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California's Utility Shakedown

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Raiding **PG&E** to finance more spending in Sacramento

Three years on, California isn't letting the San Bruno pipeline explosion go to waste. Consider Sacramento's plan to dun Pacific Gas and Electric Company shareholders with a $2.25 billion penalty on top of the nearly $2 billion they're already paying.

The California Public Utilities Commission's safety division claims PG&E must be punished for "unreasonable and imprudent conduct in neglecting to repair and replace its aging infrastructure," following a 2010 accident that killed eight people and incinerated 38 homes. No one disputes the utility's responsibility. The issue is what is a fair penalty.

PG&E has already set aside $565 million to compensate victims' families and $170 million to rebuild the city of San Bruno. Shareholders have also financed $900 million of public works improvements through 2012, and more equity-funded upgrades are planned. All of this is before prosecutors extract their pound of flesh.

Yet regulators think shareholders should have to pay even more. A recent proposal by the safety division's staff would require PG&E investors to put up an additional $1.95 billion for modernization projects that ratepayers would ordinarily fund and another $300 million as penance to the state -- merely because regulators think the utility can afford it.

Last August, the safety division enlisted Overland Consulting to determine "the maximum amount that PG&E can be required to pay" by raising additional equity without hurting its credit rating. Overland put the number at $2.25 billion.

The agency has followed up by demanding that PG&E collect $1.95 billion from investors and effectively redistribute it to customers. The state government will also grab $300 million more as a kind of punishment-transaction fee, which it plans to use for general state spending. As it happens, Governor Jerry Brown has announced that the state needs an extra $315 million this year to comply with a federal court mandate to ease prison overcrowding. It's convenient when you can raid private shareholders to fill a budget hole.

PG&E says the $2.25 billion penalty violates the state constitution's ban on excessive fines, which courts have interpreted as disproportional with those imposed in similar cases. One comparison would be the 2000 El Paso Natural Gas Company pipeline explosion that killed 12 campers in Carlsbad, New Mexico. El Paso was fined $100 million, the largest U.S. gas penalty to date. PG&E's misfortune is that California is one of only two states that doesn't cap penalties for gas violations (the other, surprise, is New York), which now presents a safety risk for utility investors.

Moody's recently warned that the penalty "does not bode well for the regulatory environment in California, which is being adversely affected by political considerations." Standard & Poor's noted that the penalty could weaken "our assessment of the California regulatory jurisdiction."

If the commission rubber stamps the proposed penalty, PG&E can petition for an administrative review. If regulators fail to see reason, the utility will have to contest the penalty in state court.

Amid a housing recovery and Silicon Valley's tech advances, California politicians are again acting as if they don't need to care about the state's business climate. Looting a utility because it's a rich, politically vulnerable target will remind other businesses why it makes more sense to invest in Texas.