

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

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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. )

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R.11-02-019  
(Filed February 24, 2011)

**OPENING COMMENTS OF  
SOUTHERN CALIFORNIA GAS COMPANY (U 904 G)  
AND SAN DIEGO GAS & ELECTRIC COMPANY (U 902 M)  
ON PROPOSED DECISION MANDATING PIPELINE SAFETY  
IMPLEMENTATION PLAN, DISALLOWING COSTS,  
AND AUTHORIZING MEMORANDUM ACCOUNT**

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IMPLEMENTATION PLAN, DISALLOWING COSTS,  
AND AUTHORIZING MEMORANDUM ACCOUNT**

Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E) submit the following Opening Comments on the Proposed Decision Mandating Pipeline Safety Implementation Plan, Disallowing Costs, and Authorizing Memorandum Account (Proposed Decision) pursuant to Rule 14.3 of the Rules of Practice and Procedure of the California Public Utilities Commission (the Commission).

**I. INTRODUCTION AND PROCEDURAL HISTORY**

On February 24, 2011, the Commission adopted 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 (OIR) instituting this Rulemaking. In the OIR, the Commission described this Rulemaking as "a forward-looking effort to establish a new model of natural gas pipeline safety regulation applicable to all

California pipelines. Specific investigations of PG&E’s conduct and any penalties will take place in a separate docket.”<sup>1</sup>

The Commission declared on June 9, 2011, that “all natural gas transmission pipelines in service in California must be brought into compliance with modern standards of safety. Historic exemptions must come to an end with an orderly and cost-conscience implementation plan.”<sup>2</sup> To accomplish this mandate, the Commission directed all California natural gas pipeline operators to file and serve “a proposed Natural Gas Transmission Pipeline Comprehensive Pressure Testing Implementation Plan (Implementation Plan) to comply with the requirement that all in-service natural gas transmission pipeline in California has been pressure tested in accord with 49 CFR 192.619, excluding subsection 49 CFR 192.619 (c).”<sup>3</sup> The Commission’s order quoted from the Order Instituting Rulemaking and notified Pacific Gas and Electric Company (PG&E) that due to “unique” circumstances involving PG&E’s system, the Commission may consider using its ratemaking authority to impose a cost sharing mechanism upon PG&E:

The extraordinary safety investments required for PG&E’s gas pipeline system and the unique circumstances of the costs of replacing the San Bruno line are situations where this Commission may use its ratemaking authority to, for example, reduce PG&E’s rate of return on specific plant investments or impose a cost sharing requirement on shareholders.<sup>4</sup>

And ordered “PG&E only” to propose a “cost allocation between shareholders and ratepayers.”<sup>5</sup>

As directed, on August 26, 2011, PG&E, SoCalGas, SDG&E and Southwest Gas Corporation filed proposed plans to meet the Commission’s objectives. In its plan Southwest Gas proposes to replace its 7.1-mile Victor Valley Transmission System, and install a remote shutoff valve on its Harper Lake Transmission System. Southwest Gas’ key objectives for evaluating its options were:

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<sup>1</sup> OIR at 3.

<sup>2</sup> D.11-06-017 at 18.

<sup>3</sup> *Id.* at 31 (Ordering Paragraph 3).

<sup>4</sup> *Id.* at 23 (quoting OIR at 11-12). (Emphasis added.)

<sup>5</sup> *Id.* (Emphasis added.)

- Must meet the requirements of the Order
- Must improve integrity and safety of transmission pipe
- Must be capable of accepting in-line inspection tools
- Should minimize service interruption to customers
- Should be cost effective in relation to benefits provided<sup>6</sup>

In recommending replacement, rather than pressure testing or reducing the pressure of the Victor Valley System, Southwest Gas determined that the benefits of replacement outweighed the only comparative benefit to pressure testing—lower cost. The identified benefits of replacement include:

- Less risks and challenges when conducting new installation pressure test
- Provides capability of accommodating in-line inspection tools
- Provides traceable, verifiable, and complete records
- Establishes a reduced operating stress level to classify pipe as distribution versus transmission
- X-ray verification and documentation of weld integrity
- Modern day installation practices
- Documentation of pipeline specifications
- No customer outage or minimal customer outage

Hearings were not conducted on Southwest Gas' proposed plan. An opening brief was filed by the Division of Ratepayer Advocates (DRA) on June 16, 2012, and Southwest Gas submitted a reply brief on June 29, 2012. No other briefs were filed.

