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 REPLY COMMENTS TO RESPONSES TO QUESTIONS IN SECTION 4 OF ADMINISTRATIVE LAW JUDGES' JULY 30, 2013 RULING REQUESTING ADDITIONAL COMMENT

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[1] PG&E is mindful of the ALJs' October 9, 2013 Ruling on DRA and TURN's Motion to Strike and has limited these reply comments consistent with that Ruling. As a result, these reply comments do not address all of the topics PG&E believes are relevant and importa nt to the Commission's consideration of the issues raised by the ALJs' questions and the other parties' responses. Furthermore, pursuant to *England v. Louisiana State Board of Medical Examiners* , 375 U.S. 411 (1964), PG&E expressly reserves its federal con stitutional and any other federal claims and reserves its right to litigate such claims in federal court following any decision by the Commission, if necessary.

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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. As PG&E explained in its response to this question, the Commission should not increase the amount of any fines or penalties based on hypothetical assumptions about tax effects now or in the future. PG&E's response is consistent with both CPSD's penalty recommendation, which "did not adjust" for assumed tax effects,[2] and longstanding Commission practice and precedent.[3]

TURN argues in its response that the Commission should adjust any penalties for forecast "tax benefits based on an imposed disallowance amount and appropriate gross-up factors."[4] However, using assumed tax deductions as a basis for setting penalties higher still would make

[2] *See* CPSD Responses to Questions in Section 4 of the ALJs' July 30, 2013 Ruling (CPSD Responses) at 2; *id.* at 5 ("CPSD made the conservative assumption when calculating its proposed penalty that none of the disallowed costs would be tax deductible.").

[3] *See* OII No. 24, D.84-05-036, 1984 Cal. PUC LEXIS 1325; PG&E Amended Responses to Questions in Section 4 of ALJs' July 30, 2013 Ruling Requesting Additional Comment (PG&E Section 4 Responses) at 8.

[4] TURN Response to Questions in Section 4 of the ALJ Ruling (TURN Responses) at 1.

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an already excessive penalty even more egregious.[5] TURN mischaracterizes the assumed tax effects as a "benefit" that would make PG&E "better off."[6] Any deductions that PG&E might record could hardly be characterized as a "benefit" given that the deductions would result from PG&E's payment of penalties imposed by the Commission. Furthermore, any deductions would not offset the huge amount of spending PG&E has already undertaken at shareholder expense before any fines and penalties ordered in these proceedings.

The Commission also should not incorporate assumed tax effects in setting penalties because PG&E may not be able to deduct the costs in question and, even if it can, the amount and timing of the deductions cannot readily be determined.[7] While PG&E believes that it should be able to deduct for income tax purposes any penalty or disallowance other than an explicit fine paid to the state, the law with respect to what constitutes a fine or penalty that may not be deducted is complex.[8] And, as CPSD explains, even if the penalties or disallowances were deductible, the timing and amount of the deductions would be difficult to predict:

> [T]here would be a time lag between when PG&E would incur its capital expenditures and when it would realize the corresponding tax benefit via depreciation. Attempting to quantify this impact would require assumptions about the amount, timing, and depreciation rates of all disallowed capital expenditures. It would then require assumptions regarding discount rate(s) to use in order to discount future tax benefits to present value. Such a discount rate has not been established in the record.[9]

Finally, as PG&E noted in its response, even a current year deduction would not have an immediate effect if PG&E does not have taxable income due to net operating loss carry forwards or other deductions.[10]

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[5] TURN, for example, would increase its proposed penalty by $256 million to reflect purported tax "benefits." *See* TURN Responses at 3 n.4.

[6] *See* TURN Responses at 9.

[7] *See* PG&E Section 4 Responses at 8-9.

[8] *See* PG&E Section 4 Responses at 8-9; *see also* CPSD Responses at 5, 9. CPSD also notes that "given that the Internal Revenue Code often changes, cost disallowances that will be incurred in future years are subject to the additional risk that the tax code itself will change." CPSD Responses at 9.

[9] CPSD Responses at 5.

[10] *See* PG&E Section 4 Responses at 9.

