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) (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)
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 OF THE UTILITY REFORM NETWORK TO PACIFIC GAS AND ELECTRIC COMPANY'S RESPONSE TO CONSUMER PROTECTION AND SAFETY DIVISION'S AMENDED REPLY BRIEF ON FINES AND REMEDIES

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I. INTRODUCTION AND SUMMARY

In accordance with the August 15, 2013 e-mail ruling of Administrative Law Judges Yip-Kikugawa and Wetzell, The Utility Reform Network ("TURN") submits this Reply to Pacific Gas and Electric Company's ("PG&E") Response to Consumer Protection and Safety Division's ("CPSD") Amended Reply Brief on Fines and Remedies ("PG&E Response").[1]

TURN welcomes CPSD's Amended Brief, which, in contrast to CPSD's previous recommendation, would justifiably impose true financial consequences on PG&E commensurate with its violations. CPSD's amended position is similar to TURN's recommendation in structure, but TURN continues to believe that its proposal strikes the best balance between, on the one hand, a fine that is proportionate to the egregious violations and, on the other hand, disallowances of infrastructure costs that were made necessary by PG&E's violations.

PG&E's Response re-hashes PG&E's previous arguments[2] and presents no meritorious objections to CPSD's Amended Brief. PG&E incorrectly contends that the Commission lacks authority to impose both fines/penalties and ratemaking disallowances, a contention that completely ignores the Commission's well-established authority to impose not just fines/penalties, but also a broad range of remedies, including disallowances. In addition, PG&E misrepresents the Commission's decision on PG&E's Pipeline Safety Implementation Plan ("PSIP"), Decision (D.) 12-12-030, which expressly contemplated making additional ratemaking disallowances for previous, tentatively-approved PSIP costs <u>in these enforcement cases</u>.

PG&E also re-argues its claims that Overland's analysis is flawed, and that CPSD incorrectly interpreted the nature of the shareholder costs included in Overland's $2.25 billion threshold figure of PG&E's ability to raise equity for fines, penalties and/or disallowances. But PG&E's criticism relies on the use of an inappropriate earnings forecast, and ignores the fact that Overland did consider PG&E's other equity needs to fund capital expenditures. More

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[1] Consistent with TURN's previous briefs on fines and remedies, 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 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; the term "total financial consequences" (or similar phrases) refer to the cumulative financial impact on PG&E of: (1) fines/penalties and (2) disallowances and other remedies. All statutory references are to the Public Utilities Code.

[2] PG&E's choice to repeat arguments it has previously made fully undermines its contention (p. 1, fn. 1) that the ten-page limit violates its due process rights.

importantly, PG&E continues to misrepresent Overland's testimony by arguing that over $2.2 billion in past and future costs count against the threshold. Overland made explicitly clear that shareholder costs included in its $2.25 billion threshold figure *do not include* all alleged cost overruns, and most certainly do not include speculative future costs that have not even been considered by the Commission.

In sum, PG&E's Response presents no valid objections to the structure and amounts of CPSD's amended recommendation and only underscores the sound legal and policy underpinnings for TURN's recommended fine/penalty of $670 million, disallowance of pre-tax PSIP costs of $1 billion, and $50 million for additional auditing and oversight remedies.

II. THE COMMISSION HAS AMPLE AUTHORITY TO IMPOSE BOTH FINES AND DISALLOWANCES ON PG&E

PG&E claims that the only lawful element of CPSD's amended proposal is the proposed $300 million fine and that there is no legal support for a companion disallowance.[3] To the contrary, for the reasons set forth below, the Commission has ample authority to impose both fines and disallowances on PG&E.[4]

A. Disallowances Are An Appropriate Remedy for Violations

PG&E's new contention that fines and disallowances are incompatible fails to acknowledge the clear distinction between fines/penalties and remedies. As CPSD states, fines/penalties imposed under Section 2104.5 must be paid to the General Fund. However, as previous briefs have shown, the Commission has broad authority under Section 701 to impose remedies for violations that are "cognate and germane" to the Commission's regulation of public utilities.[5] Disallowances are one such remedy. PG&E does not, and cannot, explain why the

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[3] PG&E Response, Aug. 21, 1013, pp. 2-5. (*See, e.g.*, p. 3: "Given CPSD's legal position, the only lawful element of its new recommendation is the $300 million 'penalty' directed to the General Fund. The balance of its recommendation, the "$1.950 billion 'disallowance,' lacks legal support.")

[4] PG&E's new argument that the Commission cannot impose disallowances contradicts PG&E's prior (correct) argument that the Commission has authority under Public Utilities Code Sections 2107 and 701 to use disallowances as a means to penalize PG&E. PG&E Coordinated Remedies Brief, May 24, 2013, p. 19 ("There is no requirement that Section 2107 penalties be paid to the General Fund and the Commission has authority under Section 701 to order that they be invested in pipeline safety.")