In its opening brief on the Southwest Gas plan, DRA proposed that Southwest Gas be denied cost recovery for its entire plan, arguing that all of the costs of the plan were a result of Southwest Gas' failure to retain historic pressure testing records.<sup>7</sup> In the alternative, DRA proposed that consideration of Southwest Gas' proposed plan be deferred to its next General Rate Case.<sup>8</sup> In reply, Southwest Gas pointed out that DRA's argument ignored the directives of the Commission in D.11-06-017 and further, ignored the evidence presented by Southwest Gas with respect to applicable industry standards:

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<sup>6</sup> Southwest Gas Implementation Plan at 7.

<sup>7</sup> DRA Opening Brief at 3.

<sup>8</sup> *Id.* at 2.

DRA's argument that all costs associated with the Implementation Plan (regardless of whether the pipe is tested or replaced) should be disallowed stems from a wholly erroneous interpretation of D.11-06-017, which fails to acknowledge the Commission's efforts to promulgate new and unprecedented safety regulations for gas utilities. In fact, DRA opines that Southwest Gas' Implementation Plan serves the sole purpose of correcting alleged non-compliance with pre-existing regulations. As detailed more fully herein, pre-existing regulations did not require Southwest Gas to conduct a strength test (i.e. pressure test) on the pipe in its Victor Valley System – as is required by D.11-06-017. Nor did pre-existing regulations require Southwest Gas to maintain traceable, verifiable, and complete records to substantiate the MAOP of its transmission facilities. Accordingly, the Company's Implementation Plan was not designed, nor should it be construed, as a remedial measure. The Implementation Plan is a forward-looking plan to enhance the safety and reliability of the Company's transmission pipeline system in accordance with the directives of D.11-06-017, and Southwest Gas is entitled to recover the associated costs.<sup>9</sup>

On August 5, 2013, Administrative Law Judge Maribeth Bushey issued the Proposed Decision, which disallows either the recovery of Southwest Gas' estimated costs of pressure testing its Victor Valley System, or the costs of replacing the Victor Valley System that exceed Southwest Gas' pressure testing estimate.<sup>10</sup> In adopting a penalty in the form of a disallowance, the Proposed Decision reasons that:

Southwest Gas based its decision to replace rather than pressure test, in part, on the unknown material specifications of the pipe as well as unknown fittings and lateral pipelines in the Victory Valley Transmission system. Maintaining complete and accurate as-built records of a natural gas transmission system is a requirement for prudent operation of the natural gas system. Southwest Gas

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<sup>9</sup> Southwest Gas Reply Brief at 3.

<sup>10</sup> The Proposed Decision is internally inconsistent on this issue and it is unclear whether the Proposed Decision intends to disallow costs for pressure testing or replacement. For example, on page 13, the Proposed Decision states "we find that the costs of pressure testing should be assigned to ratepayers, and shareholders should bear the incremental costs of replacement of the Victor Valley Transmission System." In the next sentence on page 14, however, the Proposed Decision states "we conclude that shareholders are responsible for the \$3.75 million in estimated pressure testing costs, which must be deducted from the \$7.1 million in replacement costs, leaving approximately \$3.4 million to be recorded in plant in service for inclusion in revenue requirement."



imprudently failed to retain complete and accurate as-built record of the materials, construction and fittings.<sup>11</sup>

The Proposed Decision disallows full recovery of Southwest Gas' costs on the grounds that "Southwest Gas ratepayers should not be required to bear the higher cost of replacement rather than [sic] pressure testing of pipeline due to Southwest Gas' imprudence."<sup>12</sup>

If adopted by the Commission, the Proposed Decision would violate due process, run afoul of Public Utilities Code section 2104.5, and establish poor public policy for the State of California. Southwest Gas was not provided with sufficient notice or opportunity to be heard on the issue of its recordkeeping practices, which deprives Southwest Gas of due process. This failure of due process led to the establishment of a record that is inadequate to satisfy the requirements of Public Utilities Code section 2104.5, which lists factors that the Commission must consider in determining the amount of a penalty to be imposed for failure to comply with gas pipeline safety standards. Moreover, the Proposed Decision would undermine the Commission's public safety objectives by discouraging utilities from replacing natural gas pipelines where the public safety benefits outweigh the incremental costs of replacement as an alternative to pressure testing.

