

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA



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Order Instituting Rulemaking on the
Commission's Own Motion to Adopt New
Safety and Reliability Regulations for
Natural Gas Transmission and Distribution
Pipelines and Related Ratemaking
Mechanisms.

Rulemaking 11-02-019
(Filed February 24, 2011)

**DIVISION OF RATEPAYER ADVOCATES
REPLY COMMENTS ON PROPOSED DECISION**

KAREN PAULL
TRACI BONE
MARION PELEO
Attorneys for the Division of
Ratepayer Advocates

California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102
Phone: (415) 703-2130
Fax: (415) 703-2262

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I. INTRODUCTION

In accordance with Rule 14.3 of the Rules of Practice and Procedure of the California Public Utilities Commission and with the procedural schedule set by Administrative Law Judge (ALJ) Bushey, the Division of Ratepayer Advocates (DRA) submits these reply comments on the ALJ's Proposed Decision (PD) on the Pipeline Safety Enhancement Plan (PSEP) of Pacific Gas and Electric Company (PG&E).

PG&E's comments on the PD demonstrate that it is still in "business as usual" mode, and will not change without a substantially more engaged type of regulation than has been the norm for a long time. PG&E's decades of mismanagement of its gas pipeline system – in a misguided effort to increase profits – went on for many years and resulted in one of the most tragic accidents in gas pipeline history. The fundamental organizational changes in PG&E's management that the National Transportation Safety Board found necessary cannot be implemented overnight.¹ PG&E needs to be put on probation, if you will, until it has demonstrated to the Commission and to the public that it is operating its gas system responsibly and as required by law.

PG&E says safety is now its highest priority, but has refused to acknowledge real problems with its safety plan identified by the experts in this case. Instead of addressing those problems by doing a little more work on its plan, PG&E focuses, once again, on money. PG&E praises the "thorough and thoughtful" review reflected in the PD -- even though the PD approves the technical aspects of PG&E's pipeline safety proposal with almost no consideration of the flaws identified in the expert testimony presented by DRA and intervenors. PG&E then turns to the money it seeks to recover, devoting almost all of its comments to arguing that the "significant" disallowances in the PD are "without substantial evidentiary support, and are arbitrary and capricious."²

With regard to the money, it is difficult to say which is more troubling: PG&E's laser-like focus on getting ratepayers to pay as much of the PSEP costs as possible, or the misrepresentations it makes in the process. In either case, PG&E's assertions that the PD has committed legal and/or factual error with regard to the disallowances are misplaced. The

¹ See National Transportation Safety Board Report, available at <http://www.nts.gov/doclib/reports/2011/PAR1101.pdf>.

² R.11-02-019, Opening Comments of Pacific Gas and Electric Company on Proposed Decision (PG&E Opening Comments), Nov. 16, 2012, pp. 1-3.

disallowances in the PD are fully justified by the evidence – in fact, the record supports greater disallowances, as DRA argued in its opening comments.

Notwithstanding PG&E’s nearly exclusive focus on rate recovery, the Commission should focus on safety. Specifically, the PD should be modified to address the safety issues with PG&E’s plan addressed by DRA and other intervenors. The Plan should be corrected as recommended by independent pipeline experts in this proceeding, and implementation should be overseen by an Independent Monitor until successful completion of Phase 1 of the PSEP.

II. THE COMMISSION SHOULD NOT BACK DOWN ON ALLOCATING COSTS TO SHAREHOLDERS

PG&E’s assertion that “a fair share”³ of the PSEP work is to meet new, higher standards is not supported by the record.

A. One-Way Balancing Account and Changes to Scope of Phase 1

PG&E argues that “the Commission should not require that the cost limit of the balancing account be reduced where PG&E does not need to perform a particular project at all, but instead allow those cost savings to offset cost overruns which PG&E expects through the end of 2014.”⁴ Thus, PG&E proposes that the strength-testing and replacement budget not be reduced, even where pipeline records are found that obviate the need to test or replace, and instead use the funds to cover PG&E’s cost overruns. This approach is completely at odds with PG&E’s repeatedly stated position that it is only asking ratepayers to pay for work that is actually done, and provides a disincentive to make safety-related improvements in a cost-effective manner.

B. Disallowance of 2012 Costs

PG&E complains that the PD’s disallowance of 2012 PSEP costs is “unreasonable, arbitrary and capricious” because the Commission authorized a pipeline safety memorandum account for Southern California Gas Company and San Diego Gas & Electric Company (jointly, Sempra) in D.12-04-021 and “[t]here is no rational basis on which to distinguish PG&E from Sempra....”⁵ It is entirely rational and good decision-making to tailor ratemaking treatment to

³ PG&E Opening Comments, p. 1.

