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)

PACIFIC GAS AND ELECTRIC COMPANY'S AMENDED[1] RESPONSES TO QUESTIONS IN SECTION 4 OF ADMINISTRATIVE LAW JUDGES' JULY 30, 2013 RULING REQUESTING ADDITIONAL COMMENT

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Dated: October 11, 2013

[1] Amended per the ALJs' Ruling dated October 9, 2013.

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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PACIFIC GAS AND ELECTRIC COMPANY'S AMENDED[2] RESPONSES TO QUESTIONS IN SECTION 4 OF ADMINISTRATIVE LAW JUDGES' JULY 30, 2013 RULING REQUESTING ADDITIONAL COMMENT[3]

PG&E is filing these amended responses to make the changes required by the ALJs' October 9, 2013 Ruling.

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[2] Amended per the ALJs' Ruling dated October 9, 2013.

[3] Pursuant to *England v. Louisiana State Board of Medical Examiners*, 375 U.S. 411 (1964), PG&E expressly reserves its federal constitutional and any other federal claims and reserves its right to litigate such claims in federal court following any decision by the Commission, if necessary.

PG&E accepts responsibility for the tragic San Bruno accident and acknowledges that a penalty is appropriate. But it is contrary to the law to size a penalty on the theory, advocated by CPSD and Intervenors, that the penalty should represent the maximum financial pain PG&E can bear. It is also bad policy, as such an approach would harm customers, other California utilities and the state in general.

The ALJs have asked that the parties provide "further briefing on the impact that fines and disallowances would have on PG&E's ability to raise capital and otherwise remain financially viable, including the tax treatment of amounts disallowed."[4] The questions the ALJs pose properly underscore the importance of the Commission understanding the financial and other implications of fines and penalties as it makes one of the most important decisions in its history.

The ALJs posed their questions soon after receiving CPSD's most recent penalty proposal. CPSD's amended proposal represents a $1.8 billion increase over its original recommended penalty of $2.25 billion, including the addition of a $300 million fine that would not be used to improve gas safety. CPSD would reverse the Commission's recent unanimous decision on PG&E's Pipeline Safety Enhancement Plan (PSEP)[5] and deny recovery of almost $1.2 billion of PSEP costs the Commission already found to be reasonable. This is extraordinary given that these costs are not remedial, but represent work necessary to meet California's new pipeline safety standards, which are now the most stringent in the nation. CPSD's proposal also understates by hundreds of millions of dollars the remaining costs shareholders will incur for PSEP and disregards approximately $1 billion of other gas transmission shareholder costs. If CPSD's penalty recommendation is adopted, PG&E expects to incur more than $4 billion in unrecovered costs on PSEP work, other gas transmission safety work and related fines.

[Removed pursuant to ALJ Ruling.]

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[4] July 30, 2013 Ruling Requesting Additional Comment at 4.

[5] D.12-12-030.

[Removed pursuant to ALJ Ruling.]

If CPSD and Intervenors succeed, they could end up harming PG&E, PG&E's customers and the communities PG&E serves. If the Commission adopts their proposals, PG&E will find itself in the position of needing to issue enormous amounts of equity to fund not only its planned infrastructure improvements across the entire utility but also

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[6] [Removed pursuant to ALJ Ruling.]

[7] [Removed pursuant to ALJ Ruling.]

[8] [Removed pursuant to ALJ Ruling.]

[9] [Removed pursuant to ALJ Ruling.]

[10] [Removed pursuant to ALJ Ruling.]

[11] [Removed pursuant to ALJ Ruling.]

fines and penalties that provide potential investors with no return. PG&E will need to do this in a market that may well view California's regulatory climate as problematic.

[Removed pursuant to ALJ Ruling.]

[12] [Removed pursuant to ALJ Ruling.]

[Removed pursuant to ALJ Ruling.]

[13] [Removed pursuant to ALJ Ruling.]

[14] [Removed pursuant to ALJ Ruling.]

