Decision **PROPOSED DECISION OF ALJ LONG** **(Mailed 4/15/14)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Diego Gas & Electric Company (U902G) and Southern California Gas Company (U904G) for Authority To Revise Their Rates Effective January 1, 2013, in Their Triennial Cost Allocation Proceeding	Application 11-11-002 (Filed November 1, 2011)

DECISION IMPLEMENTING A SAFETY ENHANCEMENT PLAN AND APPROVAL PROCESS FOR SAN DIEGO GAS & ELECTRIC COMPANY AND SOUTHERN CALIFORNIA GAS COMPANY; DENYING THE PROPOSED COST ALLOCATION FOR SAFETY ENHANCEMENT COSTS; AND ADOPTING A RATEMAKING SETTLEMENT

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1. Summary

1.1. Executive Summary

This decision addresses three issues: first it adopts a plan for pipeline Safety Enhancement, although it also finds that the proposed budget is too rudimentary to preapprove. However, we want the applicants to implement Safety Enhancement now. Therefore, we adopt the concepts embodied in the Decision Tree and authorize a Safety Enhancement Capital Cost Balancing Account and a Safety Enhancement Expense Balancing Account for San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) to record the costs incurred, subject to refund, after a reasonableness review. SDG&E and SoCalGas may file annually after December 31, 2015 for a reasonableness review of the completed projects recorded in the Phase 1 Safety Enhancement Capital Cost Balancing Account and annually for the expenses recorded in the Phase 1 Safety Enhancement Expense Balancing Account. SDG&E and SoCalGas may alternatively file for preapproval of specific projects seeking approval of a cap or for other specific guidance. These applications need detailed management, engineering, and accounting records to justify recovery of reasonable costs in rates. Second, this decision, in compliance with our settlement rules, adopts a reasonable all-party settlement for SDG&E and SoCalGas' Triennial Cost Allocation proceeding, which is a cost allocation, marginal cost, and rate design proceeding commonly referred to as a "phase 2" general rate case. Third, this decision rejects a specific cost allocation

modification proposed to allocate the costs of Safety Enhancement based on human exposure to risk rather than the cost of providing service to all customer classes. The following decision discusses these issues in the above order.

1.2. Decision Overview

This decision finds that San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) have presented a reasonable, albeit conceptual plan to enhance the safety of their natural gas pipeline system (Safety Enhancement). The forecast costs include capital expenditures of $229 million for SDG&E and $1.2 billion for SoCalGas, and annual operating costs of $7 million for SDG&E and $255 million for SoCalGas. In this decision, we adopt a process to recover the Costs of Safety Enhancement by creating new balancing accounts which allow the companies to begin work and recover their costs subject to refund.[1] SDG&E) and SoCalGas) may file annually after December 31, 2015 for reasonableness review of the completed projects recorded in the Phase 1 Safety Enhancement Capital Cost Balancing Account and annually for the expenses recorded in the Phase 1 Safety Enhancement Expense Balancing Account. SDG&E and SoCalGas may alternatively file for preapproval of specific projects seeking approval of a cap or for other specific guidance. These applications need project specific management, engineering, and cost records that demonstrate the reasonableness of cost recovery of the detailed implementation plan as executed by the Companies.

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[1] To be clear, the refund would be to adjust to balance in the account to reflect the outcome of a reasonableness review. If, hypothetically, $1,000 is recorded and the reasonableness review finds only $900 was prudently and reasonably incurred, the $100 difference would be removed from the account.

SDG&E and SoCalGas failed to maintain construction records or data for portions of the pipelines that would demonstrate the proper testing of these pipelines to the standards that the Commission has determined to be necessary in Decision 11-06-017. Although many of these pipelines operated for many years without failure, we can no longer assume or presume them to be safe. Because these pipelines can no longer be presumed to be safe, they can no longer be presumed to be used and useful to provide service to customers unless tested or replaced. Ratepayers should not pay twice to have a properly installed system in place, therefore, the cost of such tests for facilities installed after July 1, 1961, must be absorbed by the shareholders of SDG&E and SoCalGas in situations where the company has failed to maintain records of strength testing required at the time of installation of the pipeline.

Whenever SDG&E or SoCalGas cannot produce a record of a pressure test required at the time of installation of the pipeline and whenever the existing systems cannot be properly tested and proven to be safe, or for other reasons it is determined they should be replaced, then we will treat the remaining book value of these existing systems as abandoned plant and allocate those costs to the shareholders of SDG&E and SoCalGas. The ratepayers must however pay for the cost of the new system; the ratepayers clearly benefit by receiving a brand-new system, which will be safe, and which will safely serve them for decades.

The record developed in the proceeding showed that SDG&E and SoCalGas had, at the time[2], over 385 miles of pipeline segments which would

[2] SDG&E and SoCalGas indicate in their comments that they have since recovered some of these records.

require pressure testing or replacement because documentation could not be found that those segments sufficiently met modern requirements or did not demonstrate that at the time of construction, the pipeline segments were properly strength tested in compliance with industry best practices or mandatory regulations in place at the time of installation to support their ongoing safety operations.[3] The record also shows that SoCalGas has 23 miles of pipeline which has not been pressure tested through a static strength test, but the company has lowered this pipeline's pressure to a level at which, the company states, the pre-reduction pressure provides for a "pressure-carrying" equivalent of 125% of Maximum Allowable Operating Pressure.

We cannot estimate the true magnitude of either the testing or replacement costs or the impact on either ratepayers or shareholders at this time. Although ratepayers will bear the costs of the new and safer pipeline systems as installed, we cannot reasonably forecast and preapprove Safety Enhancement costs at this time because SDG&E and SoCalGas do not have reliable detailed cost estimates, nor can we adequately estimate the cost for testing pipelines or the remaining book value of abandoned pipelines that will be absorbed by the shareholders. This must be resolved later.

We cannot quantify the change in the degree or level of safety achieved by these anticipated projects as a part of Safety Enhancement. There is simply no metric for potential lives to be saved, avoidance of personal injury, avoidance of property loss or damages, or disruptions to the economy that would result if the

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[3] *See* the Decision Tree: Where the pipeline is operated in a class 3 or 4 location or high Consequence Area and not documented for pressure testing to 1.25 times Maximum Allowable Operating Pressure.

unmodified pipeline system remained in service as is. What we do know is that the system will be built to the best current practices, that there will be proper permanent documentation of the construction, and that the company will continue to operate the systems in a safe and reliable fashion with the capacity to do inspections and tests that may not be possible to perform on the current system.

