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)

REBUTTAL BRIEF OF THE CONSUMER PROTECTION AND SAFETY DIVISION ON FINES AND REMEDIES

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I. INTRODUCTION

Pursuant to the August 15, 2013 e-mail ruling of ALJs Wetzell and Yip-Kikugawa, CPSD hereby submits its Rebuttal Brief to PG&E's Response to CPSD's Amended Reply Brief on Fines and Remedies (PG&E's FRRB).

PG&E begins its baseless assault by stating the obvious – CPSD's Amended Reply Brief on Fines and Remedies (ARB) regarding payment by PG&E of a fine to the General Fund is inconsistent with CPSD's position in its Opening Brief on Fines and Remedies (OB). *See* PG&E FRRB, p. 1. One of the reasons CPSD filed a revised brief, as allowed by the ALJs, was to correct CPSD's legal position to argue: (1) $300 million should be the *minimum* fine; (2) fines under §§ 2107 and 2108[1] must be paid to the General Fund; and (3) $1.950 billion of disallowances should be applied to PG&E's Pipeline Safety Enhancement Program (PSEP) costs required by D.12-12-030.

PG&E is responsible for the San Bruno catastrophe and endangering many other communities due to decades of PG&E's unreasonable recordkeeping practices and violations of federal regulations adopted by the Commission (such as class location regulations). This unlawful conduct justifies the maximum "penalty" (as broadly construed) the Commission can impose without harming PG&E's creditworthiness. CPSD's expert witnesses quantified this amount as $2.25 billion in PG&E's new issuance of common equity, and generally referred to both fines and disallowances in describing "penalties." PG&E's issuance of $2.25 billion of common equity should be sufficient to pay a $300 million fine to the General Fund and $1.515 billion to decrease the burden on ratepayers from PSEP costs, and still allow PG&E to raise an additional $435 million for PSEP costs disallowed in the Commission's D.12-12-030. *See* CPSD's ARB, pp. 1-4. The Commission has the equitable and remedial authority to ensure that much of the burden of PG&E's PSEP costs be borne by shareholders, not PG&E's ratepayers.

[1] All references are to the California Public Utilities Code unless otherwise stated.

PG&E erroneously argues that CPSD only has a right to seek $300 million in *fines*, but PG&E ignores CPSD's right to seek other *remedies*. If CPSD could only seek statutory fines and was powerless to seek other remedies, CPSD would have sought much more than a $300 million fine paid to the General Fund. However, CPSD, the intervenors and PG&E itself generally agree that most of PG&E's payments should be for infrastructural improvements, as opposed to fines paid to the General Fund. *See, e.g.,* PG&E's Coordinated Remedies Brief (May 24, 2013) (CRB), p. 73, n. 335. As demonstrated below, PG&E's arguments mischaracterize CPSD's ARB, D.12-12-030, and the three Orders Instituting Investigations (OIIs).

II. THE COMMISSION HAS REMEDIAL AUTHORITY TO ORDER RATE DISALLOWANCES IN ADDITION TO FINES

In order to obscure CPSD's position, PG&E misquotes CPSD's ARB as stating: "<u>As a matter of law</u>, all PG&E *fines and remedies* derived from California Public Utilities Code §§ 2100, *et seq.,* <u>must be paid directly to California's General Fund</u>." PG&E's FRRB, p. 2 (emphasis added in underline by PG&E). In fact, CPSD's ARB, p. 5, stated: "[A]ll PG&E *fines and penalties* derived from California Public Utilities Code §§ 2100, *et seq.* . . ." (emphasis added in italics by CPSD in both quotes). In addition to the authority to impose statutory fines under § 2100, *et seq.,* the Commission has remedial and equitable authority under §§ 701 and 761, and the California Constitution, article XII. *See, e.g.,* San Bruno OII, I.12-01-007, pp. 6, 10; *Wise v. Pac. Gas & Elec. Co.* (1999) 77 Cal.App.4th 287, 299 (Commission has equitable powers incident to its express duties).