The need for infrastructure investment is not unique to California. It is estimated that the nation's utilities need to invest trillions of dollars in infrastructure over the coming decades. PG&E itself plans to invest more than $5 billion per year in infrastructure improvements[15] – one of the largest investment plans among utilities. With trillions of dollars of needed utility infrastructure investment nationwide in the coming decades, utility investors have many choices beyond PG&E and California and they will consider the extent to which the different jurisdictions provide a balanced and constructive regulatory environment.

[Removed pursuant to ALJ Ruling.]

[15] Ex. Joint-57 at 11.

[16] [Removed pursuant to ALJ Ruling.]

SECTION 4, QUESTION 1

With regard to tax benefits:

a. What, if any, methodology should be used to adjust the amount of any disallowed expenditures to account for tax benefits and thus determine the actual impact of any disallowances on PG&E and/or the amount of capital that PG&E would need to raise?

i. Should this methodology treat capital investment different from other expenses?

ii. If so, please explain how.

b. If PG&E receives accelerated tax depreciation for some of its disallowed investment, do the tax normalization rules contained in Internal Revenue Code Section 168(f)(2) and (i)(9) require the use of a deferred tax reserve account to track any difference between straight-line and accelerated depreciation for the purpose of (i) understanding the impact of fines and disallowances on PG&E by stating the impact of fines and disallowances in equivalent terms or (ii) determining a maximum feasible amount of fines and disallowances that could be absorbed by PG&E? Please explain your answer. Also please explain the effect, if any, on PG&E's ability to take accelerated depreciation for other capital investment if a deferred tax reserve is not used for these particular purposes.

a. PG&E strongly opposes the use of potential tax deductions to increase the amount of any penalties imposed in these OIIs, or any requirement that PG&E credit ratepayers for the assumed amount of avoided taxes attributable to tax deductions, for the following reasons:

[Removed pursuant to ALJ Ruling.]

[Removed pursuant to ALJ Ruling.]

Second, using assumed tax deductions from a cost borne by PG&E shareholders to increase disallowances or other penalties, or requiring PG&E to credit ratepayers the assumed amount of avoided taxes attributable to any tax deductions, would represent an unwarranted departure from established Commission precedent. As a matter of Commission policy, if shareholders pay a cost, they are entitled to the related tax effects. The Commission has long recognized this principle in previous circumstances when shareholders have borne the cost of disallowed expenses.[17] DRA contends that not reflecting potential tax effects in fines and penalties would be a "windfall" for PG&E.[18] But that is incorrect, as the tax "benefits" would arise, if at all, only because PG&E's shareholders incurred the costs in the first place. PG&E is not aware of any Commission proceeding in which a utility's shareholders were not only required to pay for something but also were ordered to credit ratepayers the amount of avoided taxes attributable to the deducted costs.

Third, trying to determine how to factor in tax deductions – even if it were appropriate to do so (which it is not) – would be very difficult as a practical matter. Any methodology would need to take into account both (1) the uncertainty regarding whether PG&E will be able to deduct the disallowed costs and (2) the timing of any potential tax savings to PG&E.

As explained in response to Section 3, Question 2, PG&E believes, on the basis of the facts as they are currently known and without the influence of any future facts, that it is entitled to deduct for income tax purposes any non-capital expenditure and to take accelerated depreciation over 20 years on any capital expenditure disallowed by the Commission, other than an explicit fine paid to the state. Those deductions, however, ultimately may not be sustained. The law with respect to what constitutes a fine or

[17] *See* OII No. 24, D.84-05-036, 1984 Cal. PUC LEXIS 1325, at *14 ("If the present ratepayers do not bear the burden of financing new plant, it follows that their rates should not be lower based on tax consequences of that investment in new plant."), *19 (shareholders should retain the tax benefit of incurring disallowed or below the line costs).