This proceeding is closed.

2. Application Background

San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) (collectively Applicants or SDG&E and SoCalGas) filed the required Triennial Cost Allocation Proceeding (Cost Allocation). In Rulemaking (R.) 11-02-019, the assigned Commissioner ruled that this Cost Allocation proceeding for both Applicants would be the most logical proceeding for the SDG&E and SoCalGas reasonableness and ratemaking review of the companies' Safety Enhancement Plans (Safety Enhancement) because this proceeding deals with all cost allocation and rate design. Therefore, Safety Enhancement was reassigned here to take advantage of the evidentiary record and policy decisions emerging on rate design and cost allocation. (*See* Ruling dated December 21, 2011.)

The Commission opened R.11-02-019 to review and establish a new model of natural gas pipeline safety regulation for California. Decision (D.) 11-06-017 ordered all California natural gas transmission pipeline operators to prepare Natural Gas Transmission Pipeline Comprehensive Pressure Testing Implementation Plans (Implementation Plans) to either pressure test or replace all segments of natural gas pipelines which were not pressure tested or lack sufficient details related to performance of any such test. The Commission

required that the Implementation Plans provide for testing or replacing all such pipelines as soon as practicable, and that at the completion of the implementation period, all California natural gas transmission pipeline segments would be (1) pressure tested, (2) have traceable, verifiable, and complete records readily available, and (3) where warranted, be capable of accommodating in-line inspection devices. In addition, the Commission required the operators to implement interim safety enhancement measures, including increased patrols and leak surveys, pressure reductions, prioritization of pressure testing for critical pipelines that must run at or near Maximum Allowable Operating Pressure values which result in hoop stress levels at or above 30% Specified Minimum Yield Stress, and other such measures that will enhance public safety during the implementation period.

On December 2, 2011, SDG&E and SoCalGas filed their Safety Enhancement plans[4] in the rulemaking. Safety Enhancement, if adopted as filed, provides for hundreds of millions of dollars in annual investment over more than a decade beginning with capital forecasts for Phase 1A of $1.2 billion for SoCalGas and $229 million for SDG&E and operating and maintenance forecasts for Phase 1A of $255 million for SoCalGas and $7 million for SDG&E. SDG&E and SoCalGas also seek to include a Phase 1B. In Phase 1B, SoCalGas and SDG&E propose to abandon and replace all pre-1946 non-piggable transmission pipelines segments remaining in the system after the completion of Phase 1A. It

[4] The term "Pipeline Safety Enhancement Plan" is the personalized name used by both Applicants in their compliance filings for the "Natural Gas Transmission Pipeline Comprehensive Pressure Testing Implementation Plans" ordered in D.11-06-017 and we will use Applicants' name, contracted to Safety Enhancement, hereafter, unless specifically citing to the filing original requirement.

originally included new construction too, to maintain service by SoCalGas and SoCalGas.[5] Safety Enhancement also includes proposals to non-destructively examine, in lieu of testing, pipeline segments of 1,000 feet or less.

In addition to the testing or replacing pipeline, Safety Enhancement includes modifications of 541 valves, and the addition of 20 valves, to provide for automated shut-off capability in order to isolate, limit the flow of gas to no more than 30 minutes, and thereby facilitate timely access of "first responders" into the area surrounding a substantial section of ruptured pipe. Safety Enhancement also includes: 1) improvements to communications and data gathering to ascertain pipeline conditions; 2) installing backflow valves to prevent gas from flowing into sections intended to be isolated from other connected lines; 3) expand the coverage of SDG&E and SoCalGas' private radio networks to serve as back-up to other available means of communications with the newly installed valves to improve system reliability; 4) installing remote leak detection equipment; and 5) increasing physical patrols and leak survey activities.

Pursuant to Pub. Util. Code § 451, each public utility in California must "furnish and maintain such adequate, efficient, just and reasonable service, instrumentalities, equipment, and facilities, . . . as are necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public." Ensuring that the management of investor-owned gas utility systems fully performs its duty of safe operations is a top priority of this Commission,

[5] SoCalGas and SDG&E Opening Brief at 191.

and the California Legislature has recently confirmed this critical function of the Commission.[6]

As set forth in D.11-06-017,[7] the Commission found that 1970 federal and 1961 California regulations for gas pipeline safety established requirements for the pressure testing natural gas transmission pipeline facilities; however, these applied only to new pipeline facilities and exempted all pre-existing in-service pipeline from the pressure test requirement. Accordingly, all pipelines installed after those dates are expected to be pressure tested, with the result that some of the oldest in-service natural gas pipeline has not been subjected to post-construction pressure testing to determine its Maximum Allowable Operating Pressure. Instead, the Maximum Allowable Operating Pressure for these untested pipeline segments is set by the highest recorded operating pressure on that segment during a defined time period.[8] Consequently, the operational records for the exempted pipeline segments are critical to determining their Maximum Allowable Operating Pressure.

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[6] Pub. Util. Code § 963(b)(3) finds that: It is the policy of the state that the commission and each gas corporation place safety of the public and gas corporation employees as the top priority. The commission shall take all reasonable and appropriate actions necessary to carry out the safety priority policy of this paragraph consistent with the principle of just and reasonable cost-based rates.

[7] The Commission's General Order 112, which became effective on July 1, 1961, mandated pressure test requirements for new transmission pipelines (operating at 20% or more of Specified Minimum Yield Strength installed in California after the effective date. Similar federal regulations followed in 1970, but exempted pipeline installed prior to that time from the pressure test requirement. Such pipeline is often referred to as "grandfathered" pipeline, because pursuant to 49 CFR §192. 619(c), pressure testing was not mandated.

[8] 49CFR §192.619(c).

After review of the detailed record in R.11-02-019 and before the National Transportation Safety Board regarding the records and vintage pipeline, the Commission concluded that the historic exemption and the utilities' record-keeping deficiencies had resulted in circumstances inconsistent with the safety, health, comfort, and convenience of utility patrons, employees, and the public. The Commission ordered all natural gas transmission pipelines in service in California to be brought into compliance with modern standards for safety, and that all California natural system operators file and serve a proposed Implementation Plan to comply with the requirement that all in-service natural gas transmission pipelines in California have been pressure tested in accord with 49 CFR Part 192 §§ 192.505 and 192.507 excluding reliance solely on § 192.619(c).