In PG&E's FRRB, p.4, n. 26, PG&E selectively quotes from the first sentence in the "scope" section in the San Bruno OII, at p. 10, stating the purpose of the OII proceedings is to determine "whether PG&E has violated laws requiring safe utility gas practices." PG&E conveniently omits the second sentence, which states: "The Commission has the broad authority to impose fines and other remedies if such violations are proven." *Id.* at 10. The Commission further down on the same page states: "We emphasize that the Commission's remedial powers are not limited to its authority to impose civil penalties." *Id.* The Commission further explains that pursuant to § 761, if it finds that PG&E's maintenance or operation expenses were unsafe or unreasonable, the Commission may consider ordering PG&E to change or improve its maintenance, operations or construction standards for its pipelines. *Id.*

From PG&E's incomplete excerpt from the San Bruno OII, PG&E also argues that "prudence and reasonableness standards are not applicable in these enforcement proceedings." (PG&E FRRB, p. 3.) PG&E omits any reference to the other language in the same San Bruno OII. Indeed, in each of the OIIs, in addition to the fines that PG&E faced under §§ 2107 and 2108, PG&E also was put on notice that it faced remedial actions by the Commission under § 761. *See e.g.,* Recordkeeping OII, I.11-02-016, p. 20, Ordering Paragraph (OP) #5 (PG&E is hereby given notice that the Commission may order PG&E to implement measures designed to prevent future gas hazards to safety pursuant to § 761). In fact, in the Recordkeeping OII, I.11-02-016, p. 20, OP #3, the Commission explicitly directed PG&E to show why the Commission should not find PG&E in violation of provisions of law or for having engaged "in *unreasonable or imprudent practices* in relation to these matters . . . If any violation by PG&E is found, PG&E is directed to show why penalties *and/or any other form of relief should not be applied.*" (Emphasis added).

PG&E also erroneously argues the Commission's rulemaking proceeding, R.11-02-019, is the only proceeding in which the Commission can decide the reasonableness or prudence of PG&E's PSEP costs and that the Commission has specifically decided in D.12-12-030 which costs were reasonable. Thus, PG&E challenges CPSD's proposed $1.950 billion disallowance as "lack[ing] a legal foundation." *See* PG&E's FRRB, pp. 3-5.[2] However, in OP #3 of D.12-12-030, the Commission specifically ordered: "All increases in revenue requirement authorized in

[2] As explained in CPSD's ARB, pp. 3-4, $635 million of this amount was disallowed by the Commission in D.12-12-030, but PG&E has already put $200 million in its reserves to cover this amount. Therefore, PG&E's argument would only apply to $1.515 billion of the proposed disallowance.

Ordering Paragraph 2 are subject to refund pending further Commission decisions in investigation (I.)11-02-016, I.11-11-009, and I.12-01-007." In response to this cross-reference, PG&E simply claims (without citation to any page of a Commission decision) that it is "clear" that the "subject to refund language" in OP #3 only allows further ratemaking action in the rulemaking proceeding, R.11-02-019. However, in sharp contrast to the clarity inferred by PG&E is the actual language in D.12-12-030, where the Commission distinguished between disallowances it had already decided and further disallowances that could occur in the OIIs: "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." D.12-12-030, p. 4.

Accordingly, the explicit language of the OIIs and D.12-12-030 put the lie to PG&E's charge that PSEP disallowances are outside of the scope of these proceedings. Indeed, in D.08-09-038, 2008 Cal. PUC LEXIS 401, *115-118 (2008), the Commission rejected a similar argument that ratemaking and refunds could not be addressed in an investigative enforcement proceeding. In D.08-09-038, the Commission imposed a fine and also determined that revenue requirements for Southern California Edison Company ("SCE") affected by SCE's fraudulent practices were subject to refund. *Id.* at * 1-2. Just like the instant proceedings, the OIR was "clear" in advising that ratemaking and refunds were within the scope of the proceeding. *Id.* at *116-118. Similarly here, it would be "extremely inefficient, costly and unreasonable" and also "unnecessary" to relitigate in the PSEP proceeding in front of a different ALJ the impact of PG&E's past unreasonable conduct on its PSEP rate recovery. *See id.* at *118-119.

