ATTACHMENT A

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

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

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

[1] 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.

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."[2] 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)[3] 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.

CPSD's and Intervenors' recommended fines and penalties are extreme and disproportionate by any measure. Forty-eight states cap the penalty that may be assessed for a gas safety violation at $2 million or less. CPSD's recommendation would be nearly 40 times the largest penalty ever imposed for a natural gas pipeline accident in the United States.[4] It is almost five times the equity investment in PG&E's gas transmission and

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

[3] D.12-12-030.

[4] *See* PG&E Coordinated Remedies Brief at 22-23, 29 (El Paso Natural Gas explosion resulted in a total penalty of $101.5 million, including a $15.5 million fine and $86 million in remedial costs).

storage (GT&S) business in 2010 [5] and almost equal to the total GT&S revenues for the nine years prior to the San Bruno accident.[6] If PG&E's GT&S business were a standalone entity, it would have long since been bankrupt. When CPSD originally proposed a total penalty of $2.25 billion, it described it as "by far the largest penalty ever imposed on a public utility in the United States."[7] CPSD has since *increased* that recommendation by another $1.8 billion to bring the total to $4 billion.

The Commission does not need to use extraordinary fines and penalties to send a message to PG&E to make its system safer. Not only has PG&E already brought in new management and overhauled its gas operations, PG&E's shareholders have funded more than $900 million in improvements to the gas transmission system through the end of 2012 and are expected to spend a total of more than $2.2 billion before any additional fines and penalties.[8] By framing their recommended penalties in terms of "the maximum that PG&E can be required to pay without hurting its [] creditworthiness,"[9] CPSD and Intervenors are essentially asking to the Commission to impose fines and penalties on PG&E as if it had not yet committed any shareholder funds to gas transmission system improvements.

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 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.

CPSD and Intervenors offer no reliable evidence that PG&E could raise the amount of equity needed to fund the fines and penalties they recommend on top of

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[5] This is based on the 2010 recorded GT&S rate base of $1.6 billion times the authorized equity ratio of 52%. *See* San Bruno Ex. PG&E-10, MPO-7 at 26 (Figure 7-15) (PG&E/O'Loughlin).

[6] San Bruno Ex. PG&E-10, MPO-7 at 2 (Figure 7-1) (PG&E/O'Loughlin) (GT&S recorded revenues from 2002 through 2010 totaled approximately $4.2 billion).

[7] CPSD Reply Brief on Fines and Remedies at 1.

[8] San Bruno Ex. PG&E-1A, Chapter 13, Appendix C (PG&E/Yura); Ex. Joint-57 at 8, 13; Ex. Joint-58; Ex. Joint-65 at 2 (Table 1). *See also infra* notes 27-31 and accompanying text.

[9] CPSD Amended Reply Brief on Fines and Remedies at 3.

PG&E's planned capital expenditures. In fact, there is no evidence that any utility has ever issued equity for the express purpose of funding fines and penalties – much less fines and penalties in the billions of dollars. In evaluating CPSD's and Intervenors' recommendations, the Commission must weigh whether those parties advocating that the Commission impose the maximum financial pain on PG&E have considered the collateral damage that their approach could cause:

- Customers will have to pay for increases to PG&E's cost of capital: The need for PG&E to raise huge amounts of capital to fund fines and penalties as well as infrastructure improvements would raise its cost of equity and debt. Because of the higher risk premium that would be necessary to attract investors to PG&E securities, PG&E's annual revenue requirement could increase substantially due to increases in its cost of capital. Customers would have to shoulder these higher costs in the next cost of capital period.[10]
- PG&E may need to reduce capital expenditures because it cannot raise enough equity: PG&E may not be able to complete work intended to improve its gas and electric operations. This concern is not merely theoretical – both PG&E and Southern California Edison lost access to the capital markets during the energy crisis.
- PG&E would create fewer jobs: To carry out its planned capital expenditures, PG&E expects to employ tens of thousands of people, directly and indirectly. Reduced spending would mean fewer jobs.
- PG&E's suppliers would be hurt: PG&E spends billions of dollars annually with thousands of suppliers, including businesses owned by women, minorities and disabled veterans. These suppliers would feel the effect of cutbacks in PG&E's capital program.
- Other California utilities and their customers may face higher costs: The rating agencies may well revise their view of the California regulatory environment and review the ratings of all California utilities – not just PG&E – if the Commission adopts an excessive penalty in these OIIs. Downgrades

[10] *See* Ex. Joint-76 (responses to Questions 3 and 5).

of other utilities could lead to increased borrowing costs and higher rates for their customers. Equity investors would also need to be provided an incentive to invest in California and would require a higher return on equity, which would increase the cost of equity for the other California utilities as well.