[5] *Consumers Lobby Against Monopolies v. Public Utils. Comm.* (1979) 25 Cal. 3d 891, 905. *See, e.g.*, Division of Ratepayer Advocates ("DRA") Opening Brief on Fines and Remedies, May 6, 2013, pp. 5-7,

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Commission may impose the numerous and varied remedies proposed by CPSD -- many with financial consequences -- that even PG&E agrees are warranted,[6] but the Commission somehow lacks authority to impose disallowances as a remedy.

As TURN has demonstrated,[7] disallowances of PSIP costs are a particularly appropriate remedy for PG&E's violations. The record in these enforcement cases makes clear that, had the PSIP pipeline testing and replacement work not been previously ordered, the Commission would need to direct PG&E to do this same work as a remedy for PG&E's recordkeeping and integrity management violations.[8] These violations prevented PG&E from being able to demonstrate the safety of its transmission pipelines that lack pressure test documentation.[9] Under these circumstances, as a remedy for PG&E's violations, PG&E should be required to pay the full cost of the PSIP testing and replacement work.[10]

B. Contrary to PG&E's Incorrect Claim, the Commission Has Expressly Anticipated Imposing Additional PSIP Disallowances In These Enforcement Cases

PG&E claims that: (1) the PSIP decision (D.12-12-030) determined that the PSIP costs that were authorized for rate recovery were not the result of unreasonable and imprudent conduct; and (2) the Commission has made clear that any additional disallowances should be made in R.11-02-019.[11] PG&E is wrong on both counts.

PG&E ignores the following statement on page 4 of the PSIP decision:

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

14-16; City of San Bruno Opening Brief on Fines and Remedies, May 6, 2013, p. 41; City and County of San Francisco ("CCSF") Opening Brief on Fines and Remedies, May 6, 2013, p. 3.

[6] PG&E Coordinated Remedies Brief, May 24, 2013, p. 94 and Appendix B (agreeing with most of CPSD's proposed remedies).

[7] TURN Opening Brief on Fines and Remedies, May 6, 2013, pp. 4-9.

[8] *Id.*, pp. 6-8.

[9] *Id.*

[10] *Id.*, pp. 8-9.

[11] PG&E Response, Aug. 21, 2013, pp. 3-5.

[12] D.12-12-030, p. 4 (emphasis added).

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The Commission could not have been clearer that, based on the expanded record regarding PG&E's past conduct developed in these enforcement cases, the Commission could find it appropriate to make "further ratemaking adjustments" – i.e., disallowances – of costs that it was tentatively authorizing for recovery in D.12-12-030. The obvious corollary of the quoted statement is that the Commission was not making any final findings that PG&E's practices were reasonable and prudent.

The above-quoted language also directly refutes PG&E's contention that any disallowances may only be ordered in R.11-02-019. Quite appropriately, the Commission recognized that the record in these cases would supply much more detailed information about the reasonableness of PG&E's practices than the Commission had in the PSIP proceeding and that such information could demonstrate that additional disallowances were warranted. It is troubling that PG&E would make an argument that is so clearly contrary to the Commission's plain words -- without even addressing this text – especially when TURN and DRA have cited and quoted these exact words in their briefs.[13]

C. Alternatively, the Commission May Impose Disallowances for Imprudence Under Sections 451 and 463

In addition to the Commission's authority under Section 701 to impose disallowances as a remedy for PG&E's violations, disallowances are also warranted under Sections 451 and 463 based on a finding of imprudence, as TURN and DRA have previously explained.[14] The same record that has been developed to determine violations can be used to assess whether PG&E's conduct was reasonable. By definition, it is never reasonable for a utility to violate the law, so that any conduct that constitutes a violation would also be imprudent and an appropriate basis for a disallowance under Sections 451 and 463.

[13] See, e.g., TURN Opening Brief on Fines and Remedies, May 6, 2013, p. 6; DRA Opening Brief on Fines and Remedies, May 6, 2013, p. 16.
[14] See, e.g., TURN Opening Brief on Fines and Remedies, May 6, 2013, p. 9; DRA Opening Brief on Fines and Remedies, May 6, 2013, pp. 14-16.

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III. THE METHODOLOGY OF THE OVERLAND REPORT IS SOUND, AND CPSD APPROPRIATELY INTERPRETS THE NATURE OF SHAREHOLDER COSTS INCLUDED IN THE $2.25 BILLION THRESHOLD AMOUNT

A. PG&E's Criticism Of Overland's Methodology Relies on an Inappropriate Earnings Forecast and Ignores Actual Testimony

PG&E claims that the Overland analysis is flawed because 1) the price to book and dividend payout ratios are not the relevant metrics to measure equity capacity, and 2) the analysis "fails to account for the real world facts affecting the amount of equity PG&E could issue," particularly PG&E's need to issue equity to fund planned capital expenditures.[15] TURN has addressed these arguments extensively in previous pleadings.[16] PG&E's criticisms rely on an inappropriate earnings forecast and continue to misrepresent Overland's testimony.