III. PG&E WAS NOT DENIED DUE PROCESS

The explicit language of the OIIs and D.12-12-030 refute PG&E's argument that PG&E was denied due process because it was somehow unaware that the Commission could disallow PSEP costs as imprudent and unreasonable in these OII proceedings. *See* PG&E FRRB, pp. 4-5. PG&E's sole legal authority is *Rosenblit v. Superior Court* (1991) 231 Cal.App.3d 1434, 1445-48 (PG&E FRRB, p. 5, n. 28). The issue in *Rosenblit* was the lack of fair notice of the nature and scope of the administrative disciplinary charges. *Id.* at 1445. In contrast, as discussed above, the OIIs and D.12-12-030 provided ample notice to PG&E that the PSEP rates could be further adjusted in the OII proceedings.

Contrary to PG&E claims, PG&E also had a full opportunity to respond to the evidence submitted in these proceedings. The record of these OII proceedings is replete with examples of how PG&E's unreasonable practices were responsible for PG&E's incurrence of the PSEP costs. In the Recordkeeping OII, I.11-02-016, there are two major examples of PG&E's unreasonable conduct. With regard to the San Bruno explosion, PG&E did not create and retain orderly records of salvaged, reconditioned and reused pipe, and has been unable to identify records that clearly document the source of the piece of pipe that failed in Segment 180. *See* CPSD Opening Brief in I.11-02-016 (ROB), pp. 24, 29. PG&E also is missing vital construction records related to the original installation of Segment 180, even though good engineering practices require retaining such records for the life of the facility. *Id.* at 34-36. Although pressure test records are essential to confirm the integrity of a pipeline, and must be retained for the life of a facility, PG&E has not located records showing that a post-installation pressure test was conducted on Segment 180. *Id.* at 38-43. Operating the high-pressure line without records or a pressure test to support the maximum allowable operating pressure was unreasonable and imprudent.

PG&E's recordkeeping failures are not limited to Segment 180, but are system-wide. Over the years, PG&E has moved used pipe from one location to another without keeping track of where the used pipe has been reinstalled. CPSD ROB, pp. 181-182. Due to this failure, PG&E cannot identify, test, inspect or remove its most risky pipes. *Id.* at 125-126. As with the Segment 180 construction project, many job files, where PG&E keeps its construction records, are missing or incomplete. *Id.* at p. 87.[3] Since

[3] Only 5.7% of PG&E's 87,018 transmission job files in its main Emeryville facility contained necessary weld records. *See* CPSD ROB, p. 167, citing CPSD Exh. 6, p. 6-64, l. 9 and CPSD Exh. 8, at 36, ll. 8-11.

1955, PG&E has failed thousands of times either to test the strength of newly installed pipes or to retain the records for the life of the pipe. *Id.* at 101-108.[4]

Similarly, in the San Bruno OII, I.12-01-007, there was substantial evidence of PG&E's unreasonable practices in virtually stopping its Gas Transmission Replacement Program and reducing its in-line inspections under its Integrity Management Program. Instead, PG&E relied upon less expensive methods for checking for corrosion or deferring maintenance altogether, contrary to the advice of its own engineers. These practices, that were done to reduce transmission safety budgets and protect PG&E's profits, almost guaranteed that defects in older pipelines (except for corrosion) would not be found until there was an explosion, as happened in San Bruno, or there were leaks from the transmission lines. *See* CPSD's Opening Brief, I.12-01-007 (Mar. 11, 2013), pp. 83-95.

IV. CPSD DID NOT MISCONTSTRUE ITS CONSULTANTS' CONCLUSIONS

A. Overland Did Not Improperly Use PG&E's Price to Book and Dividend Payout Ratios

PG&E correctly points out that Overland's analysis uses PG&E's payout ratio and price to book ratio as a guide to measuring PG&E's financial health, but takes issue with this methodology. (PG&E FRRB, p. 6.) However, using the price to book ratio is a perfectly reasonable method and was used by at least one of PG&E's investment banking firms (Morgan Stanley, Joint Exh. 70[5]), and resulted in realistic conclusions about the level of equity that PG&E could achieve.