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Although these uncertainties regarding the availability, timing and amount of tax deductions do not appear to be in dispute,[11] TURN nevertheless brushes them aside and effectively proposes that PG&E bear the risk of any failure to obtain assumed tax deductions.[12] TURN's position that the Commission should adjust for expected tax benefits upfront does not appear to have the support of CPSD or the other Intervenors, with good reason.[13] While PG&E believes the Commission should not adjust for assumed tax effects at all, it would be especially inappropriate to do so without knowing what the actual tax effects would be.

b. As PG&E explained in its prior responses, the tax normalization rules should not require the use of a deferred tax reserve to account for differences between straight-line and accelerated depreciation in the circumstances here.[14] PG&E agrees with CPSD and TURN that the Commission does not need to focus on this issue in its penalty determination, particularly if the Commission does not adjust for assumed tax effects consistent with CPSD's recommendation.[15]

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[11] *See* CPSD Responses at 1 ("both PG&E and CPSD recognize that a deduction for disallowed costs for tax purposes is not certain"); San Bruno Comments in Response to Questions in Section 4 of ALJs' July 30, 2013 Ruling (San Bruno Comments) at 4 ("it is impossible to know in advance what the ultimate tax treatment of any prospective disallowance may be"); TURN Responses at 5 ("Actual tax benefits over time may deviate from a forecast due to a difference in actual spending compared to forecast, any changes in tax rates, and any changes in depreciable lives of plants.").

[12] *See* TURN Responses at 6 (opining that "realistically the only significant risk is due to a difference between actual and forecast spending" and ignoring the possibility that the deductions would not be sustained at all).

[13] As noted, CPSD does not recommend that the Commission increase penalties to reflect assumed tax impacts now or later. CPSD adds that if the Commission wishes to adjust for tax effects, it "may deem it prudent to adopt a procedure to track costs that it deems non-recoverable and require PG&E to provide regular filings regarding the tax treatment of these costs" to avoid the uncertainty around the tax treatment. CPSD Responses at 9. *See also* San Bruno Comments at 4 ("Ultimately, the Commission must track the after-tax consequences of any penalty/disallowance that it orders, and no amount of speculation at this time on tax-related or capital-related items will change that.").

[14] *See* PG&E's Amended Responses to Questions in Section 3 of ALJs' July 30, 2013 Ruling (PG&E Section 3 Responses) at 4; PG&E Section 4 Responses at 9-10.

[15] *See* CPSD Responses at 5 ("Given PG&E's statement on page 4 of PG&E's Response to ALJ Questions, Section 3, this issue appears to be irrelevant."); TURN Responses at 4-5.

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 expen ditures 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. No party advocates that fines and penalties be adjusted to reflect the timing of PG&E's costs resulting from fines and penalties in these OIIs. CPSD correctly points out that any attempt to reflect the timing of costs in the amount of fines and penalties imposed "would require assumptions about the timing of future disallowed capital expenditures and expenses and would also require the development of a n appropriate rate at which to discount the future expenditures. Such a discount rate has not been established in the record." [16] PG&E agrees that any attempt to determine the timing of disallowed expenses or capital expenditures would be speculative, and that there is no basis in the record for choosing a discount rate even if the timing of any fines, penalties and disallowance were known. See also PG&E's reply comments to Question 5 below.

b. See PG&E's reply comments to Question 1.a above.

SECTION 4, QUESTION 3

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 w rite these capital expenditures off to expense and issue additional equity to fill the equity gap." [17] ***The Overland Report also contends that "the***

[16] CPSD Responses at 6.

[17] Exh. Joint-52 at 13.

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incremental external equity capital available to PCG is approximately $2.25 billion."[18]

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?***

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

a. This question asks whether the Commission should take into account the equity that PG&E would need for capital expenditures regardless of any fines or penalties in these OIIs. CPSD and TURN both contend that the Commission does not need to adjust fines and penalties to reflect PG&E's planned expenditures because Overland's analysis already did that.[19]

CPSD and TURN's position that the Commission can ignore PG&E's need for equity for purposes other than to pay fines and penalties because Overland already took those equity needs into account is not supported by the record.[20] *First*, Overland's approach requires treating all unrecovered and unrecoverable costs consistently – whether they are fines, penalties, disallowances or spending above adopted rate case amounts – because they all would need to be funded with equity and none of them would provide a return to investors.[21] According to Overland, all costs that are the "shareholder responsibility as opposed to any ratepayer responsibility"[22] must count toward the "maximum, or 'threshold,' level of available equity," which Overland determined is $2.25 billion.[23] Ironically, if PG&E had waited to invest shareholder funds in the gas transmission system and the same costs were labeled as a "penalty" or "disallowance" by the Commission in these OIIs, there would be no dispute from CPSD and Intervenors that those costs should count toward Overland's "threshold level." But there is no

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[18] Exh. Joint-52 at 13.

