for self-reporting can be done, at least theoretically, without weakening the deterrence that keeps a utility from wanting to commit a violation in the first place.

If we consider, for a particular violation, a fine amount f and a probability that the regulator will detect that violation p , the expected value of the sanction a utility will face

¹ Mitchell Polinsky and Steven Shavell, "The Economic Theory of Public Law Enforcement," National Bureau of Economic Research, Cambridge MA, March 1999. <http://www.nber.org/papers/w6993>.

for being in violation will be the product pf . If, for simplicity, the utility is risk-neutral, a utility will self-report a violation if the fine for self-reporting is slightly less than the expected sanction. If f_{SR} is the self-reported amount is slightly less than the expected sanction for a regulator-discovered fine,

$$f_{SR} = pf - \varepsilon$$

where ε is relatively small. For a risk-averse actor—and utilities tend to be risk averse— f_{SR} can be greater than the expected sanction pf .

While this model is simple—probably too simple to be used quantitatively²—it demonstrates that the level of a self-reported fine depends on two primary factors: the fine amount if the regulator detects the violation and the probability of the regulator detecting the violation and levying a fine. Therefore, the CPUC should only consider self-reported fines *after* it has considered 1) the fine amount for violations *not* self-reported, and 2) how aggressive the CPUC intends to seek out and levy fines for gas safety violations. The CPUC has as of yet determined neither. The first will naturally be difficult, as the CPUC has no history of fining operators for safety violations—certainly not at the staff level. This problem may be partially overcome by examining fine amounts in other states that have effective enforcement regimes of a type that the CPUC might want to emulate, and so reasonable fine amounts may be determined. The second, which involves a policy decision regarding what the CPUC’s enforcement posture should be, deserves further exploration.

Let’s assume that we know f —what the fine should be if a violation is discovered by the regulator. In the limit where the regulator has virtually unlimited resources and knows the utility’s system as well as the utility, the probability of the regulator finding a

² For instance, a regulator might wish to consider differently violations that a utility is aware of but hides from the regulator and violations that had been unknown to the utility before discovery by the regulator.

violation is 100%, $p = 1.0$, and the self-reported fine amount f_{SR} should be nearly the same as f . Let's call this the "omniscient regulator limit." In the omniscient regulator limit, there should be little or no discount to a utility for reporting a violation, as self-reporting provides no benefit to the regulator or the public that is paying its bills.

Let's examine another limit, that in which the regulator can find no violations or, if it does find violations, won't levy a fine. Let's call this the "September 8th limit." In that case $p = 0$, and therefore $f_{SR} = 0$. There should be no fine for a self-reported violation. This makes sense, as a utility that knows that it will never be sanctioned if it does not report a violation, would be loath to report a violation if it were fined any amount for doing so.

If this sounds familiar, it should. The Independent Review Panel noted that

*"Everyone with whom the Panel spoke supported the idea of "graduated enforcement" because it maintains an atmosphere of cooperation between the regulators and the operators. This atmosphere, in turn, encourages the utilities to self-report any violations. However, the Staff observed and we agree the levels of graduation may not be well calibrated."*³

The September 8th limit is therefore consistent with how the CPUC treated fines before the San Bruno explosion, or, as one CPUC staff member told the Business Advantage consultants,

*"For years, the Commissioners did not want to levy fines for safety violations. The culture was 'we will work with the utilities without using the stick...A decade of no fines.'"*⁴

³ Report of the Independent Review Panel: San Bruno Explosion (revised copy), June 24, 2011, pp. 21.

⁴ Business Advantage Consulting, "California Public Utilities Commission Safety Culture Change Project: Initial

In other words, there is very little use in talking about what the level of a self-reported fine should be if one will not fine for a violation that isn't self-reported.

This is not a theoretical concern. The CPUC has thus far shown little indication that it has the willingness to develop appropriate procedures to fine an operator for any violation that 1) isn't self-reported and 2) doesn't kill someone. Nor should inspectors and other safety staff make the decision to do so on their own, as it is a policy decision, and the political appointees of the commission should be ones accountable for that decision. To see the consequences of staff making enforcement decisions without commissioner support, one can look at what happened after staff levied a large fine on PG&E for failing to do leak surveys on 14 miles of distribution pipe for up to two decades, because of lost plat maps:

*“We were told to issue citations. We issued citations. Then we were told that we should meet with them to discuss how they could comply without complying to the law. We are told to be inconsistent. No matter what we do, they change it.”*⁵

The CPUC does not appear to have procedures to find utility violations, as can be seen in the CPUC's incomplete use of the audits recommended in P-11-22 of the National Transportation Safety Board.⁶ In his June 3rd letter to the NTSB,⁷ the CPUC's executive director lists the audits of PG&E that the CPUC has completed. It has not been clear, however, how the CPUC is to follow-up to make sure violations identified in the audit are corrected, or how the CPUC should deal with situations when a utility disagrees with

Discovery Report, January 25, 2013, p. 14. <http://www.sfgate.com/file/504/504-Safety%20Culture%20Change%20Project%20Report.pdf>

⁵ Business Advantage Consulting, p. 10.