- California's economy would be harmed: In addition to fewer jobs, an excessive penalty would add to the perception that California has a hostile climate for business investment.[11]

The Commission cannot afford to disregard these potential harms. It must ask itself: how would a multibillion dollar penalty affect California's energy future? In the aftermath of the San Bruno accident, the Commission quickly moved to establish its leadership in safety and infrastructure renewal. The Commission adopted new safety measures including the PSEP. The Commission has improved how it considers safety and risk in the ratemaking process through CPSD-directed safety and risk reviews in PG&E's 2014 General Rate Case. California Senate Bill 705 now requires the Commission and all California gas utilities to implement "best practices in the gas industry."[12]

In the three years since the San Bruno tragedy, California and this Commission have dramatically changed the paradigm for utility safety and made it one that will be a standard for the nation. PG&E is committed to these higher standards and has proactively undertaken enormous system improvements and infrastructure replacement – much of it at shareholder expense. CPSD's and Intervenors' proposals would represent a giant step backward if the practical effect is that PG&E cannot finance the improvements that the Commission and the state have called for and that PG&E has embraced.

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[13] – one of the largest investment plans among utilities. With

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[11] *See California's Utility Shakedown*, Wall St. J., Sept. 16, 2013, p. A18. In light of the ALJs' August 13 and September 16 rulings, PG&E is not quoting this article.

[12] Pub. Util. Code § 961(c).

[13] Ex. Joint-57 at 11.

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. With an adverse regulatory climate, few, if any, rational investors would put money in a California utility without a risk premium.

The continued success of a safety leadership vision for California requires a constructive regulatory environment. A $4 billion total penalty would be construed by potential investors and most other industry observers as a negative sign pointing to higher regulatory risk in California. As Mr. Fornell of Wells Fargo testified, a Commission decision significantly out of line with investor expectations could negatively affect the perception of the regulatory environment in California, and thus have an adverse impact on the debt ratings of all California utilities.[14]

PG&E understands the Commission will punish PG&E. But it must be done responsibly and with an eye toward creating a safe and secure energy future for the state and its nearly 40 million residents. Ten years ago, the Commission staff constructively worked with PG&E to resolve the bankruptcy caused by the energy crisis. In adopting the bankruptcy settlement, the Commission recognized that PG&E's creditworthiness and financial integrity were essential for it to be able to serve its customers. They still are.

[14] Although they are an important gauge of likely investor reaction, PG&E is not quoting the recent Standard & Poor's (S&P) and Moody's bulletins in light of the ALJs' August 13 and September 16 rulings. Some of these documents are publicly available. *See*, *e.g.*, Moody's Announcement, July 10, 2013, *available at* https://www.moodys.com/research/Moodys-Political-Risk-Increases-for-PGE-Californias-Largest-Utility--PR_277589; S&P Announcement, Aug. 28, 2013, *available at* http://www.standardandpoors.com/prot/ratings/articles/en/us/?articleType=HTML&assetID=1245356418795. (S&P requires users accessing its articles to register, but registration is free and available to the public.)

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 de termine 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 d epreciation 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 accelerate d 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 ab sorbed 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:

First, setting penalties and fines based on the maximum PG&E can afford to pay would disregard the constitutional mandate that fines and penalties not be excessive and it would be bad policy. The penalties recommended by CPSD and Intervenors are disproportionate by any measure. If the Commission imposes excessive fines and penalties on PG&E, investors would change their perception of the California regulatory environment and the risk of investing in PG&E – to the ultimate detriment of PG&E's customers. If the Commission further increases the amount of fines or penalties based on

assumptions about the availability of tax deductions (or requires PG&E to credit ratepayers the assumed amount of avoided taxes attributable to the tax deductions), it would only exacerbate the harm, particularly if those assumptions prove to be incorrect.