Nor is Overland's conclusion out of line with the conclusion of other well-respected Wall Street firms. In fact, in a sensitivity analysis done by International Strategy & Investment (ISI), (an equity analyst quoted and relied upon by PG&E itself), a

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[4] PG&E identified 23,760 pipe segments, constituting approximately 435.7 miles within Class 3 and 4 High Consequence Areas that lacked the required strength test records from 1953 through 2010. *See* CPSD ROB, p. 166; TURN Exh. 4.

[5] PG&E claimed confidentiality for both Joint Exhibits 70 and 61, thus CPSD is not providing any confidential data from those two exhibits.

post-tax fine exposure was estimated that is equivalent to the "threshold" level assumed in Overland's analysis. (Explained in Joint Exhibit 53, p. 25; the ISI analysis is Joint Exhibit 61.)

PG&E also claims that Overland inappropriately assumed the "existence of buyers perpetually willing to buy PG&E stock." (PG&E FRRB, p. 7.) However, Overland did not assume that buyers would perpetually buy any amount of PG&E stock. Overland assumed that, as the potential fine amount went up, PG&E's market capitalization remained the same – which caused a dilution of the implied stock price. (Joint Exh. 51, Table 10, p. 12.) A dilution (within a "relevant range") would likely make PG&E stock price more attractive. PG&E ignores the fact that "return on investment" is derived both by the income that the investor receives from the investment and *the cost of that investment.*

Another PG&E criticism is the price to book ratio "would be the same if it were raising one dollar, $100 billion, or any other amount." (PG&E FRRB, p. 6.) However, holding certain variables constant to focus on the impacts of other variables is a common practice when performing a sensitivity analysis. For example, the price to book assumptions made by Overland are consistent with the assumptions made by at least one of PG&E's own investment bankers (Morgan Stanley) in an analysis prepared for PG&E management. PG&E witness Mr. Fornell was examined on this investment banking analysis (Joint Exh. 70), which made substantially the same assumptions as Overland, to which Mr. Fornell simply replied "So they got it wrong, too. They did." (RT, p. 1488.)

Next, PG&E criticizes Overland for not using 2013 Earnings per Share (EPS). (PG&E FRRB, p. 6.) Overland used a more normal year (2012), because 2013 was abnormally low (Joint Exh. 62). The 2013 EPS was low because it takes into account some of the costs that have been disallowed by the Commission. (RT, p. 1419.)

B. CPSD Did Not Ignore Overland's Central Tenet

PG&E next argues that CPSD somehow misapplied Overland's "central tenet" that all costs that PG&E's shareholders "have and will bear" are relevant. (PG&E FRRB, p. 7.) However, PG&E includes past and future costs that seemingly have no bearing on this proceeding, or have no support in the record. For example, PG&E again requests credit for Gas Accord V (GA V) costs. (PG&E FRRB, p. 7.) However, GA V was settled in 2011. Overland's analysis was based on PG&E's own projections of its financial condition as of the date Overland issued the report in August 2012, and Overland focused on *incremental capital*, not historical costs. (RT, p. 1366.)

PG&E also contradicts its own testimony with evidence that is not in the record by stating that Ms. Yura's estimates of shareholder spending "may not represent the final 2012 shareholder costs or the most current or precise forecasts of shareholder costs in 2013 and after." (PGE FRRB, p. 7.) Instead, PG&E now claims (contrary to Ms. Yura) that PG&E expects to spend $1.25 billion in PSEP costs – an amount that is not in the evidentiary record.

V. PG&E'S REHASH OF ITS EXCESSIVE FINES ARGUMENT IS STILL BASELESS

PG&E reiterates its arguments that the proposed $2.25 billion penalty is unconstitutional under the state and federal Excessive Fines Clause in view of the alleged disproportionality to other penalties. Otherwise, PG&E fails to respond to most of CPSD's arguments on this issue.