[18] DRA Second Rebuttal Brief Regarding Fines and Remedies at 8.

similar penalty is complex. The tax authorities have broadly applied the prohibition against any deduction for fines or similar penalties to include payments in lieu of a fine or similar penalty.[19] Some expenditures made by PG&E for disallowed capital and non-capital items, which are not paid to a government, may not be deductible, through depreciation or otherwise, because they are deemed paid in lieu of a fine or penalty. This risk is hard to quantify and its application depends on the facts and circumstances of the particular case. In this matter, those facts will include future determinations not yet known.

Furthermore, even if the disallowed costs are deductible, the deduction will not have an immediate effect if PG&E is not currently taxable due to net operating loss carry forwards or other current year deductions. In addition, expenditures relating to capitalized amounts will be recovered over 20 years. The value of that deduction is significantly less than a current expense and also assumes PG&E will have taxable income in the future and Congress does not reduce the tax rate as has been recently proposed.

These uncertainties regarding the existence and timing of tax effects argue against making any adjustments to penalties or fines to reflect presumed tax deductions.

b. If the tax treatment required of disallowed plant is properly followed, the normalization rules should not be implicated in understanding the impact of fines and disallowances or in determining a maximum amount of fines or disallowances that reasonably could be absorbed by PG&E.

The normalization rules require consistency in the treatment of rate base and the calculation of tax expense for ratemaking purposes. For regulatory and GAAP purposes, PG&E will expense disallowed capital expenditures when incurred (i.e., expenditures are not capitalized or added to rate base). PG&E will not add to rate base the deferred tax asset resulting from the write-off of plant costs before the asset is depreciated for tax. Thereafter, there will be no regulatory or GAAP depreciation on these disallowed expenditures. Similarly, PG&E will not include tax depreciation produced by the disallowed expenditures in the future calculation of tax expense. As a result, for

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[19] *See* Treas. Reg. §1.162-21(b)(1); *Allied-Signal Inc. v. Comm.*, 75 A.F.T.R.2d 95-1287 (RIA) (3d Cir. Feb. 23, 1995).

ratemaking purposes, there should be no deferred tax expenses or deferred tax reserve for the difference between accelerated and straight line depreciation. In sum, after disallowance, neither these expenditures nor any of the tax consequences of these expenditures will impact customer rates.

By not including any tax effects of disallowed capital expenditures in ratemaking, the consistency requirements of the normalization rules are followed and PG&E's ability to take accelerated depreciation for other capital investment should not be affected by not using a deferred tax reserve for these particular purposes. The normalization rules would be violated only if future tax depreciation were used to reduce ratemaking tax expense.[20]

SECTION 4, QUESTION 2

With regard to the timing of expenses and tax benefits:

a. **What, if any, methodology should be used to determine the actual impact on PG&E, and/or on the amount of capital that PG&E would need to raise**

   i. **of capital expenditures or other expenses that will not be made until sometime in the future?**

   ii. **of capital expenditures or other expenses that have already been made?**

b. **What, if any, methodology should be used to determine the actual impact on PG&E, and/or on the amount of capital that PG&E would need to raise, of tax benefits that will not be received until sometime in the future. The answer to this question can be included the answers to Question 1.a. above.**

a. [Removed pursuant to ALJ Ruling.]

[20] *See* I.R.S. Priv. Ltr. Rul. 9613004 (March 29, 1996); I.R.S. Priv. Ltr. Rul. 9552007 (Dec. 29, 1995).

[Removed pursuant to ALJ Ruling.]

The Commission should reject any attempt to adjust fines and penalties upward based on purported tax or timing "benefits."

Furthermore, PG&E's ability to raise equity is dependent on the willingness of investors to provide their capital to a company – not for the purpose of investing in income-generating assets – but to pay penalties. That challenge is not made easier by extending the capital needs over multiple years, resulting in a situation where PG&E has to keep going back to the same investor pool with the same difficult value proposition.[21] Accordingly, whether the expenditure is made in the future or is a write-off of a previously capitalized investment, the equity needs are the same over time, and it would be inappropriate to try to adjust the penalty to account for timing differences. See also PG&E's response to Question 3 below.

b. The Commission should not adjust fines or penalties based on assumed tax deductions. See PG&E's response to Question 1.a above.