[19] *See* CPSD Responses at 7 (arguing that not providing credit for PG&E's existing shareholder costs is consistent with Overland's analysis); TURN Responses at 7 (same). PG&E notes that CPSD's and TURN's responses to Question 3 raise issues related to Overland's analysis that were addressed in prior briefs. PG&E's discussion in the paragraphs that follow addresses CPSD's and TURN's responses to the ALJs' question.

[20] *See* CPSD Responses at 7; TURN Responses at 7.

[21] *See* PG&E Section 4 Responses at 14-15.

[22] Joint R.T. 1370 (CPSD/Overland). *See generally* Joint R.T. 1369-71 (CPSD/Overland).

[23] Ex. Joint-51 at 10, 12 (CPSD/Overland).

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difference between costs that PG&E voluntarily invests in gas transmission safety or costs that it is ordered to invest by the Commission from the perspective of either ratepayers (who benefit equally from both) or prospective investors (who in both cases would be funding equity for purposes that would not generate a return).

Second, Overland's analysis did not take into account the fact that PG&E would need to raise enormous amounts of equity to fund both planned capital expenditures and huge fines and penalties in 2014 and later if the Commission were to adopt CPSD's or Intervenors' recommendations. Overland assumes a world in which all financial data are frozen in 2012,[24] and any equity that PG&E would need in 2013 through 2016 other than the $2.25 billion "threshold level" plays no role in its analysis.[25]

PG&E's response to this question explained that PG&E plans to invest more than $5 billion per year through 2016 on infrastructure improvements and cited evidence showing that the debt and equity PG&E will need to raise to fund these expenditures is very substantial compared to other utilities.[26] The Commission should study the data in the record showing all marketed utility equity issuances from 2008 through 2012[27] and ask itself whether PG&E would be able to issue as much equity as would be needed to fund both planned capital expenditures

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[24] *See* Ex. Joint-53 at 24 (Table 12) (CPSD/Overland) (model reflects stock price as of September 30, 2012 and projected EPS in 2012, and does not reflect any additional equity that would be need to be issued after 2012 other than equity for fines and penalties). As TURN points out, Overland states that its analysis reflects PG&E's planned equity issuances of $600 million in 2012. *See* Ex. Joint-51 at 10 (CPSD/Overland); TURN Responses at 7 (referring to same). Overland, however, never refers to any need for equity after 2012 and does not include such equity issuances in its computations.

[25] Not only does Overland's model fail to reflect PG&E's substantial equity needs for planned infrastructure improvements, Overland never discusses the fact that the amount of equity PG&E would need to issue to fund fines and penalties of the magnitude proposed by CPSD and Intervenors on top of PG&E's planned equity issuances would be unprecedented both in absolute terms and as a percentage of PG&E's market capitalization. TURN points to Overland's assertion that "[i]f we chose to ignore PG&E's ability to raise capital as required in the future, our [']threshold' analysis would look considerably different." *See* Ex. Joint-53 at 17 (CPSD/Overland); TURN Responses at 7. But the Commission should disregard Overland's vague, self-serving statement, which is unsupported and contradicted by its own testimony regarding how it arrived at the "threshold level" of equity. In fact, Overland's "model" would look exactly the same if PG&E forecast equity issuances of $10 billion per year in 2013 through 2016 or if it did not plan to issue any equity at all. *See* Ex. Joint-53 at 24 (Table 12) (CPSD/Overland) (nowhere showing capital expenditures or equity issuances in 2013 and beyond); Ex. Joint-51 at 12 (Table 10) (CPSD/Overland) (same).

[26] PG&E Section 4 Responses at 16-17.

[27] *See* Ex. Joint-66 at 24-27 & Figures 11-12 (PG&E/Fornell).

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and billions of dollars in fines and penalties. PG&E is not asking the Commission to make a dollar-for-dollar adjustment to any fines and penalties based on its planned capital expenditures that are included in rates. The Commission must recognize, however, that PG&E will need to go to the capital markets to raise equity for penalties at the same time that it will need to raise equity for planned capital expenditures. It is impossible to isolate one from the other – a fact that CPSD's and TURN's responses to the ALJs' question ignore.