The Commission required that the Implementation Plans include interim safety enhancement measures, and that the analytical focus be a list of all transmission pipeline segments that have not been previously pressure tested, with pipeline that must run at or near operating pressures that result in hoop stress levels at or above 30% of Specified Minimum Yield Strength to receive prioritized designations for replacement or pressure testing. The Commission required the operators to also give high priority to pipeline segments located in Class 3 and Class 4 locations and High Consequence Area pipelines in Class 1 and 2 locations, with pipeline segments in other locations given lower priority for pressure testing.[9] The operators were required to set forth the criteria on

[9] The Pipeline and Hazardous Materials Safety Administration regulations define the four class locations by number of human-occupied buildings located within 220 yards of the pipeline: Class 1, 10 or fewer buildings; Class 2, 10 to 45 buildings; Class 3, 46 or more buildings, or with a place of public assembly; and, Class 4, where buildings with four or more stories are prevalent. (49 CFR § 192.5.)

which pipeline segments were identified for replacement instead of pressure testing.

The Commission also required each operator to include in the Implementation Plan a priority-ranked schedule for pressure testing all pipeline not previously so tested, and to provide for pressure reductions where necessary. The Implementation Plan also must address retrofitting pipeline to allow for in-line inspection tools and the installation of, where appropriate, automated or remote-controlled shut-off valves in order to limit the flow of gas from a large breach or rupture to a pipeline segment located in a Class 3 and Class 4 locations and HCAs in Class 1 and 2 locations. The Commission, when adopting PG&E's safety enhancement plan in D.12-12-030, has already clearly articulated its philosophy and policy that natural gas pipelines must be made to be safe and reliable. We adhere here to that same commitment.[10]

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[10] Among all public utility facilities, natural gas transmission and distribution pipelines present the greatest public safety challenges. Unlike more common public utility facilities, gas pipelines carry flammable gas under pressure - in transmission lines, often at high pressure - and these pipelines are typically located in public right-of-ways, at times in densely populated areas. The dimensions of the threat to public safety from natural gas pipeline systems, including the pace at which death and life-altering injuries can occur, are far more extreme than other public utility systems. This unique feature requires that natural gas system operators and this Commission assume a different perspective when considering natural gas system operations. This perspective must include a planning horizon commensurate with that of the pipelines; that is, in perpetuity, as well as an immediate awareness of the extreme public safety consequences of neglecting safe system construction and operation.

In the context of an unending obligation to ensure safety, we must also realize that in practical terms safety is exacting, detailed, and repetitive. It is also expensive, so ensuring that high value safety improvements are prioritized and obtaining efficiencies wherever possible is also essential. And, in the end, if the goal of safe operations is met, the reward is that absolutely nothing bad happens. In short, safety is difficult, expensive and seemingly without reward. (D.12-12-030 at 43.)

While emphasizing the importance and need to make these safety improvements in California's natural gas transmission systems, the Commission also stressed that it will closely scrutinize the costs to be imposed on ratepayers. In D.11-06-017, the Commission required that the Implementation Plans explicitly analyze cost and demonstrate that the proposed expenditures obtain the greatest safety value for ratepayers. The Commission stated its commitment to ensuring that California's working families and businesses pay only for necessary safety improvements, and the Commission encouraged customers to participate in the process for reviewing the Implementation Plans.

3. Burden and Standard of Proof, and Record

3.1. Overview

Pursuant to Pub. Util. Code § 451 all rates and charges collected by a public utility must be "just and reasonable," and a public utility may not change any rate "except upon a showing before the commission and a finding by the commission that the new rate is justified." (§ 454.) The Commission requires that the public utility demonstrate with admissible evidence that the costs it seeks to include in revenue requirement are reasonable and prudent. The Commission is charged with the responsibility of ensuring that all rates demanded or received by a public utility are just and reasonable.

SDG&E and SoCalGas must meet the burden of proving that they are entitled to the relief sought in this proceeding, and SDG&E and SoCalGas have the burden of affirmatively establishing the reasonableness of all aspects of the application.[11]

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[11] *See* generally Application of Southern California Edison Company for Authority to, Among Other Things, Increase Its Authorized Revenues For Electric Service in 2009,

Footnote continued on next page

With the burden of proof placed on SDG&E and SoCalGas, the Commission has held that the standard of proof SDG&E and SoCalGas must meet is that of a preponderance of evidence.[12] Preponderance of the evidence usually is defined "in terms of probability of truth, e.g., 'such evidence as, when weighed with that opposed to it, has more convincing force and the greater probability of truth'"[13] In short; SDG&E and SoCalGas must present more evidence that supports the requested result than would support an alternative outcome.

We have analyzed the record in this proceeding within these parameters. These are the same parameter used for Pacific Gas & Electric Company (PG&E). (D.12-12-030 at 41.)

3.2. Application of Standard

It is thus quite clear that SDG&E and SoCalGas bear the burden of proof for the reasonableness of its past practices in building, maintaining, and operating the pipeline systems and for its ratesetting proposals in this proceeding. Parties have debated what standard to apply: clear and convincing or preponderance, a lower standard. The Commission's standard for reasonableness issues is the preponderance standard, and we find that at even

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And to Reflect That Increase In Rates (D.09-03-025, *mimeo*. at 8) (March 12, 2009) and Decisions cited therein.

[12] *See* D. 12-12-030, at 44. "Decision Mandating Pipeline Safety Implementation Plan, Disallowing Costs, Allocating Risk of Inefficient Construction Management to Shareholders, and Requiring Ongoing Improvement in Safety Engineering."

[13] In the Matter of the Application of San Diego Gas & Electric Company for a Certificate of Public Convenience and Necessity for the Sunrise Powerlink Transmission Project, D.08-12-058, *citing* Witkin, Calif. Evidence, 4th Edition, Vol. 1, 184.

the lower standard of preponderance of evidence, SDG&E and SoCalGas failed to have adequate and reliable records for significant segments of their system and must therefore bear some of the consequences that result from those inadequate records. We further find that SDG&E and SoCalGas's showing was inadequate in detail and thoroughness to approve Safety Enhancement as proposed thus failing the usual preponderance test. This has been one of the main challenges in this proceeding. Therefore, as discussed below, we will require further showing before approving any final cost recovery from the balancing accounts.