1. The 2013 Earnings Per Share Forecast is Not Representative of Future Earnings

PG&E claims that the two metrics used by Overland – the price to book and dividend payout ratios – are not proper measures of PG&E's ability to raise equity.[17] But PG&E has created an artificial strawman only tangentially related to the issue at hand.

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 shareholder value and the potential impact of shareholder dilution due to issuing shares to fund penalties and disallowances.[18] If these metrics remain unharmed by the projected $2.25 billion equity issuance to pay fines, penalties and disallowances, the logical conclusion is that shareholders will continue to purchase PG&E stock.

PG&E also claims that Overland should have used PG&E's 2013 earnings per share ("EPS") forecast, resulting in a much lower threshold level of possible equity issuance. But the 2013 EPS forecast is not representative of the future because PG&E admits that it "is projecting

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[15] PG&E Response, August 21, 2013, p. 6-7.

[16] See, TURN Opening Brief on Fines and Remedies, May 6, 2013, pp. 33-43; TURN Reply Brief on Fines and Remedies, June 7, 2013, pp. 37-47.

[17] PG&E Response, August 21, 2013, p. 6. See, also, PG&E Coordinated Remedies Brief, May 24, 2013, p. 75.

[18] As explained in TURN's Opening Brief, shareholder value is generally based on expected dividends and stock price appreciation. See, TURN Opening Brief on Fines and Remedies, p. 37.

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that 2013 will be a comparatively low earnings year" due to non-recurring charges.[19] As explained in confidential portions of testimony and briefs, PG&E's 2013 EPS forecast is unusual and does not reflect the long-term financial health of the company.[20] Overland's 2012 EPS number is much closer to long-term EPS forecasts.

2. Overland Considered PG&E's Equity Needs

PG&E claims that Overland "fails to account" for PG&E's significant equity needs for future capital spending.[21] But this claim is incorrect, since Overland explicitly took into account PG&E's planned capital expenditures and planned equity issuances for 2012-2016 in determining the "threshold case."[22] Overland assumed full dollar for dollar dilution of shareholder value in order to account for the lack of earnings potential of the new equity.[23]

The sale of additional equities to fund penalties and disallowances will need to be structured to reflect investor expectations. 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.[24] 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 basis for concern that investors will not buy the shares at a reasonable price.

B. PG&E Misrepresents the Nature of "Shareholder Costs" That Overland Considered To Be Part of the $2.25 Billion Threshold Figure

PG&E also reiterates its argument that Overland's figure of $2.25 billion should include *all past and future shareholder costs*, including "approximately $1.25 billion in PSEP costs" and "approximately $1 billion (actual and forecast) above Gas Accord V adopted amounts."[25] PG&E's arguments misrepresent the Overland testimony and misapply the facts on the record.

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[19] See, PG&E Coordinated Remedies Brief, May 24, 2013, p. 77.
[20] See, for example, Ex. Joint-65 at 3; 14 Confidential Jt. RT 1422:12-25, Lubow/CPSD. See, also, TURN Confidential Reply Brief on Fines and Remedies, June 7, 2013, p. 46.
[21] PG&E Response, August 21, 2013, p. 7.
[22] Exh. Jt. 53, p. 17:12-20.
[23] Exh. Jt. 54, p. 9:16-26 (Lubow and Malko/CPSD). Mr. Fornell admitted this fact during cross-examination, though he still maintained that it does not account for "the reality of going out and trying to sell these shares." 14 RT 1495:11-25.
[24] Mr. Fornell addressed this issue extensively during cross-examination. See, Jt. RT 1587-1588, Fornell/PG&E.
[25] PG&E Response, August 21, 2013, p. 7-8.

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Overland experts made clear that in no way should all potential cost overruns, including totally speculative future forecast costs, be included as valid components of the $2.25 billion.

PG&E's correctly quotes from Overland's oral testimony that a penalty includes "costs that are being incurred for *Commission-approved activities* but not allowed into rates…."[26] But PG&E then claims that CPSD was wrong to deduct the $380.5 million in contingency costs; and PG&E claims credit for various expenses in 2013, 2014 and beyond as shareholder costs that should be credited towards the $2.25 billion.