CPSD has twice cited *Hale v. Morgan* (1978) 22 Cal.3d 388, 401. *See* CPSD Reply Brief in I.11-02-016 (Apr. 24, 2013), p. 22; CPSD ARB, p. 9. In *Hale*, the California Supreme Court explicitly distinguished *People v. Western Airlines* (1954) 42 Cal.2d 621, 627-28, which *upheld* § 2107, despite the daily and unlimited nature of the penalty, because the Commission can exercise discretion in setting penalties (*see* § 2107) and in compromising fines (*see* § 2104.5). PG&E refuses to recognize this distinction or *Hale's* holding that the statute at issue in *Hale* was unconstitutional because the statutory fine was mandatory, replacing reasoned discretion with an adding machine, subjecting the landlord to infinite penalties regardless of the circumstances. *See Hale,* 22 Cal.3d at 402. Instead, PG&E cites *Hale* as somehow supporting PG&E's argument that the fines and remedies sought by CPSD are disproportionate, and the Supreme Court found that a statutory cap "weigh[s] heavily in the constitutional analysis" of whether a fine is excessive. PG&E's FRRB, p. 9, n. 60. Again, the issue in *Hale* was whether a mandatory, non-discretionary penalty was constitutional. Moreover, the first statute the Court in *Hale* cited to contrast with the California law was Washington's, which was similar except that its imposition of a fine was discretionary rather than mandatory. *See Hale,* 22 Cal.3d at 403.[6]

Secondly, although PG&E pays lip service to "the severity of the San Bruno tragedy," PG&E shows it does not really understand its severity by alleging other accidents were comparable "even if the comparisons were less than perfect." *See* PG&E FRRB, p. 9. PG&E never responds to the five key points which justify the amount of the penalties proposed by CPSD. *See* CPSD's ARB, p.7. In the three OIIs, CPSD and the intervenors established how extremely severe and unprecedented PG&E's unreasonable and unsafe practices were for decades, threatening communities throughout Northern and Central California and resulting in the San Bruno catastrophe. The San Bruno catastrophe was the result of numerous and preventable errors by PG&E, which caused a 30-inch transmission pipeline to explode and then a lengthy fire in a major metropolitan area, killing eight persons, injuring 58 others, and destroying or damaging more than 100 homes. In terms of proportionality, the $300 million fine, by itself, is too small, particularly relative to the Rancho Cordova explosion, in which one person died, and which was primarily caused by PG&E's negligence on two days (the day of the faulty pipe installation, and the day of the explosion). In that investigation, the Commission refused to accept a settlement of $26 million to the General Fund, and instead directed PG&E to pay a $38 million fine. *See* D.11-12-021, 2011 Cal. PUC LEXIS 531.

Finally, CPSD has proposed that PG&E pay a $300 million fine to the General Fund and $1.515 billion for specific remedies and additional disallowances or refunds of

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[6] Ignoring *Hale,* without any supporting legal analysis, PG&E submits a list of purportedly capped state gas safety penalty statutes that PG&E claims shows a maximum penalty of $2 million, "consistent" with federal law. *See* PG&E's FRRB, pp. 8-10 and attachment. Putting aside the veracity of PG&E's list and conclusions, how could PG&E credibly claim this federal limit in light of its acknowledgement that the El Paso Natural Gas Company's pipeline explosion resulted in a penalty of $101.5 million? *See* PG&E CRB, p. 22.

PSEP costs. PG&E's claim that this is a $4 billion penalty has no support in the record. Nor does PG&E cite a single case where a state commission's order of refunds or disallowance of costs offends the Excessive Fines Clauses. *See* CPSD's ARB, pp. 8-10.

VI. CONCLUSION

CPSD respectfully requests that the Commission order PG&E shareholders to pay, at a minimum, a $300 million fine to the General Fund, and up to $1.515 billion for remedial relief, in addition to the $635 million disallowance, which the Commission already ordered.

Respectfully submitted,

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