<u>SECTION 4, QUESTION 3</u>

The Overland Report states that "Currently, the company is assuming recovery of these PSEP capital costs and the company is financing these costs with its existing capital structure. However, if these costs are disallowed, the company plans to write these capital expenditures off to expense and issue additional equity to fill the equity gap."[22] The Overland Report also contends that "the incremental external equity capital available to PCG is approximately $2.25 billion."[23]

a. In order to understand the impact of any disallowed capital expenditures on PG&E's need for *incremental* equity, should there be an adjustment to reflect the amount of equity that PG&E would have issued to fund capital expenditures regardless of any disallowance?

[21] Mr. Fornell explained that if the Commission were to impose very large fines or penalties, PG&E probably would have to raise the needed equity through more than one stock issuance. Joint R.T. 1587-88 (PG&E/Fornell); *see also* Joint R.T. 1448 (PG&E/Fornell). But that does not mean that investors, analysts and rating agencies would not take into account the entire amount of fines and penalties – whether they were payable all at once or over a longer period of time – when assessing the regulatory environment and the risk of investing in PG&E.

[22] **Exh. Joint-52 at 13.**

[23] **Exh. Joint-52 at 13.**

b. If the answer above is "yes," what methodology should be used to make this adjustment?

a. To respond fully and fairly to this question, which asks about the relationship between fines and penalties in these OIIs and PG&E's need for equity for other purposes, PG&E must provide context regarding Overland's approach and the implications of PG&E needing to raise capital for large fines and penalties as well as planned capital expenditures.

Overland's Approach Requires Counting the Amounts PG&E's Shareholders Are Already Funding. The Commission should take into account the amounts that PG&E is spending to improve its gas operations in setting any fines and penalties because (1) these shareholder costs show there is no need for additional fines or penalties to motivate PG&E to improve the safety of its gas transmission system; (2) they must be included when comparing proposed fines and penalties to those imposed in other comparable situations; and (3) they must factor into any assessment of how additional fines and penalties will affect PG&E and its customers.

CPSD and Intervenors, on the other hand, argue that PG&E should be penalized up to the maximum financial harm, using Overland's testimony to establish that upper limit. Overland's "threshold level" of $2.25 billion is nothing but a made up number developed through a flawed methodology unconnected to real world facts.[24] Yet, even Overland's approach recognizes that the Commission must take into account the full extent of costs being borne by PG&E's shareholders. Overland concluded that PG&E could issue equity of $2.25 billion to fund *all shareholder costs*, not just fines and penalties imposed in these OIIs.[25] As Overland explained, its analysis focused on determining the maximum amount of equity PG&E could issue to fund any "nonrevenue producing" costs.[26] In other words, any equity the company needs to issue for costs "that would be the shareholder responsibility as opposed to any ratepayer responsibility"

[24] *See* PG&E Coordinated Remedies Brief at 73-79; PG&E Response to CPSD Amended Reply Brief on Fines and Remedies at 6-7.

[25] Ex. Joint-53 at 22, 27 (CPSD/Overland); Joint R.T. 1367, 1369-71 (CPSD/Overland).

[26] Joint R.T. 1367 (CPSD/Overland).

would count toward the "threshold level"[27] – including "costs that are being incurred for Commission-approved activities but not allowed into rates, like some of the pipeline safety enhancement plan costs, or other costs that the company has incurred and is continuing to incur that are above and beyond whatever was in rates."[28]

In short, whether the Commission accepts CPSD's and Intervenors' approach and sets fines and penalties at the maximum PG&E can withstand or properly rejects those recommendations and penalizes PG&E an appropriate amount under the circumstances, the Commission must consider all of the costs incurred by PG&E's shareholders.

[Removed pursuant to ALJ Ruling.]

[27] Joint R.T. 1370 (CPSD/Overland).

[28] Joint R.T. 1370-71 (CPSD/Overland).

[29] [Removed pursuant to ALJ Ruling.]

[30] [Removed pursuant to ALJ Ruling.]