3.3. Record

The record for this proceeding consists of the documents filed and served and the testimony and exhibits admitted during the evidentiary hearings. This record is the sole basis for this decision.

4. SDG&E & SoCalGas' Safety Enhancement

4.1. Decision Tree

SDG&E and SoCalGas produced two exhibits, the first of which is a "Decision Tree" included here as Attachment I,[14] and a more complicated table that reconciled all the natural gas pipeline system into various classifications or risk factors, age, documentation, etc., referred to as a "Reconciliation" included here as Attachment II.[15]

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[14] Ex. SCG-33-R.

[15] Ex. SCG-34-R.

The Decision Tree results in a first cut allocation of SDG&E and SoCalGas's pipelines into the proposed phases 1A, 1B, and Phase 2. It is the heart of SDG&E and SoCalGas's Safety Enhancement process.

The Decision Tree and Reconciliation are works in progress, showing the first steps taken by SDG&E and SoCalGas to define the scope of work for Safety Enhancement. SDG&E and SoCalGas began by categorizing the existing system's condition and risk. Phase 1A is the first most critical grouping of pipeline facilities which need to be addressed. SDG&E and SoCalGas also proposed a Phase 1B.

In its January 17, 2012 Technical Report on SDG&E and SoCalGas's Pipeline Safety Enhancement Plan, the Commission's Safety and Enforcement Division (Safety Div.), then Consumer Protection and Safety Division, discussed its review of SDG&E and SoCalGas's Safety Enhancement process, including its Decision Tree (in an earlier form to the Decision Tree in Attachment I). The Safety Div. report stated: "The use of a documented pressure test of (125% of Maximum Allowable Operating Pressure) at the start of the … decision tree process, is a conservative, first cut, approach…" and that as shown by research, "…it can provide some level of assurance as to the stability of the longitudinal seams on a pipeline." The Safety Div. report went on to find that: "Overall, the … decision tree process for prioritization in Phase 1A, and the sub-prioritization process included therein, appears to result in reasonably prioritized segments."

In regard to automated valves, the Safety Div. report found that SDG&E and SoCalGas "…have used a sound approach towards determining where automated valves should be installed in order to reduce the consequences of a major breach. This approach appropriately considers pipeline diameter, the operating stress on the line, and geological threats as part of the determination

process." Essentially, the Safety Div. found that the companies' proposal to use remote controlled valves to isolate (generally purged of gas) an 8-mile segment of pipeline of any diameter, within 15 minutes of the last valve necessary for isolation being closed, as reasonable. However, Safety Div. did recommend that fewer automated valves, instead of remote controlled valves included in Safety Enhancement, would provide similar protection, albeit with a slight increase in risk of gas loss due to false closures.

4.1.1. Decisions Made Under the Decision Tree

The Decision Tree starts with 3,885 total miles: 245 for SDG&E, and 3,630 for SoCalGas. By the end of the process it has allocated those miles into a variety of sub-categories: for immediate replacement; or testing and possible replacement; inspection and then either replacement or left in service; or those for which there is no further action. In fact the largest grouping of pipeline of 3,305 miles, falls into Boxes 8 and 9, no further action category, and only 385 miles fall into the most complex categories where they are Class 3 or 4 Locations, or High Consequence Areas, and not documented as ever having been strength tested to a level of 125% of Maximum Allowable Operating Pressure.

Some parties argue that Phase 1B should be considered later after the most critical portions of the system are resolved in Phase 1A. If we have learned one institutional lesson it would be that we need to look at safety generally, and Safety Enhancement in particular, as an integrated and ongoing commitment and that it is not a couple of quick fixes. Therefore, we approve the Decision Tree as it embodies the decision making processes for SDG&E and SoCalGas. The reasonableness review that we order should allow parties to address any

concerns regarding Phase 1B. For example, whether every segment needs to be replaced or its safety concerns could be addressed in some other manner.

As noted, the Decision Tree is a management process, which is also a work in progress. For example, SDG&E and SoCalGas removed from Phase 1 their proposal to construct a new 36-inch line, Line 3602. (Exhibit SCG-22 at 7-8.) This and all other new construction must be addressed in either new applications for those projects or in the new application for Phase 2.

4.2. Positions of the Parties

4.2.1. Office of Ratepayer Advocates - Summary

The Office of Ratepayer Advocates[16] (ORA) argues that for the years 2012 through 2015, SDG&E and SoCalGas ask the Commission to order ratepayer funding of a total of approximately $1.7 billion in capital expenditures and Operations and Maintenance expenses for direct costs only; excluding carrying costs such as taxes, depreciation, rate of return or other costs necessary to support the investment. Even using this incomplete estimate, ORA is gravely concerned that this would be a 10% rate hike. (Opening Brief at 1.) Further, ORA notes the Commission has stated its "… primary efforts have been focused on ensuring that California's natural gas transmission system operators are properly calculating the Maximum Allowable Operating Pressure for each segment of the natural gas pipeline transmission system." (Citing to D.12-04-021, at 1.) ORA points out the Commission has ordered utilities to prepare Natural Gas Transmission Pipeline Comprehensive Pressure Testing

[16] Like Safety Div., ORA had a name-change during this proceeding. The exhibits in the record introduced by ORA are labeled with the old acronym "DRA" and therefore those citations will use "DRA" whereas we will use ORA for the entity in this decision.

Implementation Plans. According to , SDG&E and SoCalGas,the companies need $12 billion worth of revenue requirements to assure the Commission that it is properly calculating the Maximum Allowable Operating Pressure for its gas transmission system. In DRA's opinion "if that is indeed true, then something is very wrong here. Either the Sempra utilities' gas transmission system is in a terrible state of disrepair, or the utilities are using the opportunity to pad shareholder returns by proposing capital improvement projects that are well beyond the primary directive of the Commission. Clearly, Sempra's ratepayers should not be forced to pay for the remedial or excessive improvements Sempra proposes." (DRA Opening Brief at 2.)