⁶ “With assistance from the Pipeline and Hazardous Materials Safety Administration, conduct a comprehensive audit of all aspects of Pacific Gas and Electric Company operations, including control room operations, emergency planning, record-keeping, performance-based risk and integrity management programs, and public awareness programs. (P-11-22)”

⁷ <http://www.cpuc.ca.gov/NR/rdonlyres/575B54C4-B55C-471B-AE76-BC9C1F4ED560/0/6313LettertoNTSBregardingpipelinesafety.pdf>

audit findings. Both of these situations are evident in looking at the audits of PG&E performed to date and PG&E's responses to those audits, accessible on the CPUC's website.⁸

For instance, in response to CPUC findings of violation in PG&E's risk assessment program, PG&E makes statements such as,

"PG&E believes it is compliant with 192.917(e). The CPSD misquotes 192.917(e)(3)."

"PG&E believes it meets the intent of 49 CFR §§ 192.917(e)(3) and 192.917(e)(4)."

*"PG&E is in compliance with §192.917 (e)(1)."*⁹

The CPUC has not appeared to have made an evaluation PG&E's responses from any of the NTSB-recommended audits, despite the fact that, for some of the audits, it has had a year to do so.

It is imperative that the CPUC develop protocols for the evaluation of utility audit responses and follow-through to ensure its safety-related lapses are corrected. The NTSB had found this to be a weakness in the CPUC before the explosion in San Bruno:

"Another concern is the fact that the CPUC did not follow up on its 2005 audit finding that PG&E lacked a process to evaluate the use of ASVs and RCVs... Although PG&E prepared a memorandum, dated June 14, 2006, addressing this issue, the CPUC apparently did not evaluate the adequacy of this response. If it did, it failed to identify the flawed analysis that concluded the use of ASVs would

⁸ Public access recommended in IRP's Recommendation 6.3.3.6. <http://www.cpuc.ca.gov/NR/rdonlyres/85E17CDA-7CE2-4D2D-93BA-B95D25CF98B2/0/cpucfinalreportrevised62411.pdf>

⁹ <http://www.cpuc.ca.gov/NR/rdonlyres/F0B3A7F3-EE90-4913-9FA7-C307AAF22FF4/0/2011IntegrityManagementAudit.pdf>

*have little effect on increasing safety or protecting property.”*¹⁰

CPUC staff has noted this problem as well. As Business Advantage Consulting notes, “there is a lack of clear processes for following up and a lackadaisical attitude toward follow through...minimal resources are dedicated to evaluation or compliance at any level.”¹¹

A touchstone for the CPUC to consider is the recent Department of Finance audit of the CPUC.¹² The CPUC was afforded the opportunity to respond, and Finance then evaluated the adequacy of that response. Similarly, NTSB evaluates and posts publically an evaluation of the responses to its recommendations. If the CPUC has evaluated PG&E’s responses to any of the audits it has conducted in 2011 and 2012, it has not posted them, and should.

Gas safety isn’t the only area where the CPUC enforcement policies might need clarifying. After the final report of the 2011 San Gabriel Valley windstorms, CPSD made a number of recommendations. No fine was issued, and it is not clear from that enforcement action will be taken, or what kind of follow up will be made on the recommendations.

Commissioners and the Executive Director need to give safety staff clear direction on how and when to assess penalties for unreported violations before the Safety and Enforcement Division can have a productive discussion on how to treat self-reported

¹⁰ National Transportation Safety Board, 2011. *Pacific Gas and Electric Company Natural Gas Transmission Pipeline Rupture and Fire, San Bruno, California, September 9, 2010*. Pipeline Accident Report NTSB/PAR-11/01. Washington, DC, p. 120. <http://www.nts.gov/doclib/reports/2011/PAR1101.pdf>

¹¹ Business Advantage Consulting, p. 7.

¹² “California Public Utilities Commission Budget Process Performance Audit,” Office of State Audits and Evaluations, Department of Finance, December 2012. http://www.dof.ca.gov/osae/audit_reports/documents/FinalReport-CaliforniaPublicUtilitiesCommissionPerformanceAuditWEB.pdf

violations. Otherwise, the CPUC is at risk of remaining in the September 8th enforcement limit.

Respectfully submitted,

/s/ JERRY HILL

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