[31] [Removed pursuant to ALJ Ruling.]

[32] [Removed pursuant to ALJ Ruling.]

[Removed pursuant to ALJ Ruling.]

PG&E's Shareholder Costs Count Against the Same Total Amount of Equity PG&E Can Raise for Non-Income-Generating Purposes. In highlighting the costs its shareholders are incurring, PG&E is not asking the Commission to include these costs in rates or to reopen the PSEP proceeding. Rather, PG&E's point is that the Commission must consider the full extent of PG&E's PSEP costs, spending above Gas Accord V adopted expense amounts, and other shareholder costs in setting any penalty in these proceedings – and they all count toward Overland's $2.25 billion "threshold level."

[Removed pursuant to ALJ Ruling.]

[33] [Removed pursuant to ALJ Ruling.]

[34] [Removed pursuant to ALJ Ruling.]

[35] [Removed pursuant to ALJ Ruling.]

CPSD itself explained:

> [T]he Commission's disallowed amounts are not part of a "credit mechanism." *They involve dollars which PG&E still must raise through the equity capital market as part of the same $2.25 billion* which the Overland Consulting group claimed was the necessary limit to which the Commission could disallow amounts or impose fines on PG&E for its violations in the OIIs without affecting PG&E's creditworthiness.[36]

This is true of all the PSEP shareholder costs, spending above Gas Accord V adopted expense amounts and other categories of costs that PG&E's shareholders have incurred or will incur – not just the $435 million in PSEP costs identified by CPSD.

In terms of assessing the amount of equity that PG&E needs and how much it would be able to raise, it does not matter whether costs are labeled as "penalties"[37] or how they would be treated from a "ratemaking perspective."[38] This is not a rate case and PG&E is not asking for rate recovery for the shareholder costs identified above. What a prospective investor cares about is that the equity will not be used for an income-generating investment.[39] The equity that PG&E needs to issue to fund spending above the amounts approved in rates in Gas Accord V or PSEP, costs that PG&E never requested in rates, or fines and penalties in these OIIs all must count against the same total amount of equity that PG&E reasonably can raise for non-income-generating purposes.

[Removed pursuant to ALJ Ruling.]

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[36] CPSD Response to San Bruno Motion to Strike at 2 (emphasis added).

[37] *See, e.g.*, DRA Second Rebuttal Brief Regarding Fines and Remedies at 6 (arguing costs the Commission found unreasonable in PSEP cannot be part of a "penalty").

[38] *See, e.g.*, DRA Second Rebuttal Brief Regarding Fines and Remedies at 6 (arguing it "makes no sense from a ratemaking perspective" to count, for example, costs that "PG&E never requested rate recovery for" as part of total amount of equity PG&E can issue under Overland's approach).

[39] Ex. Joint-66 at 23-25 (PG&E/Fornell); *see also* Joint R.T. 1432 (CPSD/Overland).

[Removed pursuant to ALJ Ruling.]

<u>PG&E Does Not Have Access to a Limitless Supply of Equity Capital – Particularly to Fund Fines or Penalties – and May Be Forced to Curtail Capital Expenditures</u>. PG&E projects capital expenditures in excess of $5 billion annually from 2013 through 2016.[45] This is one of the largest capital plans of any utility in the country and it is intended to make important safety and reliability improvements to PG&E's utility operations. A large portion of these capital expenditures will need to be financed

[40] [Removed pursuant to ALJ Ruling.]

[41] [Removed pursuant to ALJ Ruling.]

[42] [Removed pursuant to ALJ Ruling.]

[43] [Removed pursuant to ALJ Ruling.]

[44] [Removed pursuant to ALJ Ruling.]

[45] Ex. Joint-57 at 6, 11; Ex. Joint-66 at 17 (Figure 7) (PG&E/Fornell).

externally through both equity and debt. PG&E projects equity issuances of $1 billion to $1.2 billion in 2013 and very large additional equity issuances each year through 2016.[46] Any equity that PG&E must issue to fund a fine or penalty in these OIIs would be incremental to its planned equity issuances to fund infrastructure improvements.