ORA proposes that for the years 2012 through 2015:

- the Commission authorize ratepayer funding of no more than $69.75 million for the combined utilities (Ex. DRA-5 at 20);
- SDG&E and SoCalGas should pay for all pressure testing of natural gas transmission lines installed since 1935. If SDG&E and SoCalGas chooses to replace, rather than test, pipelines installed after 1935, the companies should bear the costs, and the Commission should adopt a rate of return adjustment for those replacement pipelines (DRA Opening Brief at 4);
- does not oppose ratepayer funding of hydrotesting costs for 12 miles of transmission pipeline installed prior to 1935, but not at the excessive cost level SDG&E and SoCalGas proposes (DRA Ex. 2 at 78);
- does not oppose ratepayer funding of some valve upgrade work, but recommends SDG&E and SoCalGas's $122 million request be reduced to $52 million for the years 2012-2015 (Ex. DRA-4 at 9); and
- opposes all of SDG&E and SoCalGas's other attempts to impose system enhancement costs on ratepayers. Specifically, inclusion of costs for testing or replacing

> segments of distribution pipelines and non-criteria miles of transmission pipelines, for "mitigation" of pre-1946 construction methods, and for system enhancement projects like methane detectors, fiber optic cables, information technology programs (Ex. DRA-2, at 29-42.)

4.2.2. Discussion

Because we adopt a balancing account approach to redress the inadequate budgets offered by SDG&E and SoCalGas, we need not address ORA's immediate concerns about forecasts; in fact we take a more conservative approach and we will use balancing accounts and reasonableness reviews. As discussed throughout, we are very concerned about costs imposed on ratepayers and we endeavor to strike a fair balance between ratepayers and shareholders. All of ORA's issues should be addressed in the reasonableness review for the balancing accounts.

4.2.3. The Utility Reform Network's (TURN) Summary

TURN was an active participant on Safety Enhancement and has raised some serious concerns in its Opening Brief as summarized below. Essentially TURN is concerned that SDG&E and SoCalGas has not provided a detailed well budgeted plan and that the Commission should not authorize rate recovery based on the level of detail in our record. TURN goes on to criticize, as vague and incomplete proposals, SDG&E and SoCalGas's specific requests for shut-off valves, and other related systems as a part of Safety Enhancement.

a) SDG&E and SoCalGas Safety Enhancement is based on preliminary cost estimates that the utilities themselves did not prepare and it reflects an incomplete analysis of which specific pipelines will be replaced rather than pressure-tested.

b) Under SDG&E and SoCalGas's proposal there would be no reasonableness review of the recorded costs associated with actual pressure tests or pipeline replacements.

c) The Commission should simultaneously begin a subset of pipeline safety programs while ensuring its ability to perform the "comprehensive analysis" called for in D.11-06-017 before approving SDG&E and SoCalGas's proposed estimate of $1.7 billion in direct costs.

d) No recovery of testing or replacement costs in Phase 1 for post-1955 pipe segments should be approved now because these costs would not have been necessary if the SDG&E and SoCalGas Utilities had retained the pressure test records for those segments as directed by applicable standards and regulations. TURN argues these records are necessary to validate the safe operating pressure of transmission pipelines and are therefore critical for public safety. TURN argues California law therefore requires shareholders to absorb all the costs resulting from SDG&E and SoCalGas's violations of these important pipeline safety laws and standards.

e) For those segments with an identified manufacturing threat that are slated for replacement or remediation under Safety Enhancement, SDG&E and SoCalGas should be required to demonstrate that any testing that should have been conducted under federal Integrity Management requirements would not obviate the need to address the segment in here.

f) The Commission should defer action on SDG&E and SoCalGas's proposed Decision Tree (the process summarized in Ex. SCG-33-R and Attachment I) at this time; the ultimate determination of whether to pressure test or replace a line is a key decision for each and every pipeline that is a subject of the plan. TURN argues that the decision tree relies on "promised-but-not-unveiled" criteria that are more in the nature of still-evolving "guidelines that provide direction."

g) The Commission should reject the SDG&E and SoCalGas proposal that the current review of Safety Enhancement can serve as the likely exclusive opportunity for the agency to address the utilities' decision-making process. TURN proposes as a substitute the actual review of the actual decisions rather than the last-minute proposal for an advisory board, etc.

h) The Commission should deny rate recovery for the vast majority of the costs labeled "interim safety enhancement measures," because they are in fact records search costs that should not be included in rates, arguing that recovery would be prohibited retroactive ratemaking, the costs are connected to past utility imprudence, and SDG&E and SoCalGas has failed to demonstrate the reasonableness of the costs.

i) The Commission should promote further exploration and development of in-line inspection technologies; because TURN believes the cost of an in-line inspection is substantially lower than the cost of a pressure test, if the Commission can determine that the results are similarly reliable for purposes of assessing the condition of an existing pipeline segment, the overall cost of the assessment would decline.

j) The Commission should adopt the principle that reliance on automatic shut-off valves is the preferred approach where feasible, and direct the Safety Division and the utilities to work together to reduce the number of remote controlled valves installed and thereby increase the potential cost-effectiveness of this element of Safety Enhancement.

k) The Commission should reject the utilities' proposal to include all pipeline segments designated "accelerated miles," and instead permit the SDG&E and SoCalGas Utilities to propose inclusion of "accelerated miles" on a project-specific basis once they have completed the engineering and planning for each project and seek Commission approval of that project.

l) The Commission should not adopt the SDG&E and SoCalGas proposals for "technology enhancements" due to their failure to present any evidence that the value to customers of the fiber optics and methane detection monitors warrants incurring the cost.

m) The Commission should not adopt the SDG&E and SoCalGas Utilities' proposal for pre-1956 pipeline "mitigation" measures at this time. The utilities have not demonstrated that these construction techniques are jeopardizing the safety of their pipeline systems, yet these measures represent the most expensive single component contained within the Proposed Case.

n) For the Enterprise Asset Management System the Commission should authorize the SDG&E and SoCalGas Utilities to track the related costs in their Pipeline Safety and Reliability Memorandum Accounts, subject to subsequent reasonableness review. In addition to cost-effectiveness and other more traditional reasonableness review issues, SDG&E and SoCalGas would need to demonstrate that the effort is incremental to the effort necessary to meet existing prudent record-keeping standards.

4.2.4. Discussion

Because we adopt a balancing account approach to redress the inadequate budgets offered by SDG&E and SoCalGas we need not address TURN's immediate concerns about forecasts and costs generally; in fact, we take a more conservative approach and we will use balancing accounts and reasonableness reviews. This is a greater protection than TURN's memorandum account proposal. We do discuss below and adopt the elimination of any incentive compensation for management employees. As discussed throughout, we are very concerned about costs imposed on ratepayers and we endeavor to strike a fair balance between ratepayers and shareholders. We do not agree that examining pre-1956 pipelines should be deferred. As discussed in the decision

we adopt the intended scope of work as summarized by the Decision Tree instead.