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.[15] DRA contends that not reflecting potential tax effects in fines and penalties would be a "windfall" for PG&E.[16] 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

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[15] *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).

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

similar penalty is complex. The tax aut horities have broadly applied the prohibition against any deduction for fines or similar penalties to include payments in lieu of a fine or similar penalty.[17] Some expenditures made by PG&E for disallowed capital and non - capital items, which are not paid t o 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 o ther 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 t reatment 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., ex penditures 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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[17] *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 defer red 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 effect s 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 res erve for these particular purposes. The normalization rules would be violated only if future tax depreciation were used to reduce ratemaking tax expense.[18]

SECTION 4, QUESTION 2

With regard to the timing of expenses and tax benefits:

a. What, if any, methodo logy 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 expense s 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 answ er to this question can be included the answers to Question 1.a. above.

a. This question appears to be based on the flawed premise that the ultimate penalty should be set at a level just short of destroying PG&E's ability to raise capital instead of in an amount commensurate with proven violations and fines and penalties that have been imposed in comparable situations. The approach advocated by CPSD and Intervenors is inconsistent with the constitutional requirement of proportionality and

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

disregards the f act that PG&E has already undertaken major improvements to its gas transmission system at shareholder expense. The Commission should reject any attempt to adjust fines and penalties upward based on purported tax or timing "benefits."

Furthermore, PG&E's a bility 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 nee ds 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.[19] 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.

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 write these capital expenditures off to expense and issue additional equity to fill the equity gap."[20] The Overland Report also contends that "the incremental external equity capital available to PCG is approximately $2.25 billion."[21]

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?

[19] 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.

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

[21] **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.[22] 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.[23] As Overland explained, its analysis focused on determining the maximum amount of equity PG&E could issue to fund any "nonrevenue producing" costs.[24] In other words, any equity the company needs to issue for costs "that would be the shareholder responsibility as opposed to any ratepayer responsibility"

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

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

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

would count toward the "threshold level" [25] – 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 comp any has incurred and is continuing to incur that are above and beyond whatever was in rates."[26]

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 th ose 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. CPSD's and Intervenors' proposals misapply Overland by disregarding huge amounts of shareholder costs that should be taken into account under Overland's approach to determining the maximum non-revenue-generating costs PG&E could absorb.

The Current Penalty Proposals Would Mean a Total Effective Penalty of At Least $4 Billion. CPSD's and Inte rvenors' penalty recommendations all fail to take account of the true financial impact on PG&E. P rior to any fines, disallowances or other penalties imposed in these proceedings, PG&E's shareholders have incurred or will incur approximately $2.2 billion in gas transmission safety-related costs. These costs consist of (1) PSEP expenses of approximately $600 million through 2012 [27] and forecast expense spending of approximately $300 million in 2013 and 2014; [28] (2) PSEP capital expenditures of $353 million; [29] and (3) other safety -related expense spending of approximately $1 billion (actual and forecast) above Gas Accord V adopted amounts. [30]

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

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

[27] San Bruno Ex. PG&E -1A, Chapter 13, Appendix C (PG&E/Yura). The shareholder spending amounts shown in this paragraph are based on the information in the record, which may not represent the final 2012 shareholder costs or the most current or precise forecasts of shareholder costs in 2013 and after. For example, the cost information presented in San Brun o Ex. PG&E -1A, Chapter 13, Appendix C for 2010 through 2012 is based on information compiled prior to year-end 2012. As PG&E has stated previously, if the Commission adopts a penalty that depends on the specific amount of costs incurred, it is PG&E's expe ctation that the Commission will review or audit those costs.

[28] Ex. Joint-57 at 8 (showing forecast unrecovered PSEP expenses in 2013 and using the low end of the range), 13 (showing these expenses continue in 2014).

[29] Ex. Joint-58 (table including disallowed capital expenditures).

[30] San Bruno Ex. PG&E -1A, Chapter 13, Appendix C (PG&E/Yura) (showing integrity management and other non-PSEP expense spending of $179 million); Ex. Joint -65 at 2 (Table 1)

PG&E is also incurring additional shareholder costs outside the gas transmission operations.[31]

Based on these shareholder costs, CPSD's recommendation, for example, represents an effective penalty of approximately $4 billion in fines and gas transmission shareholder costs:

Impact of CPSD's Penalty Proposal
(In Millions of Dollars)

	Current CPSD Proposal
Fine	$300
PSEP Disallowance	$435
Refund of Authorized PSEP Revenues	$1,169
Additional Disallowed Gas Transmission Expenditures	$346
Total Penalty per CPSD[32]	**$2,250**
Remaining Shareholder Funded PSEP Costs and Gas Accord V Expenses[33]	~1,750
Total Effective Penalty for Gas Transmission	**~$4,000**

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."