## **II. DISCUSSION**

### **A. The Proposed Decision Violates the Fundamental Due Process Requirements of Notice and an Opportunity to Be Heard.**

The Commission's prior orders in this Rulemaking expressly state that this proceeding is "a forward-looking effort to establish a new model of natural gas pipeline safety regulation applicable to all California pipelines," that "[s]pecific investigations of PG&E's conduct and any penalties will take place in a separate docket," and that due to "unique" circumstances involving PG&E's system, "PG&E only" should propose a "cost allocation between shareholders and ratepayers." At no time has the Commission ordered that the recordkeeping practices of any pipeline operators other than PG&E be examined in this proceeding. Indeed, prior Commission

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<sup>11</sup> Proposed Decision at 13.

<sup>12</sup> *Id.*

orders do not so much as hint at the possibility of a penalty being imposed against a pipeline operator in connection with its proposed plan to help the Commission achieve its goal of bringing California's aging natural gas infrastructure into compliance with modern standards of safety. Nevertheless, the Proposed Decision imposes a penalty upon Southwest Gas for perceived recordkeeping shortcomings and orders its shareholders to fund approximately half the costs of its pipeline safety implementation plan.

United States Supreme Court and California Supreme Court precedents make clear that due process requires that a party in an administrative proceeding be given a fair and full opportunity to present its case and be heard.<sup>13</sup> In fact, the very grant of authority to the Commission is prefaced by the requirement that Commission procedures are “[s]ubject to statute and due process.”<sup>14</sup> The U.S. Supreme Court has held that “prior notice and a hearing is central to the Constitution’s command of due process.”<sup>15</sup> Similarly, the California Supreme Court has stated that due process in a Commission proceeding is provided by meeting the requirement of “adequate notice to a party affected and an opportunity to be heard before a valid order can be made.”<sup>16</sup>

Here, the Commission provided no prior notice to Southwest Gas that it could be subject to large penalties for perceived recordkeeping shortcomings pertaining to pipelines installed more than five decades ago. In fact, the Commission expressly notified the parties that “[s]pecific investigations of PG&E’s conduct and any penalties will take place in a separate docket.”<sup>17</sup> Unaware of the potential assessment of large recordkeeping penalties, Southwest Gas was deprived of the opportunity to present any evidence on the issue and even waived its right to have a hearing at all.

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<sup>13</sup> See U.S. Const., 14th Amend., Cal. Const., art. 1, § 7. See also *Mathews v. Eldridge*, 424 U.S. 319 (1976); *People v. Western Airlines*, 42 Cal.2d 621, 632 (1954).

<sup>14</sup> Cal. Const., Art. XII § 2.

<sup>15</sup> *United States v. James Daniel Good Real Property*, 510 U.S. 43, 53 (1993).

<sup>16</sup> *People v. Western Air Lines, Inc.*, 42 Cal. 2d 621, 632 (1954).

<sup>17</sup> OIR at 3.

**B. The Proposed Decision Violates Due Process By Imposing a Penalty Against Southwest Gas for “Imprudence,” Without Alleging a Violation of Any Specific Law or Commission Order.**

The Proposed Decision states, without citation, that “[m]aintaining complete and accurate as-built records of a natural gas transmission system is a requirement for prudent operation of the natural gas system,” and finds that “Southwest Gas imprudently failed to retain complete and accurate as-built record of the materials, construction and fittings for the entirety of its 7.1 mile Victor Valley Transmission System.”<sup>18</sup> On this basis, the Proposed Decision concludes that “Southwest Gas ratepayers should not be required to bear the higher cost of replacement rather than [sic] pressure testing of pipeline due to Southwest Gas’ imprudence.”<sup>19</sup>

The Proposed Decision does not cite to a specific statute or order of the Commission to support the imposition of an over \$3.1 million penalty against Southwest Gas. “When prohibiting conduct by government regulation, the regulation must be sufficiently clear so that ‘ordinary people can understand what conduct is prohibited’ and so it ‘does not encourage arbitrary and discriminatory enforcement.’”<sup>20</sup> The United States Supreme Court explained the dangers inherent in the enforcement of ambiguous laws as follows:

Vague laws offend several important values. First, because we assume that man is free to steer between lawful and unlawful conduct, we insist that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly. Vague laws may trap the innocent by not providing fair warning. Second, if arbitrary and discriminatory enforcement is to be prevented, laws must provide explicit standards for those who apply them. A vague law impermissibly delegates basic policy matters to policemen, judges, and juries for resolution on an *ad hoc* and subjective basis, with the attendant dangers of arbitrary and discriminatory application. Third, but related, where a vague statute abuts upon sensitive areas

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<sup>18</sup> Proposed Decision at 13.