We believe that we have addressed TURN's programmatic concerns with Safety Enhancement even though we authorize more work than TURN recommends; for example, we authorize the Phase 1B work to ensure it is performed in a timely manner. Likewise, by adopting the analytical approach embodied in the Decision Tree we address all pipelines to ensure the system as a whole can be relied upon to be safe, and not just complying with the safety rules of a bygone era.

4.2.5. Southern California Generation Coalition - Summary

The Southern California Generation Coalition (Coalition) in its opening brief argues that the application and testimony lacked the necessary detail needed before the Commission could adequately conduct a review of the proposed expenditures and authorize rate recovery. The Coalition proposed that the Commission should "review on a case-by-case basis" utilizing an existing tool used by this Commission, the Expedited Application Docket procedure, each pipeline segment as a specific project within Safety Enhancement. (Coalition Opening Brief at 1.) As discussed below, we find merit with this concept, which we expand on in our balancing account methodology, but we do not adopt a series of mini-reviews by project or groups of projects. Preapproval would unduly delay Safety Enhancement and relieve SDG&E and SoCalGas of their obligation to exercise expert and prudent management.

4.2.6. Discussion

Safety Enhancement will take years to complete and will encompass numerous individual projects. It is only fair that ratepayers should have the

benefit of detailed plans for this Commission to consider before authorizing or preapproving the expenditure of many hundreds of millions of dollars.

As set forth below, we find that SDG&E and SoCalGas have presented an adequate justification for Safety Enhancement at a conceptual level and we approve their Decision Tree (Attachment I) analytical approach. We find, however, that the budgets offered in support of this billion-dollar proposal are not sufficiently detailed to justify ratemaking pre-approval at this time. We authorize SDG&E and SoCalGas to file Tier 2 advice letters to establish balancing accounts and, in time, subsequent applications to demonstrate the reasonableness of costs and recover those costs in rates. We authorize SDG&E and SoCalGas to proceed with Safety Enhancement projects that conform to the Decision Tree logic and track the costs of the work in a series of balancing accounts described below. This decision does not preclude SoCalGas or SDG&E from submitting additional applications for specific projects for further guidance or approval. For example, SDG&E and SoCalGas may prefer to file one or more applications before undertaking specific projects, asking for pre-approval for the related revenue requirement to be included in rates which would be subject to a cap. Or, simply use the balancing accounts authorized in this decision and rely on the reasonableness reviews to authorize subsequent rate recovery.

For the Safety Enhancement Capital Cost Balancing Account SDG&E and SoCalGas may file reasonableness review applications for the recorded balances which reflect completed projects. This might be every other year or whenever there is a large balance. For the Safety Enhancement Expense Balancing Account, SDG&E and SoCalGas may file annually for a reasonableness review of the account balance beginning after December 31, 2015. They may also choose to file less often.

5. Safety Enhancement – Applying Section 454 Standard

5.1. Decision Tree

The Decision Tree is consistent with the priorities we set forth in D.11-06-017 and reflects a reasoned and orderly approach to testing or replacing natural gas pipeline in the SDG&E and SoCalGas systems. We find that SDG&E and SoCalGas have justified this approach to prioritizing the testing and replacement of natural gas pipeline systems. Therefore, we approve the Decision Tree and the analytical processes shown therein.

5.2. Ratemaking Proposal

During the evidentiary hearings SDG&E and SoCalGas produced two exhibits, Decision Tree the Reconciliation which explain and document both the review process (Decision Tree) proposed by SDG&E and SoCalGas and demonstrated in table form that the planning counted for the entire system (Reconciliation). This involved discussion and input from the parties and directions from the Judge. SDG&E and SoCalGas were eventually able to demonstrate that the Decision Tree does constitute a comprehensive plan to fully review and where necessary replace the natural gas system. The Reconciliation, and the time it took for the company to prepare it, illustrates both the complexity of the problem and that neither SDG&E nor SoCalGas, as of serving testimony or the evidentiary hearings, had sufficient management systems and personnel in place to show that they fully understand the flaws and weaknesses in the implementation plan and they do not have a complete plan in place which would result in a safe and reliable natural gas system.

The witness for the applicants clearly demonstrated that the budget preparation performed for this proceeding by SDG&E and SoCalGas is rudimentary at best. The witness contrasted the company's proposal with the

budget requirements used by the federal government for major procurement projects. The witness clearly showed that SDG&E and SoCalGas at best a "level 5" budget in a system where a level 5 budget is extremely preliminary, in fact rudimentary, and then only after careful planning and design does the budget progressively improve to levels 4, 3, 2, and finally level 1which is the most complete an advanced level of budgetary planning.[17]

In testimony, SDG&E and SoCalGas admitted:

> The estimates in our workpapers represent best available cost projections considering the nature and extent of projects that needed to be estimated for the PSEP, and the short timeframe available to develop them. SoCalGas and SDG&E acknowledge that these estimates are necessarily preliminary and often somewhat conceptual in nature. (Ex. SCG-21 at 1-2.)

The budget proposals of SDG&E and SoCalGas are clearly not sufficient to justify this Commission to authorize for ratemaking purposes. There are only two clear alternatives: authorize the program but make the companies fully liable for all risk of reasonableness review in an after-the-fact review of the final cost of the project; or require the companies to more fully develop budget proposals on a segment by segment basis for project construction, and seek commission approval based upon the level 1 quality of budgeting.

We therefore find that SDG&E and SoCalGas have not justified their proposed ratemaking for the costs of Safety Enhancement with their current showing. We direct SDG&E and SoCalGas to file new applications, consistent

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[17] "Class 5 or slightly better" characterization is based on a "recommended practice" produced by the Association for the Advancement of Cost Engineering.

with today's decision, with detailed project descriptions and history and adequate cost records to justify recovery in rates.

5.3. Safety Enhancement Balancing Accounts

A balancing account is an appropriate regulatory tool where the scope of work is known and accepted as is here, Safety Enhancement as described by the Decision Tree and elsewhere in testimony by SDG&E and SoCalGas, etc., and we find it to be a sufficient project scope; but there is not a reasonable forecast of cost. A memorandum account is an alternative regulatory tool that would only be appropriate here if we could not find that Safety Enhancement was necessary and defined. Note that SDG&E and SoCalGas already have a memorandum account for Safety Enhancement where we have not found a scope of work to be reasonable nor have we found those costs to be reasonable for rate recovery.