(additional gas transmission expenses included in referenced $250 million above authorized levels in 2012 and 2013); Ex. Joint-57 at 8 (showing costs of emerging work in 2013 and using the midpoint of the range), 13 (referencing emerging work in 2014 and beyond).

[31] Ex. Joint-65 at 2 (Table 1) (referencing expense spending above authorized amounts for core operations in 2012 and 2013); Ex. Joint-58 (showing contribution to City of San Bruno of $70 million).

[32] *See* CPSD Amended Reply Brief on Fines and Remedies at 4.

[33] This amount is calculated as follows (rounding down): Total shareholder gas transmission costs shown above of approximately $2.2 billion less $435 million.

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.[34]

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"[35] or how they would be treated from a "ratemaking perspective."[36] 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.[37] 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.

A Disproportionately Large Penalty Will Increase the Risk of Investing in PG&E and California Utilities Generally. CPSD's and Intervenors' recommended fines and penalties are so extreme and disproportionate that, if adopted, they would have a negative impact on the market's perception of the regulatory environment in California. Mr. Fornell of Wells Fargo, who has decades of experience working for leading utility equity

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

[35] *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").

[36] *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).

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

underwriters,[38] testified that if the Commission imposes a penalty that is both significantly larger than expected and is perceived to be excessive, investors will reassess their perception of the regulatory environment in California and the risk of investing in PG&E.[39]

The Commission should consider the reaction of the rating agencies to CPSD's penalty proposal because their reaction is an important indicator of how the capital markets will respond if the Commission adopts CPSD's or another comparable penalty. There is no dispute that "[t]he perceived quality of the regulatory environment in which a utility operates is among the most important factors affecting the utility's ability to attract capital at reasonable rates."[40] According to S&P, "regulatory risk is perhaps the most important factor" in assessing a utility's overall business risk.[41] The regulatory environment and the utility's ability to recover costs determine 50 percent of Moody's ratings.[42] If the Commission imposes a disproportionate penalty on PG&E, the reaction of the investment community is likely to be negative.

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. PG&E projects capital expenditures in excess of $5 billion annually from 2013 through 2016.[43] 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

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[38] Mr. Fornell's employer Wells Fargo is a leading underwriter of utility equity and debt securities. Ex. Joint-66 at 2-3 (PG&E/Fornell). Mr. Fornell personally has 23 years of experience as an investment banker focused on utilities and energy sectors. Joint R.T. 1553 (PG&E/Fornell); Ex. Joint-66 (PG&E/Fornell) (Mr. Fornell's resume is attached on the last page). Among other relevant experience, Mr. Fornell served as the lead for one of the largest equity offerings ever by a U.S. utility (while he was employed by J.P. Morgan). Joint R.T. 1537-40 (PG&E/Fornell).

[39] Ex. Joint-66 at 19, 21-22 (PG&E/Fornell); Joint R.T. 1448-49 (PG&E/Fornell).

[40] Ex. Joint-60 (data request response in which Overland identified "legitimate points" made in Mr. Fornell's report).

[41] Ex. Joint-66 at 10 (PG&E/Fornell) (citing S&P's "Assessing U.S. Utility Regulatory Environments," Todd A. Shipment, p. 2, Nov. 7, 2007).

[42] Ex. Joint-66 at 10-11 & Figure 5 (PG&E/Fornell).

[43] 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.[44] 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.[45] Only three of the 30 utility equity offerings since 2008 were larger than $600 million.[46] 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.[47] Unlike PG&E, however, they used the proceeds principally to fund major acquisitions with an associated return for investors.[48] 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."[49] 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.

Utility investors, including PG&E's, tend to be relatively risk-averse and value stable, predictable returns.[50] Utilities that operate in a regulatory environment where they earn reliable returns on invested capital are more likely to represent an attractive risk-return tradeoff for utility investors.[51] If CPSD's or a similar recommendation is adopted,

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

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

[46] 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).