<sup>19</sup> *Id.*

<sup>20</sup> *Great American Houseboat Co., v. U.S.*, 780 F.2d 741, 746 (1986). *See also Chalmers v. City of Los Angeles*, 762 F.2d 753, 757 (1985) (quoting *Kolender v. Lawson*, 461 U.S. 352, 357 (1983) (“Government regulation must be sufficiently clear so that ordinary people can understand what conduct is being prohibited, and so that the regulation ‘does not encourage arbitrary and discriminatory enforcement.’”) (Internal citations omitted.)

of basic First Amendment freedoms, it operates to inhibit the exercise of those freedoms. Uncertain meanings inevitably lead citizens to steer far wider of the unlawful zone than if the boundaries of the forbidden areas were clearly marked.<sup>21</sup>

In light of those inherent dangers, “[i]t is a basic principle of due process that an enactment is void for vagueness if its prohibitions are not clearly defined.”<sup>22</sup>

The Proposed Decision violates due process by imposing a large penalty against Southwest Gas without alleging a violation of any specific law or regulation.

**C. The Proposed Decision is Based on an Inadequate Factual Record That Cannot Satisfy the Requirements of Public Utilities Code section 2104.5.**

As discussed above, Southwest Gas was never provided notice of a violation, was never provided an opportunity to offer evidence regarding its recordkeeping or the prudence of its operations, and was never provided with an opportunity to offer evidence in mitigation of the proposed penalty amount. Without the benefit of a complete record, the imposition of a penalty upon Southwest Gas for perceived inadequacies in recordkeeping contravenes the requirements of Public Utilities Code section 2104.5 that, in determining the amount of any penalty for violation of any provision of the Public Utilities Code, or of any rule, regulation, general order or order of the Commission involving safety standards for pipeline facilities or the transportation of gas in the State of California, the Commission must consider “the appropriateness of such penalty to the size of the business of the person charged, the gravity of the violation, and the good faith of the person charged in attempting to achieve compliance, after notification of a violation.”

The imposition of a penalty against Southwest Gas without the benefit of a factual record also violates longstanding Commission precedent, which provides that the Commission must take the following factors into account before assessing a penalty: (1) physical harm to people or property; (2) economic harm (with the severity of a violation increasing with the level of costs imposed upon the victims of the violation and the unlawful benefits gained by the Respondent);

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<sup>21</sup> *Grayned v. City of Rockford*, 408 U.S. 104, 108-09 (1972) (internal quotation marks, brackets and ellipsis omitted).

<sup>22</sup> *Id.* at 108.

(3) harm to the regulatory process; (4) the number and scope of the violations; (5) Respondent's actions to prevent a violation; (6) Respondent's actions to detect a violation; (7) Respondent's actions to disclose and rectify a violation; (8) need for deterrence; (9) Constitutional limitations on excessive fines; (10) the degree of wrongdoing; (11) public interest; and (12) the role of precedent.<sup>23</sup>

Penalties should not be an afterthought imposed in the form of a disallowance in a Commission decision, without the benefit of a factual record, in a rulemaking proceeding focused on forward-looking rules and regulations. If the Commission determines that further investigation of the recordkeeping practices of a pipeline operator is warranted, it should do so in a formal investigatory proceeding, or at a minimum, in a separate phase of this proceeding after providing the respondent operator with notice and an opportunity to be heard.

**D. The Proposed Decision Errs By Failing to Consider the Numerous Reasons, Unrelated to Recordkeeping, That May Support Replacement Over Pressure Testing.**

Imposition of a penalty in a Rulemaking proceeding in the form of a disallowance not only violates due process, Public Utilities Code section 2104.5, and longstanding Commission precedent, but it also would be poor public policy. The Proposed Decision largely ignores the numerous other reasons, in addition to lack of records, for Southwest Gas' proposal to replace rather than pressure test the Victor Valley System. While the availability of records was one factor in Southwest Gas' proposed decision-making process, other important factors include compliance with the Commission's order to consider retrofitting pipelines to make them piggable (the 1957 pipeline cannot be retrofitted to accommodate in-line inspection technology), the impacts to customers if the Victor Valley System were to be taken out of service for pressure testing, and the benefits of having a new pipeline versus an older pipeline nearing the end of its

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<sup>23</sup> See D.98-12-075.

useful life.<sup>24</sup> Southwest Gas determined that, taken in totality, these factors weighed in favor of replacement.