TURN also argues that there should be no adjustment for the amount of equity that PG&E needs to issue because "PG&E's forecast capital expenditures for 2013-2016 are based on [] unrealistic assumptions" about the results in upcoming rate cases.[28] Even if that were true, PG&E's forecast outcomes in upcoming rate cases have nothing to do with the $2.2 billion that PG&E's shareholders are incurring to improve the gas transmission system prior to any additional penalties in these proceedings. It is these shareholder costs that the Commission must treat exactly like new penalties and fines in determining the overall amount of costs that PG&E's shareholders should bear. Furthermore, TURN is wrong as a factual matter. PG&E's planned capital expenditures are very significant – $4.5 billion annually – even at the low end of the guidance range, which does not assume spending levels consistent with rate case requests.[29]

b. See PG&E's response to this question.

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 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).

See PG&E's reply comments to Questions 1-3 above.

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[28] TURN Responses at 7-8.

[29] *See* Ex. Joint-57 at 11 (showing guidance ranges for capital expenditures for 2014-2016). The information in the record concerning PG&E's planned capital expenditures is based not only on internal PG&E forecasts, but also information that PG&E has shared publicly with investors. *See id.* at 1. TURN offers no evidence to show that these forecasts and guidance do not reliably indicate the relative magnitude of PG&E's planned capital program.

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SECTION 4, QUESTION 5

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 party has recommended that the Commission increase any fines or penalties based on the fact that all of the costs imposed on PG&E would not need to be paid at once. As CPSD and TURN point out, Overland and Mr. Fornell agree that PG&E probably would need to issue equity for larges fines and penalties in tranches over an extended period of time.[30] Overland testified that its "threshold level" of equity represented the amount of equity that it believes PG&E could issue for fines and penalties (and other shareholder costs) over approximately a 12-month period.[31] Mr. Fornell testified that if PG&E needs to raise large amounts of equity to fund fines or penalties, he would recommend that PG&E – *out of necessity* – split the equity issuances into smaller amounts to try to maximize the chance that PG&E could raise the total amount it needs.[32] Thus, the record supports the conclusion that if the Commission imposes fines and penalties that would require PG&E to raise substantial amounts of equity, PG&E would not be able to raise the equity all at once.

Overland never testified, however, that PG&E could raise even more equity than its "threshold level" if the fines and penalties were spread over multiple years. To the extent that is the premise of the ALJs' question, it has no basis in the record. CPSD's response supports this observation. According to CPSD, "an attempt to quantify this impact would be highly speculative and not recommended."[33]

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[30] *See* CPSD Responses at 8; TURN Responses at 8.

[31] Joint R.T. 1383-84 (CPSD/Overland) ("I would anticipate that it would be done over a period of a year or less.").

[32] Mr. Fornell testified that, if he were asked to advise PG&E on how to raise equity to fund a hypothetical $2 billion fine, he would tell the company, "don't do it all at once." Joint R.T. 1587 (PG&E/Fornell). He also described the numerous challenges that the company would face, including needing to curtail planned capital expenditures, and the fact that he "wouldn't rush to the market" to try to raise equity. Joint R.T. 1587-89 (PG&E/Fornell).

[33] CPSD Responses at 8.

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SECTION 4, QUESTION 6

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

No. See PG&E's reply comments to 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 procee ding 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. For the reasons discussed above and in PG&E's responses, the Commission should not make any adjustments to penalties due to anticipated tax e ffects or the timing of any fines or penalties.

In discussing its recommended penalty, TURN discusses the possibility that the Commission could either order PG&E to pay for certain specified categories of work or a fixed dollar amount.[34] To the extent actu al costs greatly exceed forecast costs, ordering PG&E to pay for a category of work rather than spend a particular amount of money would have the effect of increasing the total penalty imposed on PG&E. [35] As TURN points out, the Commission could "eliminate this source of uncertainty by disallowing a specific fixed dollar amount of expenditures, regardless of whether those costs were for the PSIP Phase 1 replacement work or other work on the gas transmission system, such as PSIP Phase 2."[36]

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[34] *See* TURN Responses at 6, 9-10.

[35] *See* TURN Responses at 6 (noting that there could be a significant difference between actual and forecast spending for any category of work).

[36] TURN Responses at 6; *see also id.* at 10 ("As discussed above, the Commission could eliminate this potential variance [between forecast spending for a disallowed category of work and PG&E's actual

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.