SDG&E and SoCalGas must file Tier 2 Advice Letters to establish two new balancing accounts for each company: a Safety Enhancement Capital Cost Balancing Account and a Safety Enhancement Expense Balancing Account. These accounts will record the revenue requirement for capitalized pipeline and other facilities and the actual expenses for Safety Enhancement that are not capitalized. SDG&E and SoCalGas must follow conventional utility accounting practices and separately record costs normally expensed in the expense-related balancing account and only record in the capital balancing account those Safety Enhancement costs which are typically capitalized as plant in service.[18] The

[18] Further, capitalized costs are those costs, which in a general rate case, are treated as plant in service for rate base purposes; and they are recovered not as a lump sum, but as annualized revenue requirements, over time, following the Commission's well established ratemaking practices. Nothing in the brevity of these descriptions here or

Footnote continued on next page

companies have the discretion to file annual cost recovery applications to review the reasonableness of completed capital projects included in the accounts and annual (or multi-year) expenses.

We believe that there is a major concern that we must not only ensure that the cost for these projects are reasonable based upon a competent and thorough analysis and design and budget process, but that also the project itself meets the overarching goal of enhancing the safety and reliability of the pipeline system.

We agree with TURN that SDG&E and SoCalGas's proposals as offered in this proceeding are incomplete and are an inadequate platform for authorizing construction or granting rate relief. We also recognize TURN's point that the Utilities have a financial incentive to favor pipeline replacement over testing, given that the former receives rate base treatment and a rate of return. Our requirement for a reasonableness review will allow parties to examine whether replacement has been favored over less costly but more prudent alternatives.

We are concerned however that TURN singles out pre-1946 pipeline mitigation because it is the most expensive i.e., extensive, component of SDG&E and SoCalGas's proposed mitigations. In fact, we are concerned that it is the oldest pipe, pre-1956, that might lack documentation; might be of the lowest quality of materials or construction, or even maintenance; and is least likely to meet current safety standards and therefore this pipe should be a focus of Safety Enhancement. Because we require SDG&E and SoCalGas to submit detailed records for all work performed for all testing and replacement, TURN's concerns can be addressed in the reasonableness review of the balancing accounts.

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elsewhere in the decision is intended to alter conventional and well-established ratemaking practices.

We also see no benefit to creating any oversight or advisory board to muddle the clear line of responsibility that rests solely with SDG&E and SoCalGas to competently manage and maintain the pipeline system. TURN is right to be concerned and we will not adopt such a board.

SDG&E and SoCalGas argues that ratepayers must bear all costs of compliance including testing and replacement of pipeline as a result of failing tests or lack of documentation. SDG&E and SoCalGas also asks for preapproval. ORA proposes an ex-post review, i.e., a reasonableness review after work is completed. SDG&E and SoCalGas argue:

> ex post reviews create an incentive for inefficient expenditure on the part of the utility. Rather than devoting resources to implementing an approved plan, the utility will focus on documenting the justification for each expenditure, and when forced to invest, will choose less-efficient systems with low capital costs (but possibly higher operating costs) to hedge the risk that they will not be able to recover the full capital cost of the investment. (SDG&E and SoCalGas Opening Brief at 56.)

We decline to adopt SDG&E and SoCalGas' inadequate cost forecasts and preapprove cost recovery. Instead our use of balancing accounts lets the companies exercise expert professional judgment and begin Safety Enhancement that is necessary to ensure a safe and reliable system.

5.4. Safety Division Oversight

The Commission's Safety Division (Safety Div.) has broad delegated authority to generally enforce the Commission's safety jurisdiction. Specific to SDG&E and SoCalGas's Safety Enhancement we delegate to Safety Div. the specific authority to directly observe and inspect the testing, maintenance and construction, and all other technical aspects of Safety Enhancement to ensure public safety both during the immediate maintenance or construction activity.

and to ensure that the pipeline system and related equipment will be able to operate safely and efficiently for their service lives. Safety Div. may issue verbal requests for information which must be promptly answered, although Safety Div. must subsequently reduce all requests to writing. SDG&E and SoCalGas may not delay responding or wait for the written confirmation.

The Director Safety Div. should be delegated the following specific authority to act in addition to all existing general authority delegated to staff in order to effectively protect the ratepayers and therefore may inspect, inquire, review, examine and participate in all activities of any kind related to Safety Enhancement SDG&E, SoCalGas, all of their contractors shall immediately provide any document, analysis, test result, plan, of any kind related to Safety Enhancement as requested by Safety Div.'s staff or its contractors. Safety Div. must subsequently confirm all requests in written form, however all responses to must be immediate. Safety Div. may issue immediate stop work orders to SDG&E and SoCalGas, and all of their contractors when necessary to protect public safety. SDG&E and SoCalGas must comply immediately. The Director of the Safety Div. is authorized to order SDG&E and SoCalGas to take such action as may be necessary to protect immediate public safety. Specifically, the Director is authorized to issue immediate stop work orders when necessary to immediately protect the public or to ensure public safety in the future from possible errors or flaws in design, testing, maintenance and construction related to Safety Enhancement.

The Safety Div. must file and serve a copy of any stop work order in this proceeding no later than close of business of the Commission's next business day following the issuance of a stop work order. The Commission's Executive Director, and the Chief Administrative Law Judge, together shall ensure that

SDG&E and SoCalGas, and all other parties to this proceeding, shall have timely procedural opportunities for a review of any action or stop work orders issued by Safety Div. as may be feasible under the specific circumstances whenever Safety exercises its delegated authority.

6. Ratemaking Principles to be Applied in Reasonableness Applications

6.1. Summary

This decision does not propose or adopt any penalty for SDG&E or SoCalGas. We do however identify certain costs that should be absorbed by shareholders instead of ratepayers. Consistent with long-standing ratemaking principles, ratepayers will generally bear the reasonable costs for a safe and reliable natural gas transmission system. However, where imprudent actions by the gas system operator have led to unreasonable costs, we will assign those costs to shareholders.