⁴ PG&E Opening Comments, p. 25.

⁵ PG&E Opening Comments, p. 11.

respond to the fact that the San Bruno explosion occurred in PG&E's service territory, and the ensuing investigations revealed decades of mismanagement and neglect by PG&E of its gas operations, despite more than adequate ratepayer funding.⁶ The PD properly recognizes that "the need for urgent pre-Commission approval action was caused at least in part by PG&E's own actions, and ... PG&E ... used the rule prohibiting retroactive rate adjustments to retain substantial benefits in the past."⁷

PG&E is also wrong that the PD's disallowance of its 2012 valve automation costs violates Public Utilities Code § 957(b). Section 957 requires the Commission to first approve a valve location plan and only requires reimbursement of costs "incurred for implementation of" the approved plan. PG&E is not entitled to rate recovery for activities that PG&E undertook before the Commission approved a plan under § 957. That is a decision that is within the Commission's discretion. Further, PG&E's plan, and the PD's approval of it, fail to comply with the basic requirements of § 957. To correct this legal error, PG&E should be required to develop a plan consistent with § 957 that properly balances costs with public safety, based on a record that has not yet been developed in this case.

C. Disallowance of Recordkeeping Costs

PG&E fails to show any legal, technical or factual error in the PD's disallowance of costs associated with PG&E's Gas Transmission Asset Management Program (GTAM). Contrary to PG&E's arguments that the GTAM is something new,⁸ the PD's conclusion that GTAM is a remedial effort caused by PG&E's past recordkeeping failures is amply supported by the record evidence. DRA and other parties have shown that the "traceable, verifiable and complete" requirement is not a new record-keeping standard, PG&E has failed to meet such standard for decades, and PG&E's recordkeeping failures contributed to the San Bruno explosion.⁹ Meanwhile, PG&E has received ample funding in its rate cases to pay for GTAM and other data management programs.¹⁰ Moreover, PG&E's GTAM proposal contains many deficiencies in its

⁶ See DRA Opening Brief, pp. 25-49.

⁷ PD, p. 84.

⁸ See PG&E Opening Comments, pp. 16-19.

⁹ See DRA Opening Brief, pp. 25-41.

¹⁰ See DRA Opening Brief, pp. 41-49.

forecasts of costs.¹¹ Accordingly, PG&E has failed to show that its proposed rate increase is just and reasonable.

D. Disallowance of Contingency

Both PG&E¹² and Sempra¹³ argue against the PD's denial of a contingency budget, primarily by reiterating fallacious arguments that the Assigned Commissioner and ALJ have already considered and rejected. Both companies fail to identify any true legal, technical or factual error in the PD on this issue.

The PD recognizes that baseline budgets and contingency are inextricably linked within a cost estimate.¹⁴ However, regardless of how the authorized budget is determined, there will ultimately be a hard budget authority cap equal to the baseline budget plus any authorized contingency, and DRA provided evidence supporting a total budget authority much lower than provided by the PD.¹⁵ The PD adopts the approach of establishing the authorized program budget by tying the two together (in effect, including a contingency by approving costs at the level requested by PG&E, which the record shows are order of magnitude higher than the cost estimates by multiple expert witnesses) given the record evidence that PG&E's cost estimates are inflated and that its contingency analysis is inconsistent with industry and Commission standards and fatally flawed.¹⁶ However, to the extent the Commission agrees with DRA's Opening Comments on the PD, another approach would be to adopt more reasonable program costs and a separately-stated contingency.

¹¹ See DRA Opening Brief, p. 49, and Exhibit 148, DRA Direct Testimony, Chap. 8/Godfrey.

¹² See PG&E Opening Comments, pp. 4-8.

¹³ See Opening Comments of Southern California Gas Company and San Diego Gas & Electric Company on Proposed Decision Mandating Pipeline Safety Implementation Plan, Disallowing Costs, Imposing Earnings Limitations, Allocating Risk Of Inefficient Construction Management to Shareholders, and Requiring On-Going Improvement In Safety Engineering (Sempra Opening Comments), Nov. 16, 2012, pp. 21-24.

¹⁴ Exhibit 2, PG&E Direct Testimony, p. 7-44, Table 7-9 shows a relationship between AACE Estimate Class and contingency.

¹⁵ Exhibit 144, DRA Direct Testimony/Roberts, p.111. Table 17 shows the 2011-2014 baseline pipeline modernization budgets authorized for rate recovery should be reduced from \$1,357.3 million to \$563 million. With DRA's recommended default contingency rate of 8%, the total budget would be \$608 million. This is roughly half of the budget approved in the PD for comparable scope: \$1,212 million. See PD Attachment E, Table E-4, line 1.