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

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

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

[50] Ex. Joint-66 at 6-7 (PG&E/Fornell).

[51] Ex. Joint-66 at 6, 9-10 (PG&E/Fornell).

PG&E would be asking investors for billions of dollars to pay fines and penalties in what would likely be perceived as a much riskier regulatory climate and without offering any return. CPSD and Int ervenors are effectively telling the Commission to trust their assertion that PG&E will have no trouble raising the money to fund their recommended penalties and fines. But they cannot point to a single real world example of a utility that has been able t o shoulder a similar burden. Instead, they are asking the Commission to put its faith entirely in Overland's flawed theoretical analysis, which itself found that PG&E cannot sustain total penalties and unrecovered costs of more than $2.25 billion.

As a practical matter, if the Commission imposes excessive fines and penalties, PG&E would need to raise huge amounts of equity to fund those fines and penalties in addition to what it needs for planned infrastructure improvements. It would need to do this in an unreceptive market that would perceive significant regulatory risk. PG&E may not be able to raise all the equity it needs, and may need to defer capital expenditures intended to improve the safety and reliability of its systems. This would not be by choice. The market would dictate this regrettable outcome as there is a limited amount of equity capital available to PG&E or any other company for uses that generate no return.

An Excessive Penalty Would Raise PG&E's Cost of Capital. Investors have choices where to invest their money and PG&E must compete for their capital. An excessive penalty, and the implications of a decision by the Commission to adopt such a penalty, would increase PG&E's cost of equity as investors would require additional compensation to invest in a company whose regulatory environment they would perceive as unpredictable, adverse and excessively punitive. Higher equity costs would be passed on to customers in the next cost of capital proceeding.

A Disproportionate Penalty May Lead to a Rating Downgrade and Higher Debt Costs. If the Commission adopts CPSD's or a similar penalty recommendation it is possible that PG&E could be downgraded to below investment grade. Overland testified that "[t]he utility industry is one of the m ost capital intensive industries in the country. Large capital investments require financing, so access to the capital markets (both debt and equity) is critical."[52] Investment grade credit ratings are important "to ensuring on an ongoing basis that PG&E can reliably and efficiently raise capital to finance construction

[52] Ex. Joint-53 at 4 (CPSD/Overland); *see also* Ex. Joint-66 at 12 (PG&E/Fornell).

of new infrastructure, accommodate seasonal fluctuations in cash collections and disbursements, and meet its obligations to serve customers."[53] Sub-investment grade companies, including utilities, have limited access to capital, especially during times of financial markets distress.[54] The Commission has concluded that "adopting a long-term goal of maintaining and improving PG&E's credit ratings is good public policy."[55] The Commission should carefully consider the effect its decision may have on the credit ratings of PG&E and the other California utilities.

Any downgrade would have significant negative ramifications for PG&E, including higher borrowing costs, potentially losing access to debt markets, and incremental collateral obligations.[56] Just as PG&E needs large amounts of equity to fund planned capital improvements, it is also forecasting very substantial debt issuances each year from 2013 through 2016.[57] Higher debt costs would be passed on to customers in the next cost of capital proceeding. More immediately, customer rates could be increased through PG&E's annual ERRA proceedings to reflect higher short-term borrowing costs, higher procurement costs, and higher collateral costs.[58] Customers would also be harmed if PG&E needs to defer planned infrastructure improvements due to the cost or unavailability of debt financing. As a matter of policy, the Commission should consider recent rating agencies reports and comments regarding the risk of a potential downgrade.

Any Methodology to Set Fines and Penalties Must Take Into Account the Costs That Shareholders Are Already Bearing. 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 must take into account all of the costs PG&E's shareholders have incurred or will incur to

[53] D.03-12-035 (*mimeo*) at 42.

[54] Ex. Joint-66 at 12 (PG&E/Fornell).

[55] D.03-12-035 (*mimeo*) at 44.

[56] *See* Ex. Joint-66 at 12-14 (PG&E/Fornell).

[57] Ex. Joint-66 at 17 (Figure 8) (PG&E/Fornell) (providing amounts of PG&E's forecast debt issuances).

[58] *See* Ex. Joint-66 at 13-14 (PG&E/Fornell) (discussing collateral obligations to support purchase commitments).