The Proposed Decision ignores all of the benefits to customers of having a new pipeline, including uninterrupted service, piggability and a much longer useful life, and establishes a public policy of discouraging the replacement of a pipeline, even when it might be more beneficial to customers and increase public safety to do so. The objectives of the Commission for transmission system safety improvements will be best achieved by allowing pipeline operators to recover the costs of implementing the Commission's new pipeline safety rules, with the decision of whether to pressure test or replace made on its own merits, rather than on the basis of "who pays."

**E. To the Extent the Proposed Decision Disallows Southwest Gas' Recovery of Any of the Costs of Replacing the Victor Valley System, This Would Violate the Takings Clause of the United States and California Constitutions.**

As noted above, the Proposed Decision is internally inconsistent in that it alternates between concluding that Southwest Gas' shareholders must cover the costs of pressure testing the Victor Valley System and that the shareholders must fund the capital costs above the pressure testing estimate of replacing the Victor Valley System. To the extent the Proposed Decision would require Southwest Gas' shareholders to construct a brand new pipeline and devote that pipeline to the service of Southwest's customers without the ability to earn a return on their investment, this would constitute a taking, in violation of the United States and California Constitutions.

Both the United States and California Constitutions prohibit a governmental taking of private property without just compensation.<sup>25</sup> In the context of public utilities, it is well settled

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<sup>24</sup> The Proposed Decision mentions these factors in the initial discussion, but does not consider them further. *See* Proposed Decision at 7.

<sup>25</sup> U.S. Const., Amend. V and XIV; Cal. Const. Art. I, Sec. 19. Although there are some differences in the wording of these two documents, and some decisions that have concluded that the California Constitution offers more protection to the property owner, these comments follow prior Commission precedent and do not distinguish between the two. *See, e.g.,* Application of Calaveras Telephone Co. et al, D.10-10-036 at 8, n. 4.

that these constitutional safeguards bar a regulator from setting rates for the use of utility property that are so unjust as to be confiscatory.<sup>26</sup> There are many court and Commission decisions that recognize the concept of this kind of regulatory taking. But they typically conclude no such showing has been made because the cost recovery allowed—while less and perhaps far less than the complaining utility requested—is not so low as to constitute a taking. That standard has been variously described not only as “confiscatory,” but also “unjust and unreasonable,” causing “deep financial hardship,” or “the functional equivalent of an ‘ouster.’”<sup>27</sup>

### III. CONCLUSION

For the reasons set forth above, and the facts established in the record of this proceeding, SoCalGas and SDG&E urge the Commission to revise the Proposed Decision to authorize the recovery from customers of reasonable testing and replacement costs incurred by Southwest to meet the Commission’s new pipeline safety standards.

Respectfully submitted,

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<sup>26</sup> *Duquesne Light Co. v. Barasch* (1989) 488 U.S. 299, 307 (quoting *Covington & Lexington Turnpike Road Co. v. Sandford* (1896) 164 U.S. 578, 597).

<sup>27</sup> *Bluefield Waterworks & Improvement Co. v. W. Va. Pub. Serv. Comm.* (1923) 262 U.S. 679, 690; *20<sup>th</sup> Century Insurance v. Garamendi* (1994) 8 Cal. 4th 216, 296; OIR Re Local Exchange Service and OII Re Competition for Local Exchange Service, D. 97-04-090, 1997 Cal. PUC LEXIS 363 \*32 citing *Yee v. Escondido* (1992) 503 U.S. 519, 522.

**Subject Matter Index of Recommended Changes to the Proposed Decision**

<b>Subject Matter Index of Recommended Changes to Proposed Decision</b>	<b>Citations in Proposed Decision</b>
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## Appendix of Proposed Revisions to Findings of Fact and Conclusions of Law

### Findings of Fact

None

### Conclusions of Law

6. Southwest Gas ~~imprudently~~ failed to retain complete and accurate as-built record of the materials, construction and fittings for the entirety of its 7.1 mile Victor Valley Transmission System.

7. Safely and completely addressing ~~Southwest Gas' imprudence~~ the Commission's directives and objectives set forth in D.11-06-017 requires replacement of the Victor Valley Transmission System rather than the less-expensive pressure testing of the System.

8. ~~Southwest Gas ratepayers should bear the cost of pressure testing, and shareholders should bear the incremental costs equivalent to replacement of the Victor Valley Transmission System.~~ Recovery from customers of the costs of implementing the Commission's new pipeline safety standards is reasonable.