PG&E's planned equity issuances – before any fine or penalty in these proceedings – are already very substantial compared to other utilities. Any utility equity issuance of more than $500 million is relatively unusual and will attract heightened investor scrutiny.[47] Only three of the 30 utility equity offerings since 2008 were larger than $600 million.[48] PPL Corp. and UIL Holdings are the two utilities that issued the most equity as a percentage of their market capitalization (in a single issuance or multiple issuances) from 2008 through 2012.[49] Unlike PG&E, however, they used the proceeds principally to fund major acquisitions with an associated return for investors.[50] Overland concedes that it is "intuitively obvious" that an "equity offering to fund a penalty is not going to be as well received by investors as would an offering to fund capital expenditures or an acquisition that would add to the earnings of the company."[51] In fact, there is no evidence that any utility has ever issued equity specifically for the purpose of paying a fine or penalty – much less equity in the billions of dollars.

[Removed pursuant to ALJ Ruling.]

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[46] Ex. Joint-57 at 9; Ex. Joint-66 at 17 (Figure 9) (PG&E/Fornell).

[47] Ex. Joint-66 at 26 (PG&E/Fornell).

[48] Ex. Joint-66 at 25 (PG&E/Fornell). Indeed, only 21 of the 61 publicly traded electric and gas utilities (with market capitalization over $850 million) issued equity from 2008 through 2012 through marketed offerings – and there were only four such issuances in total in 2011 and 2012. Ex. Joint-66 at 25 (Figure 11), 29 (Appendix) (PG&E/Fornell).

[49] Ex. Joint-66 at 25-27 & Figures 11, 12 (PG&E/Fornell).

[50] Ex. Joint-66 at 26-27 (PG&E/Fornell).

[51] Ex. Joint-53 at 9 (CPSD/Overland); *see also* Ex. Joint-66 at 3, 15 (PG&E/Fornell).

[52] [Removed pursuant to ALJ Ruling.]

[53] [Removed pursuant to ALJ Ruling.]

[Removed pursuant to ALJ Ruling.]

54 [Removed pursuant to ALJ Ruling.]

[Removed pursuant to ALJ Ruling.]

<u>Any Methodology to Set Fines and Penalties Must Take Into Account the Costs That Shareholders Are Already Bearing</u>. The Commission cannot impose fines and penalties in a vacuum, without regard to the impact that excessive fines and penalties likely would have on PG&E's ability to raise capital for planned expenditures and the cost of any capital it does raise. Any fines and penalties imposed in these proceedings

[55] [Removed pursuant to ALJ Ruling.]

[56] [Removed pursuant to ALJ Ruling.]

[57] [Removed pursuant to ALJ Ruling.]

[58] [Removed pursuant to ALJ Ruling.]

[59] [Removed pursuant to ALJ Ruling.]

[60] [Removed pursuant to ALJ Ruling.]

must take into account all of the costs PG&E's shareholders have incurred or will incur to improve gas operations. This is essential because (1) otherwise, the Commission in effect would be penalizing PG&E for having spent money voluntarily and (2) all of these costs affect what additional amount of equity PG&E realistically can issue to fund new fines and penalties.

[Removed pursuant to ALJ Ruling.]

The focus cannot be solely on new fines and penalties. Rather, the Commission must treat *all* shareholder expenditures to improve PG&E's gas operations the same whether they are imposed in these proceedings, determined in the Commission's PSEP decision (D.12-12-030), or incurred voluntarily by PG&E.[61]

In other words, if the Commission were to apply Overland's "threshold level" of $2.25 billion in equity, all of PG&E's shareholder costs (including but not limited to fines and penalties) should count toward that amount.

[Removed pursuant to ALJ Ruling.]

b. If the Commission structures a penalty such that PG&E must spend a certain amount on gas transmission safety before recovering costs from customers in

[61] TURN's argument that costs the Commission has not expressly approved cannot count toward the "threshold level" of equity PG&E can finance makes no sense. *See* TURN Reply to PG&E Response to CPSD Amended Reply Brief on Fines and Remedies at 7 (distinguishing between costs for "Commission-approved activities" and those the Commission never approved). *None of the shareholder costs at issue were approved by the Commission to be included in rates.* If they had been, they would not be paid by shareholders.