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 realistic ally can issue to fund new fines and penalties.

CPSD and Intervenors – not PG&E – have framed the issue as: how much equity can PG&E raise to fund fines and penalties? This approach is flawed for the reasons discussed above. But, if that is the perspective the Commission adopts, it is impossible to disregard PG&E's other shareholder costs that also must be financed. The focus cannot be solely on new fines and penalties. Rather, the Commission must treat *all* shareholder expenditures to improve PG&E's ga s 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.[59]

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. CPSD and Intervenors want it both ways – they urge that PG&E be penalized up to the financial brink but they also want to ignore PG&E's costs that are not explicit penalties imposed by the Commission even though those costs also must be financed. Their position is contrary to Overland,[60] illogical and untenable.

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 rates, all shareholder expenditures should count toward the penalty amount, without

[59] 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 Commi ssion to be included in rates .* If they had been, they would not be paid by shareholders.

[60] TURN contends that Overland testified PG&E's spending of the PSEP contingency should not be counted toward the "threshold" amount of equity, but that is not corre ct. *See* TURN Reply to PG&E Response to CPSD Amended Reply Brief on Fines and Remedies at 7. Specifically with regard to the contingency, Overland agreed that, "from an investor standpoint, if PG&E actually spends that money and it is not recoverable in r ates, [it does not matter] whether it's a penalty or simply an unrecovered cost because the Commission decided PG&E hadn't satisfied whatever burden of proof it felt needed to be satisfied." Joint R.T. 1432 (CPSD/Overland).

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 co sts 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. [61] 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 sha reholders as opposed to ratepayers, it agreed that "the Commission, of course, will ultimately sort this out."[62]

SECTION 4, QUESTION 4

Are there any other factors that require adjustment of the nominal dollars of any disallowed expenditures so that the imp act 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,

[61] *See* TURN Reply to PG&E Respon se to CPSD Amended Reply Brief on Fines and Remedies at 7 (referring to "speculative future forecast costs"). Continuing a point raised by Overland, TURN also argues that whether a cost is borne by shareholders ultimately depends on whether PG&E "earned m ore or less than its authorized rate of return." *Id.* at 8. Even assuming this is correct, it does not argue against counting all shareholder costs toward Overland's $2.25 billion. PG&E could provide information about its returns (or otherwise demonstrate that its shareholders in fact paid the identified costs) in any review or audit of its shareholder expenditures. Furthermore, Overland could not have known whether PG&E earned more or less than the authorized return in 2012 when it testified on March 4, 2013 (*see* Joint R.T. 1425 (CPSD/Overland)), as PG&E had not even completed its 2012 Statement of Earnings by that date. PG&E's 2012 Statement of Earnings is now complete and would show whether PG&E earned more or less than the authorized rate of return.

[62] 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).

identify those factors and the methodology t hat should be used to make the adjustment(s).

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

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. 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.

SECTION 4, QUESTION 6

Should the CPUC adopt a methodol ogy 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 disal lowed 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 P G&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 explaine d 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 C ommission'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 t hose 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 st ep 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. [63] Proportionality is the touchstone of the inquiry under the Californi a Constitution's Excessive Fines Clause.[64] At a total of $4 billion, CPSD's new proposed penalty is nearly 40 times the largest penalty ever imposed for a natural gas pipeline accident (one in which 12 people died).[65] It is also almost five times the equit y investment in PG&E's GT&S business in 2010[66] and almost equal to the total GT&S revenues for the nine years prior to the San

[63] *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).

[64] Cal. Const. art. I, § 17. *See People ex rel. Lockyer v. R.J. Reynolds Tobacco Co* ., 37 Cal. 4th 707, 728 (2006).

[65] *See* PG&E Coordinated Remedies Brief at 22-23.

[66] This is based on the 2010 recorded GT& S rate base of $1.6 billion times the authorized equity ratio of 52%. *See* San Bruno Ex. PG&E-10, MPO-7 at 26 (Figure 7-15) (PG&E/O'Loughlin).

Bruno accident.[67] In addition to this empirical evidence, CPSD's self-professed desire to inflict the maximum possible pain demonstrates that proportionality plays no role in CPSD's recommendation.

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.