¹⁶ See DRA Opening Brief, pp. 110-117.

The PD properly recognizes that PG&E's cost estimates are inflated,¹⁷ but the record supports more significant cost reductions. PG&E's claims that its cost estimates are superior to others have no merit.¹⁸ PG&E's baseline estimates were unsupported, thereby contradicting industry cost estimating standards.¹⁹ They were also primarily based on the experience of outside consultants rather than California or PG&E-specific experience.²⁰ PG&E's own witness admitted that "neither one of us [PG&E or Gulf] had a lot of experience in pressure testing existing pipelines."²¹ In contrast, DRA provided both a high level analysis of gas industry data and a detailed "bottom up" analysis from an expert pipeline engineer with experience spanning four decades, multiple continents, and both on- and off-shore projects.²² PG&E also grossly misinterprets the PD, which refers to DRA's expert testimony as "thorough"²³ rather than "flawed."²⁴ In addition, DRA's analysis in the Sempra case demonstrated that water-related costs represent over 75% of Sempra's requested hydrotest costs excluding contingency,²⁵ and how proper management of these costs could lead to hydrotest costs even lower than DRA's estimated costs in the PG&E case.²⁶ DRA's analysis of water disposal costs in the Sempra case is relevant to the PG&E case because a large component of PG&E's estimated hydrotest costs is

¹⁷ See PD, pp. 100-101.

¹⁸ See DRA Opening Brief, pp. 67-110.

¹⁹ For example, PG&E Exhibit 16, ACEE Recommended Practice 34R-05, p. WP 7-32, states that a basis of estimate (BOE) should "be factually complete" and "able to support your facts and findings." DRA documented many incomplete and unsupported cost elements of PG&E's BOE.

²⁰ See DRA Opening Brief, pp. 103-105.

²¹ 11 RT 1405, ll. 25-27, Hogenson/PG&E.

²² Analysis of gas industry data was provided by DRA Witness Scholz in Exhibit 147, and PG&E criticism of this testimony was rebutted in DRA Opening Brief, pp. 97-100. Bottom-up calculations were provided by DRA Witness Delfino in Exhibit 146, and PG&E criticism of this testimony was rebutted in DRA Opening Brief, pp. 100-102.

²³ PD, p. 70.

²⁴ PG&E Opening Comments, p. 7.

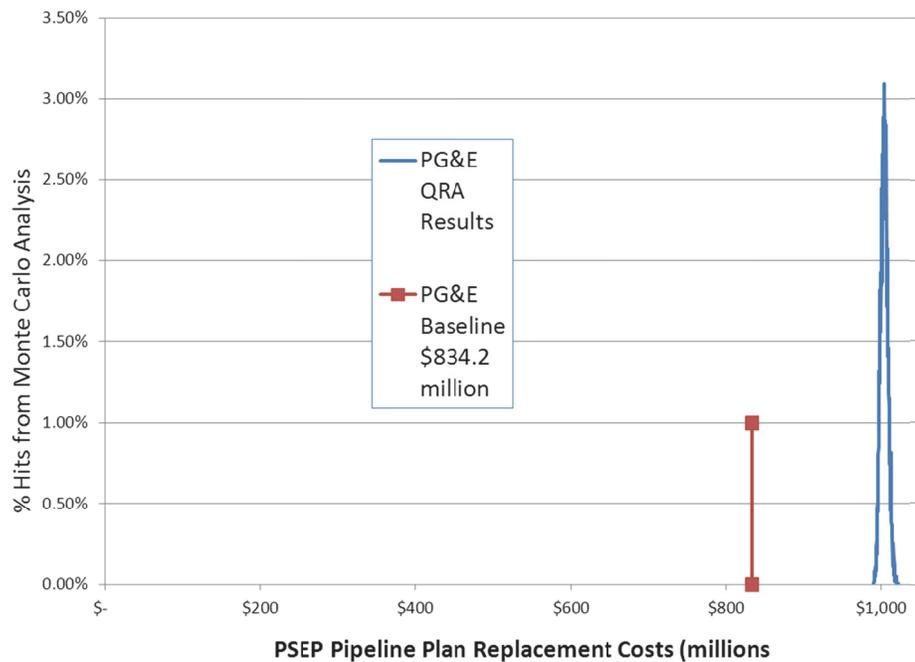
²⁵ DRA Opening Brief in A.11-11-002, p. 82.