CPSD and TURN ask the Commission to disregard any effect that their proposed penalties could have on PG&E's cost of capital and ultimately on customer rates. TURN does not dispute that large fines and penalties could cause PG&E's cost of equity to increase, [37] but it argues that the elevated cost of equity likely would not last until the next cost of capital proceeding and therefore would not affect ratepayers. [38] TURN fails to take into account, however, PG&E's enormous equity needs going out many years into the future and the literally unprecedented size of the fines and penalties being proposed. Very few utilities have issued equity for any purpose in recent years, [39] and there is no evidence that a utility has *ever* issued equity for the specific purpose of paying a fine or penalty. In light of these unique circumstances, the Commission cannot assume that PG&E's cost of equity will not remain high for many years due to the risk premium PG&E will need to pay to raise capital. [40] Moreover, TURN disregards the potential harm to ratepayers and the communities PG&E serves if PG&E must cut back on capital expenditures because it cannot both pay excessive fines and penalties and make planned infrastructure improvements. Those cutbacks would harm customers, too, even though they might not have a direct effect on rates.

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spending] by disallowing a set amount (for example, $1 billion) in capital costs, irrespective of the nature of the work done by PG&E.").

[37] TURN Responses at 11-12 ("TURN does not disagree that there could be increased equity capital costs in the short term.").

[38] TURN Responses at 12.

[39] *See* Ex. Joint-66 at 25 (Figure 11) (PG&E/Fornell) (only four total marketed equity issuances in any amount in 2011 and 2012).

[40] *See* Joint R.T. 1448-49 (PG&E/Fornell) ("I think to the extent that a fine or penalty greatly exceeds what the investment community anticipates a fine will be, that will change the investment community's perception of the risk of investing in PG&E shares. It will affect their assessment of the risk of doing business in a political and regulatory environment that would [levy] a fine greater than what they anticipated. *So long-term consequence of that is that the cost of equity for PG&E would be increased. And that conceivably could have an impact on future earnings and rate cases.*") (emphasis added).

CPSD argues that PG&E's concern that its debt ratings would be under pressure if the Commission imposes an excessive fine is "directly contradictory to evidence in the record," noting that S&P and Moody's "have maintained their ratings on PG&E despite [their] anticipation of a substantial fine."[41] Not only does CPSD ignore Mr. Fornell's testimony,[42] the fact that S&P and Moody's have not yet lowered PG&E's ratings is not particularly informative since the Commission has not issued its penalty decision. Indeed, at the time of the S&P and Moody's statements referenced by Overland (and cited by CPSD), CPSD and Intervenors had not yet made their extreme and disproportionate penalty recommendations. To be sure, as CPSD points out, S&P and Moody's were anticipating "substantial" penalties.[43] In its statements quoted by Overland, Moody's said that it was expecting a "very sizable penalty," but that meant only that Moody's "'would not be surprised if the amount of penalty exceeded' the $200 million amount previously accrued by PCG."[44] For its part, S&P assumed that PG&E would "incur at least $1.7 billion in out-of-pocket costs and fines not recoverable in customer rates."[45] These amounts are, of course, dwarfed by CPSD's total recommended fines and penalties of $4 billion.[46]

TURN has repeatedly accused PG&E of "blackmail" in urging the Commission to consider the reaction of the investor community to fines and penalties in these proceedings.[47]

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[41] CPSD Responses at 11.

[42] *See, e.g.*, Ex. Joint-66 at 22 (PG&E/Fornell) ("Given the substantial emphasis put on the regulatory environment by credit rating agencies, a credit rating downgrade is possible in response to a fine or penalty in excess of expectations."); Joint R.T. 1620, 1633-34 (PG&E/Fornell).

[43] *See* CPSD Responses at 11.

[44] Ex. Joint-53 at 6 (CPSD/Overland) (quoting Moody's); *see also* CPSD Responses at 11.

[45] Ex. Joint-72 at 5 (S&P's PG&E Corp. report dated Dec. 17, 2012). The quoted passage immediately follows S&P's discussion of the Commission's PSEP decision (which S&P describes as "not . . . credit supportive"), making clear that the reference to "costs and fines not recoverable in customer rates" refers to *all* unrecoverable gas transmission costs, not only new fines and penalties in the San Bruno OIIs. *See id.*

[46] Even based on the *much lower* total fines, penalties and disallowances it anticipated, S&P "consider[ed] PG&E's financial risk profile to be significant" (Ex. Joint-72 at 7) and stated that it would lower PG&E's rating "if the business risk profile does not strengthen" (*id.* at 4). Moody's indicated that PG&E's rating could be downgraded if "there is meaningful cost recovery leakage over a multi-year period," as likely would be the case if CPSD's proposed penalties were adopted. *See* Ex. Joint-51 at 3 (Table 1) (CPSD/Overland) (quoting Moody's).