CPSD has stated that, as a matter of law, only fines payable to the State's General Fund may be imposed under California Public Utilities Code §§ 2100, *et seq*.[68] If the Commission adopts CPSD's position, it should not impose a large fine payable to the General Fund. Such a fine would not help customers and would not provide any more of a deterrent for PG&E than the huge amount of shareholder costs that it is already incurring, without any penalties imposed in these OIIs. As discussed above, PG&E has already spent, or is forecast to spend, approximately $2.2 billion in shareholder funds to improve the gas transmission system.

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. CPSD's revised penalty recommendation, for example, purports to be consistent with Overland's testimony that the maximum amount

[67] San Bruno Ex. PG&E-10, MPO-7 at 2 (Figure 7-1) (PG&E/O'Loughlin) (GT&S recorded revenues from 2002 through 2010 totaled approximately $4.2 billion).

[68] CPSD Amended Reply Brief on Fines and Remedies at 5.

of incremental equity PG&E could issue to fund any unrecovered or unrecoverable costs is $2.25 billion. In fact, CPSD includes only $435 million out of a total of $1.25 billion in PSEP -related shareholder costs and entirely disregards approximately $1 billion in spending above Gas Accord V amounts.

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 disre gards 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.

An Excessive Penalty Could Have Significant Ramifications Beyond Its Effect on PG&E's Shareholders. The total amount of costs that would be imposed on PG&E as a result of any fines or penalties, including the costs PG&E's shareholders are alread y incurring, is an important factor for the Commission to consider in comparing alternative fines and penalties. If CPSD's recommendation, for example, is adopted, PG&E's shareholders will be required to pay approximately $4 billion in total fines and pen alties relating to the gas transmission business. The higher the fines and penalties, the more likely that they would have negative repercussions, which could include:

- PG&E may need to curtail capital expenditures : As explained above, PG&E simply may not be able to raise enough equity to fund penalties and planned capital expenditures. Putting PG&E in the position of having to defer capital expenditures intended to improve the safety and reliability of its systems would be contrary to the message that th e Commission should want to send in its decision in these proceedings. This is particularly true if PG&E would need to reduce capital expenditures to pay a large fine to the State's General Fund.
- Customers would have to pay for increases to PG&E's cost of capital: Another likely outcome would be that PG&E's cost of capital would go up significantly. These higher financing costs would be passed on to customers in PG&E's next cost of capital proceeding (or possibly sooner if PG&E brings

an emergency cost of capital case).[69] CPSD and Intervenors may argue that PG&E's shareholders should have to shoulder any increased financing costs, but they would fail to recognize that prospective investors would simply take their money elsewhere and the market for PG&E's equity and debt might dry up.

- Reduced capital expenditures would mean fewer jobs: PG&E has one of the largest capital investment plans in the utility industry. To carry out its planned investments in 2014 through 2016, PG&E expects to employ tens of thousands of people, directly and indirectly. If PG&E is forced to cut back on planned capital expenditures, the result would be fewer jobs across PG&E's service area.
- PG&E's suppliers would be hurt: PG&E spends billions of dollars each year with thousands of suppliers, including small and medium-sized businesses owned by women, minorities and disabled veterans. These businesses – some of which rely on PG&E for a large share of their revenue – would feel the ripple effect of PG&E reducing capital expenditures and other costs.
- Other California utilities and their ratepayers may face higher costs: S&P and Moody's may review the ratings of all California utilities if the Commission adopts CPSD's extreme recommendation, as that would indicate a significant deterioration in the regulatory climate in California. Any downgrades of other utilities could increase borrowing costs for those utilities or lead them to reduce capital expenditures with the same negative effects as for PG&E and its customers. Equity investors would also need to be provided an incentive to invest in California and would require a higher return on equity, which would increase the cost of equity for the other California utilities.
- An excessive fine would be a major disincentive to invest in California: California's business climate is already widely regarded as one of the nation's least attractive, in large part due to what is perceived as onerous regulation. If

[69] *See* Ex. Joint-76 (responses to Questions 3 and 5). As noted above, customer rates also could be increased through PG&E's annual ERRA proceedings to reflect higher short-term borrowing costs, higher procurement costs, and higher collateral costs.

the Commission adopts CPSD's or a similar proposal, it would be a further warning sign to investors and companies considering doing business in California to stay away.

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

Respectfully submitted,

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