²⁶ See A.11-11-002, Exhibit DRA-3, Opening Testimony of DRA Witness Roberts. Figure 3 on page III-11 shows that Sempra's proposed variable hydrotest costs were lower than PG&E's for small diameter pipes. DRA's analysis showed that Sempra's variable costs should be less than \$25 per barrel rather than approximately \$94 per barrel as proposed. See also p. IV-26 and DRA workpaper TCR WP-2. DRA requests that the Commission take official notice of this testimony in the instant proceeding. Sempra's PSEP was originally within the scope of this proceeding but was transferred to A.11-11-002. See Assigned Commissioner's Ruling of December 21, 2011, in R.11-02-019 and A.11-11-002.

based on a presumed need to clean pipeline *prior* to testing.²⁷ PG&E claims that additional cleaning runs led to even higher costs in 2011,²⁸ and yet DRA showed that treating the water *after* testing is much more cost-effective and is viable in most test locations.²⁹

The record also shows that PG&E’s quantitative risk analysis (QRA) was fundamentally flawed: it assumed zero probability that actual program costs could be *less* than PG&E’s baseline estimate.³⁰

DRA Table 1 – Program Costs Cannot Be Less Than PG&E Baseline Estimates



Thus, the record shows that PG&E “misdesigned” the QRA, padded the baseline estimates, or both. Both practices contradict common sense and industry guidance.³¹

Sempra states that “a scarcity of essential skilled labor and/or materials” could drive up construction costs” but provided no evidence supporting this point in either case.³² PG&E

²⁷ Exhibit 144, DRA Direct Testimony/Roberts, Figure 11, p.75.

²⁸ PG&E Opening Comments, p.7.

²⁹ DRA Opening Brief in A.11-11-002, p.88 specifically and pp. 85-90 generally. Post-test water treatment was also discussed in the PG&E case in DRA Opening Brief, pp.86-89.

³⁰ Exhibit 144, DRA Direct Testimony/Roberts, Figure 16, p.102.

³¹ DRA Opening Brief, pp. 111-113. See also Exhibit 16, DOE Cost Estimating Guide: “Estimators should refrain from buying contingency or unnecessary allowances,” p. WP 7-252.

³² Sempra Opening Comments, p. 23.

argues that project management office (PMO) costs are not a substitute for contingency, but correctly notes that “these PMO costs cover the essential management structure to deliver the component projects of the PSEP in a timely, **cost effective** and high quality manner.”³³ Indeed, PG&E’s PMO testimony and contingency testimony were provided by the same consultant, who stated that “PG&E is taking a proactive management approach to achieve the aggressive Program objectives while managing the inevitable risks the Program will face as it proceeds through its life cycle.”³⁴ PG&E’s statement that an effective PMO helps reduce or avoid cost overruns is consistent with the PD’s finding that an investment of \$34.8 million for PMO expenditures, on top of separate charges for construction, project, and engineering management, will help ensure program work can be completed within the adopted baseline budget.³⁵

Finally, PG&E’s statement that its estimate for hydrotest costs “ranged from \$760,000 to \$850,000 per mile”³⁶ mischaracterizes its own rebuttal testimony³⁷ and is also inconsistent with PG&E’s direct testimony, which gave a range from \$248,000 to \$14 **million** per mile.³⁸ The statement in PG&E’s opening comments is, however, consistent with DRA’s analysis that the PD’s estimate of hydrotest costs at \$95.80 per foot (\$505,582 per mile) is too low.³⁹

The record supports *both* lower baseline costs *and* a lower contingency rate than those proposed by PG&E, which together justify a lower total program budget than approved in the PD. An accurate baseline budget based on well-supported evidence, as provided by DRA, coupled with an 8% contingency rate, in lieu of an accurate QRA (which PG&E failed to provide), would result in a lower budget for PG&E’s PSEP than that approved in the PD. Accordingly, it would be arbitrary and capricious to increase the proposed budget as PG&E requests.

³³ PG&E Opening Comments, p. 5, emphasis added.

³⁴ Exhibit 2, Direct Testimony of Price Waterhouse Cooper (PwC) consultants, p.7-1, lines 11-13.

³⁵ See DRA Opening Brief, pp. 84, 91.

³⁶ PG&E Opening Comments, p. 7.

³⁷ Exhibit 21, PG&E Rebuttal Testimony, p.4-2 gives approximate costs for two size ranges of pipes.

³⁸ Exhibit 2, p.3-42, costs of \$47 to \$2,646 per foot multiplied by 5280 feet per mile.

³⁹ DRA Opening Comments, Appendix B.