[62] [Removed pursuant to ALJ Ruling.]

rates, all shareholder expenditures should count toward the penalty amount, without adjustments for potential tax effects or timing differences, and whether those expenditures relate to fines and penalties in these OIIs, disallowances in the PSEP decision, or spending over adopted rates case amounts. While there is sufficient information in the record to allow the Commission to estimate the total amount of shareholder costs incurred through 2012 and to be incurred in 2013 and after (approximately $2.2 billion), the Commission could review or audit PG&E's actual expenditures so that, in the end, it would not need to rely solely on the shareholder spending data currently in the record.

This approach would alleviate the concern raised by TURN that the Commission should not assume the accuracy of PG&E's shareholder costs, particularly forecast costs that have not yet been spent.[63] Providing for some type of after-the-fact review or audit of PG&E's shareholder costs would also be consistent with Overland. While Overland quibbled with whether some of the shareholder costs PG&E identified on the record were or would be funded by shareholders as opposed to ratepayers, it agreed that "the Commission, of course, will ultimately sort this out."[64]

SECTION 4, QUESTION 4

Are there any other factors that require adjustment of the nominal dollars of any disallowed expenditures so that the impact on PG&E of any disallowances can be directly compared to any fines payable to

[63] [Removed pursuant to ALJ Ruling.]

[64] Joint R.T. 1428 (CPSD/Overland). Overland also conceded that it had not conducted any analysis regarding whether the identified shareholder costs were in fact embedded in customer rates. Joint R.T. 1430-31 (CPSD/Overland).

the State's General Fund that may be imposed on PG&E or to calculate the amount of capital that PG&E would need to raise? If so, identify those factors and the methodology that should be used to make the adjustment(s).

No. See PG&E's Responses to Section 4, Questions 1-3.

<u>**SECTION 4, QUESTION 5**</u>

If PG&E were to issue equity *over a period of years* to fund any fines or disallowances, would that have the effect of increasing the amount of such equity that PG&E could raise without negatively affecting PG&E's ability to raise capital and otherwise remain financially viable? Please explain.

a. If so, how could this additional amount of equity be calculated?

No. Whether issued all at once or over a period of years, the total amount of equity that PG&E could raise to fund any fines or disallowances without negatively affecting its ability to raise capital would not change. PG&E's ability to raise equity capital is limited by investor willingness to invest in PG&E, which is in large part a function of investors' perception of the California regulatory environment. Investors will consider the complete multi-year impact of the final penalty, as well as the signal it sends about the regulatory environment, in evaluating PG&E as an investment opportunity. See also PG&E's response to Section 4, Question 3.

<u>**SECTION 4, QUESTION 6**</u>

Should the CPUC adopt a methodology for recovering for ratepayers tax benefits that PG&E will accrue from any disallowed expenditures? If so, what should this methodology be?

No. See PG&E's response to Section 4, Question 1 above.

SECTION 4, QUESTION 7

With regard to any methodology recommended in your response to Questions 1 – 6 above:

a. How can this methodology be applied in this proceeding without waiting for all of any disallowed expenses to be incurred or all of the tax impacts to occur?

b. If the methodology cannot be applied in this proceeding to all disallowances, please explain what cannot be done in these proceedings and why. Also, please explain when and how the methodology will need to be applied after the conclusion of these proceedings.

a. In response to Question 3 above, PG&E discusses why the Commission should not distinguish between the amounts that PG&E is already spending to improve the gas transmission system and any new fines or penalties imposed in these OIIs. This methodology can be applied without waiting for disallowed expenses to be incurred by relying on PG&E's actual shareholder expenditures through 2012 and forecast expenditures in 2013 and later as reflected in the information in the record. Furthermore, if the Commission structures the penalties to require PG&E to spend a particular amount on gas transmission safety without rate recovery, the Commission could review or audit PG&E's actual expenditures so that, in the end, it would not need to rely solely on the information currently in the record.