The various costs identified in PG&E's footnotes 47 and 49 fail to meet the standards enunciated by Overland. First, PG&E includes various costs that are *not* for "Commission-approved activities," but represent forecasts of costs that PG&E might incur in the future. Most egregiously, PG&E includes "emerging work in 2013 and 2014" that may be included in its upcoming Gas Transmission and Storage ("Gas Accord") rate case application. There is absolutely no factual basis for assuming that this work will be "approved," that PG&E will spend money on this work, and that, if the work is actually approved, PG&E will not recover the costs in rates. As TURN explained previously, PG&E is asking the Commission for a blank check to shield shareholders from any future costs overruns as an element of the penalty imposed in these proceedings.[27]

The treatment of contingency costs in D.12-12-030 is a prime example of how PG&E misrepresents Overland's testimony. Overland's witness Lubow specifically explained that contingency costs do not fall into the "Commission-approved" category. [28] The Commission rejected the contingency in D.12-12-030 as an adder to the cost forecast, based on PG&E's already high cost forecast, similar to any rate case determination that authorized costs should be less than forecast by the utility.[29]

Second, PG&E fails to demonstrate that the majority of the costs it claims as shareholder costs are or will be "above and beyond whatever is in rates." Overland's witness Lubow

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[26] PG&E Response, August 21, 2013, p. 7,quoting Jt. R.T. 1369-71 (emphasis added).
[27] TURN Reply Brief on Fines and Remedies, June 7, 2013, p. 31-36. Indeed, Overland specifically disagreed that any of the "emerging" future work was considered as part of the $2.25 billion. See, for example, 14 Jt. RT 1435:15-20, Lubow/CPSD. PG&E has, apparently, at least dropped its argument that even cost overruns in "other operational areas" should be counted towards the $2.25 billion threshold.
[28] 14 Sealed Jt. RT 1425:7-16, Lubow/CPSD.
[29] See, D.12-12-030 at 98-99.

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explained that 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."[30] PG&E did not dispute or question this conclusion.

PG&E has not shown how much of its purported cost overruns in 2012-2013 were "not included in rates."[31] More significantly, the majority of the $2.25[32] billion claimed as shareholder costs by PG&E consists of *forecast costs*, including for "emerging work" in the Gas Accord. There is no basis for any claim that such costs were considered by Overland as part of the threshold of costs "not included in rates."[33] The Commission should thoroughly reject PG&E's attempt to use these proceedings to insulate itself from potential future cost overruns.

IV. PG&E'S EXCESSIVE FINES ARGUMENT IS WITHOUT MERIT

PG&E repeats the argument it made in its previous fines and remedies brief that CPSD's proposed fine and remedies would violate the excessive fines clause of the California Constitution.[34] Parties have already thoroughly demonstrated that this argument is completely lacking in merit.[35]

The only change in PG&E's argument takes PG&E's bad arithmetic to a new extreme: PG&E claims that CPSD's proposed penalty has gone from 22 times the previous largest penalty for pipeline accidents to 40 times that amount.[36] PG&E bases its arithmetic on a $4 billion figure that finds absolutely no support in the record[37] and should be given no weight by the

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[30] 14 RT 1425:23-25, Lubow/CPSD.
[31] Based on Ex. PG&E-1A (PG&E/Yura), TURN conservatively credited PG&E with $150.2 million in PSEP cost overruns for 2011-2012, despite a lack of conclusive evidence that these were not covered by rates. See, TURN Opening Brief on Fines and Remedies, May 6, 2013, p. 46.
[32] PG&E claims shareholder costs of $1.25 billion for PSEP and $1 billion for Gas Accord costs. PG&E Response, p. 8. This number should not presumably be confused with the $2.25 billion threshold calculated by Overland.
[33] See, for example, the discussion of future "right of way encroachment costs" by Overland witness Lubow. 14 Jt. RT 1435:15-20, Lubow/CPSD.
[34] PG&E Response, Aug. 21, 2013, pp. 8-10.
[35] See, e.g., CCSF Reply Brief on Fines and Remedies, June 7, 2013, pp. 7-24; DRA Reply Brief on Fines and Remedies, June 7, 2013, pp. 13-15.
TURN Reply Brief on Fines and Remedies, June 7, 2013, p. 5
[36] PG&E Response, Aug. 21, 2013, pp. 8-9.
[37] PG&E presents this number on page 7 of its brief, but is unable to supply a citation to the record for it.

Commission for reasons explained in Section III above and TURN's previous reply brief.[38] In any event, the vast majority of PG&E's $4 billion concoction consists of amounts that constitute the costs of remedies, disallowances, and other operating costs that are not punitive in nature and have no place in a constitutional excessive fines analysis.[39]

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Respectfully submitted,

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[38] TURN Reply Brief on Fines and Remedies, June 7, 2013, pp. 37-44.
[39] See, e.g., CCSF Reply Brief on Fines and Remedies, June 7, 2013, pp. 11-13.