E. ROE Reduction

Contrary to PG&E’s assertions,⁴⁰ there is nothing illegal about the PD’s time-limited reduction of PG&E’s return-on-equity (ROE) for Phase 1 capital investments. It is consistent with ratemaking principles, within the Commission’s ratemaking authority and furthers the policy goals of this rulemaking, and is in the public interest. Reducing PG&E’s authorized ROE appropriately “reflects PG&E’s poor management of its natural gas transmission system.”⁴¹ It mitigates the impact of the investment on ratepayers in a relatively small way while allowing PG&E to recover its costs during the reduction period, thereby striking an equitable balance between ratepayers and shareholders.⁴²

F. Escalation Rate

Both PG&E and Sempra oppose the PD’s adoption of a lower escalation rate than proposed by PG&E.⁴³ However, neither has shown any legal, technical, or factual error to support their objections. DRA’s testimony showed that PG&E’s proposed escalation rate is too high.⁴⁴ The record evidence supports the PD’s conclusion that DRA’s recommended escalation rate is reasonable.⁴⁵

G. Depreciation

PG&E opposes the PD’s adoption of TURN’s proposal to apply 65 years as the depreciable life of gas transmission mains installed pursuant to the PSEP.⁴⁶ TURN presented ample evidence to support of its recommendation⁴⁷ and the PD’s agreement with TURN’s position constitutes no legal, technical or factual error.

⁴⁰ See PG&E Opening Comments, pp. 14-16.

⁴¹ PD, p. 108.

⁴² See DRA Opening Brief, pp. 20-21.

⁴³ See PG&E Opening Comments, pp. 20-22; Sempra Opening Comments, pp. 24-25.

⁴⁴ See Exhibit 147, DRA Direct Testimony/Scholz, pp. 16-17.

⁴⁵ See DRA Opening Brief, pp. 91-93.

⁴⁶ See PG&E Opening Comments, pp. 19-20.

⁴⁷ See TURN Opening Brief, pp. 126-127.

III. PG&E WOULD HAVE THE COMMISSION IGNORE EVIDENCE FROM THE RELATED INVESTIGATIONS THAT SUPPORTS DISALLOWANCES

PG&E objects to the PD “[a]dopting a significant disallowance here based on an issue that has been clearly reserved to and disputed in the San Bruno OII....”⁴⁸ The analysis and findings contained in the Overland Report go to whether PG&E has justified the rate increases it seeks related to the PSEP and thus are clearly relevant to the issue of disallowances in this ratemaking proceeding. The ALJ implicitly recognized this by admitting the Overland Report into evidence in this docket. *Excluding* such highly relevant evidence from this proceeding would be inconsistent with due process and the Commission’s notice to parties in this proceeding that it may take official notice of evidence presented in the related enforcement cases.⁴⁹ The Commission has previously rejected a similar attempt by PG&E to exclude relevant evidence from this proceeding,⁵⁰ and it should do likewise here.

IV. PG&E FAILS TO RECOGNIZE THAT INDEPENDENT MONITORING IS NEEDED

PG&E states that it will work with CPSD to determine “the appropriate level of oversight” of PSEP implementation.⁵¹ This approach is insufficient to demonstrate that both Commission and PG&E are serious about improving safety. As explained in DRA’s opening comments, program implementation should be overseen by independent monitors and, to that end, DRA has proposed revisions to the PD to facilitate the establishment of an appropriate PSEP oversight process.⁵²

⁴⁸ PG&E Opening Comments, p. 13.

⁴⁹ See Order Instituting Rulemaking, R.11-02-019, p. 12, note 6 (“We will take official notice of the record in other proceedings, including the investigation of PG&E’s gas system record-keeping, in our ratemaking determination.”) and D.11-06-017, p. 23 (“As we indicated in [the Order Instituting Rulemaking 11-02-019], we intend to take official notice of the record in other proceedings, including the investigation of PG&E’s gas system record-keeping (I.11-02-016), in our ratemaking determination.”)

⁵⁰ PG&E’s motion to amend the scoping memo and reassign evidence of past practices to the Records OII (I.11-02-016) was not granted, and such evidence was admitted into the record of this rulemaking.

⁵¹ See PG&E Opening Comments, pp. 23-24.

⁵² See DRA Opening Comments, pp. 14-16.

V. CONCLUSION

For the reasons set forth in DRA's opening and reply comments, and based on the substantial record of this proceeding, DRA renews its request to modify the PD as recommended by DRA, and to reject the changes sought by PG&E and Sempra.

Respectfully submitted,

/s/ MARION PELEO

Marion Peleo

Attorney for the Division of Ratepayer Advocates

California Public Utilities Commission

505 Van Ness Avenue

San Francisco, CA 94102

Phone: (415) 703-2130

Fax: (415) 703-2262

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