As explained in response to Question 1 above, any method that inflates the amount of fines or penalties based on assumed tax deductions would be unfair and inappropriate. If the amount of avoided taxes attributable to tax deductions is estimated at the time of the Commission's decision, it will necessarily be uncertain. Assuming that PG&E will avoid taxes in the future could have the result of increasing an already excessive penalty (i.e., if CPSD's or Intervenors' recommendations were adopted).

b. Not applicable.

SECTION 4, QUESTION 8

Provide any comments you may have on PG&E's response to Question 5 in Section 3 above.

Not applicable.

SECTION 4, QUESTION 9

Provide any other comments you may have about how the impact of any fines and any disallowances imposed on PG&E should be compared to each other or how they differently affect PG&E's need for additional capital.

The Commission should take into account the following factors in comparing different possible fines and penalties in these proceedings, including those recommended by CPSD and Intervenors:

Penalties Must be Constitutionally Proportionate. Never before to PG&E's knowledge has CPSD or any intervenor asked the Commission to set a penalty based on the "maximum" amount a utility can pay and remain one step from bankruptcy. Rather, the Commission has used financial capacity as a mitigating factor where higher penalties otherwise might have been warranted based on the facts of the case.[65]

[Removed pursuant to ALJ Ruling.]

[65] *See, e.g., Investigation of Vista Group Int'l, Inc.*, D.01-09-017, 2001 Cal. PUC LEXIS 820, at *33 (2001) (applying financial condition as mitigating factor); *Investigation of Titan Telecomm., Inc.*, D.03-01-079, 2003 Cal. PUC LEXIS 79, at *37 (2003) (same).

[66] [Removed pursuant to ALJ Ruling.]

[67] [Removed pursuant to ALJ Ruling.]

[68] [Removed pursuant to ALJ Ruling.]

[Removed pursuant to ALJ Ruling.]

Penalties Should Be Used to Improve Gas Safety. The Commission should compare not only the total amount of proposed penalties but also whether the recommended penalties include a fine that would be paid to the State's General Fund. No public interest is served by imposing fines that will not be used to improve gas safety.

[Removed pursuant to ALJ Ruling.]

Fines and Penalties Should Not Be Inflated Based on Assumed Tax Effects. For the reasons PG&E explained in response to Question 1 above, the Commission should reject any attempt to increase fines or penalties based on the possibility that PG&E would receive a tax deduction now or in the future.

PG&E Should Be Given Full Credit for the Costs That Its Shareholders Are Bearing Before Any Fines or Penalties. PG&E needs to go to the same pool of potential investors to raise capital for spending over rate case adopted amounts, PSEP disallowances, or any new penalties and fines in these proceedings. Any penalty that fails to take full account of the costs PG&E's shareholders are incurring – regardless of whether they were approved by the Commission – understates the financial risks to PG&E and penalizes PG&E for not having waited to start spending its shareholders' money to improve the gas system.

[Removed pursuant to ALJ Ruling.]

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[69] [Removed pursuant to ALJ Ruling.]

[70] [Removed pursuant to ALJ Ruling.]

[Removed pursuant to ALJ Ruling.]

Thus, the extent to which different potential penalties reflect *all* of PG&E's costs incurred in improving its gas transmission operations is a critical basis of comparison. Because it disregards substantial shareholder spending on gas safety, what CPSD characterizes as a $2.25 billion penalty recommendation is not directly comparable to its prior $2.25 billion penalty recommendation that counted all shareholder costs towards the total penalty amount.

[Removed pursuant to ALJ Ruling.]

[Removed pursuant to ALJ Ruling.]

71 [Removed pursuant to ALJ Ruling.]

[Removed pursuant to ALJ Ruling.]

The Commission cannot afford to disregard these possible impacts in comparing different potential fines and penalties.

Respectfully submitted,

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