[47] *See* TURN Responses at 12 ("But the Commission should not be blackmailed by threats regarding investors' 'perception of the regulatory environment in California.'") (citation omitted); TURN Remedies

TURN ignores the fact that PG&E cannot control or limit third parties' responses to the Commission's decisions, and that investors and rating agencies will react based on their rational perceptions of the risks flowing from those decisions, not on TURN's wishful thinking. TURN also argues that there is "no basis for assuming any credit downgrade aside from the vague threat of a response by ratings agencies to a perception of increased regulatory risk."[48] In fact, the possibility of a downgrade if the Commission imposes excessive fines and penalties is well established in the record.[49] Because the ALJs denied PG&E's motion to reopen the record to introduce the more recent rating agency reports, PG&E is unable to quote the reports that reflect the rating agencies' reaction to CPSD's and Intervenors' penalty recommendations.[50] But, as TURN well knows, the possibility of a downgrade for PG&E (and other California utilities) is not a mere figment of PG&E's imagination and it is irresponsible to suggest it is. The Commission must consider all of the potential implications of its actions as it makes one of the most important decisions in its history.

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.

See PG&E's response to this question and the reply comments above.

SUPPLEMENTAL QUESTION IN ALJS' RULING REQUESTING CLARIFICATION FROM PG&E[51]

The ALJs' posed the following question in reference to PG&E's response to Question 3 in PG&E's Responses to Section 3 Questions, in which PG&E responded in part:

Brief at 39 ("The Commission should not be blackmailed by this self-serving threat from Wall Street investor analysts.").

[48] TURN Responses at 13.

[49] *See* Ex. Joint-66 at 22 (PG&E/Fornell); Joint R.T. 1620, 1633-34 (PG&E/Fornell); *see also* Ex. Joint-72 at 4, 7; Ex. Joint-51 at 3 (Table 1) (CPSD/Overland).

[50] *See* ALJs' August 1, 2013 Ruling.

[51] ALJs' Ruling dated Sept. 26, 2013.

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> For regulatory and GAAP purposes, PG&E will expense disallowed expenses as incurred. Fines a re recorded as below the line costs when imposed and do not affect PG&E's regulatory accounts.
>
> 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).

We request clarification of these answers from PG&E. Did PG&E mean to say that these expenditures (capital and non -capital) will be recognized for GAAP accounting purposes (1) based on when PG&E becomes liable to pay others for those items or (2) based o n when those expenses are disallowed. Please clarify your answer to this question as part of your reply comments due on October 7, 2013 and explain your answer in sufficient detail as to avoid any further ambiguity.

PG&E recognizes all operating expenses , whether allowed or disallowed, when the expense is incurred or, in other words, "when PG&E becomes liable to pay others for those items."

For capital, the accounting for GAAP purposes depends on whether PG&E has already incurred costs for the project at the time of the disallowance. If capital projects are disallowed prospectively, i.e., before PG&E has incurred any costs, PG&E will recognize the costs of the projects as they are incurred (as with operating expenses). For capital projects that PG&E has already begun at the time of the Commission decision disallowing some or all of the costs of the projects, PG&E takes an immediate charge for the amounts disallowed or the spending expected to exceed a regulatory cap (assuming costs above the cap are not r ecoverable), up to the amount already recorded on the balance sheet. An expected disallowance above the amount recorded on the balance sheet will be expensed in the period incurred.

To illustrate this with a hypothetical example: PG&E requests authorizat ion for a capital project forecasted to cost $1 million. While the Commission is considering PG&E's request, PG&E spends $200,000 on the project, and records these costs on its balance sheet as capital. The Commission subsequently approves the project, b ut places a cost cap of $700,000 (costs above $700,000 are not recoverable). In this example, PG&E expects the project to cost $1 million, but has only received approval for costs up to $700,000; the remaining $300,000 of costs are disallowed. PG&E will take a charge for $200,000 when it receives the Commission decision (as it has already incurred capital expenditures up to that amount), and will

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subsequently take a charge for the remaining $100,000 when the capital expenditure is incurred, i.e., "when PG&E becomes liable to pay others for those items."

Respectfully submitted,

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