6.2. Penalty, Disallowance or Consequences

California law, Commission practice and precedent, and common sense, all essentially require that before ratepayers bear any costs incurred by the utility, that those costs must be just and reasonable. That is, the costs must have been prudently incurred by competent management exercising the best practices of the era, and using well-trained, well-informed and conscientious employees and contractors who are performing their jobs properly. When that occurs, the commission can find the costs incurred by the utility to be just and reasonable and therefore, they can be recovered from ratepayers. When this is not the case however, the Commission can and must disallow those costs: that is unjust or unreasonable costs must not be recovered in rates from ratepayers.

SDG&E and SoCalGas presented an outside witness whose essential theme was that if the companies failed to recover any cost whatsoever this amounted to a penalty. We find this testimony completely unpersuasive and we accord it no weight. SDG&E and SoCalGas's witness would have us believe that any disallowance for unreasonable, imprudent costs, i.e., a regulatory disallowance, is a penalty. We do not believe that. A better descriptor would be "consequences" which can be defined as "a result or affect, typically one that is unwelcome or unpleasant," and the Oxford English Dictionary[19] uses the example "to bear the consequences," meaning "accept responsibility for the negative results or effects of one's choices or action." The Oxford English Dictionary also defines the word penalty as "a punishment imposed for breaking a law, rule, or contract."[20]

It is quite clear that any costs which may be disallowed in a subsequent proceeding are merely the proper consequences of imprudent actions by the utility and do not constitute a penalty. In addition to those consequences however, the Commission has the authority and may in fact impose a penalty when the act that was imprudent also breaks a law, a rule, or contract. As discussed elsewhere in this decision we find that SDG&E and SoCalGas must

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[19] http://oxforddictionaries.com/?region=uk

[20] SDG&E and SoCalGas fare no better using the equally precise definitions found in Black's Law Dictionary, Sixth Edition, (1980). Penalty: "An elastic term with many shades of meaning; it involves the idea of punishment, corporeal or pecuniary, or civil or criminal, although its meaning is generally confined to pecuniary punishment." Disallowance: "To refuse to allow, to deny the need or validity of, to disown or reject." And, Consequence [singular not plural]: "The result following in natural sequence from an event which is adapted to produce, or to aid in producing, such result."

bear some costs of Safety Enhancement but we impose no fines here based on this record.

6.3. Disallowance or Consequences

We find that SDG&E and SoCalGas has over 385 miles of pipeline which do not have documentation of a strength test of at least 125% of Maximum Allowable Operating Pressure.

The Decision Tree shows that at the time SDG&E and SoCalGas filed this application 385 miles were operated in Class 3 or 4 locations or High Consequence Areas that lacked documentation of pressure testing to a carrying capacity of 125% of Maximum Allowable Operating Pressure

Beginning on January 1, 1956 industry standards adopted, and later in 1961, the CPUC adopted, the first strength-testing requirement for transmission pipelines. It is reasonable to require the shareholders of SDG&E and SoCalGas to absorb the costs of pressure testing Phase 1 facilities that were installed after July 1, 1961, but do not have an adequate pressure test record. In addition, if they are replaced without testing, the replacement cost should be reduced by the equivalent cost of testing. This is a reasonable consequence, consistent with ratemaking principles, of not having the otherwise necessary records to validate the testing to then-current standards when the pipeline was installed.

We find that no later than as of January 1, 1956, industry standards provided that all gas pipeline segments operating over 20% Specified Minimum Yield Strength to be strength tested to a level of 125% of Maximum Allowable Operating Pressure in Class 1 and 2 locations and 150% in Class 3 and 4 locations. The required test pressure had to be maintained for a period of no less than 1 hour after the pressure stabilized in all portions of the test sections (i.e., a static pressure test) prior to it entering service. Moreover, Section 841.417 of

American Standard Gas Distribution and Transmission Piping System (ASA B31.8-1958), which was subsequently adopted by the Commission in General Order 112 required operating companies to at a minimum maintain: "for the useful life of each pipeline and main, records showing the type of fluid used for test and the test pressure."

Beginning no later than January 1, 1956 according to industry standards, and then on July 1, 1961, by General Order 112, SDG&E and SoCalGas have been required to strength test all pipeline segments, with a Maximum Allowable Operating Pressure of 20% of Specified Minimum Yield Strength or greater installed beyond these dates, and maintain records to demonstrate compliance. Beginning in 1956 industry standards, and then after July 1, 1961, Commission record keeping requirements evolved to require more specific strength test data to be documented. A prudent system operator should have retained records of these pressure tests. We must decide whether the record for Phase 1 supports applying the 1956 industry standard or the 1961 General Order. The record for Phase 1 of Safety Enhancement shows that SDG&E and SoCalGas assert that they minimally complied with General Order and were not industry leaders adopting the industry standard in 1956. Therefore, for pipeline installed after July 1, 1961, where either SDG&E or SoCalGas cannot produce records that provide the minimum information required by these regulations to demonstrate compliance with the regulatory strength testing and record keeping requirements of General Order 112 and its revisions, as well the requirements of 49 CFR, Part 192 and its revisions beyond the effective date of Part 192, the shareholders must bear the

costs of retesting these pipelines.[21] Where replacement of the pipeline is planned rather than test existing pipelines, the system average cost of actual pressure testing should be an offset against the replacement costs of the pipelines for revenue requirement purposes. In this way shareholders bear the costs of remedial pressure tests and ratepayers pay for all other costs of testing or replacing a pipeline.

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[21] 49 CFR §192.619(c).

The record shows that interim Federal standards were issued on November 7, 1968, as Part 190 of Title 49 of Code of Federal Regulations (CFR) and became effective on December 13, 1968. The Part 190 adopted the then existing State safety standards for gas pipelines as interim regulations. Effective November 12, 1970, the minimum Federal standards were adopted as Part 192 of Title 49 of the CFR, except for those provisions applicable to design, installation, construction, initial inspection, and initial testing. These exceptions remained in effect in Part 190 until March 13, 1971, when it was adopted into Part 192 and the existing interim standards (Part 190 of Title 49 CFR) were completely revoked.

The 49 CFR §192.517, recordkeeping and retention states: "Each operator shall make, and retain for the useful life of the pipeline, a record of each test performed under §§ 192.505 and 192.507. The record must contain at least the following information:

(a) The operator's name, the name of the operator's employee responsible for making the test, and the name of any test company used.

(b) Test medium used.

(c) Test pressure.

(d) Test duration[.]

(e) Pressure recording charts, or other record of pressure readings[.]

(f) Elevation variations, whenever significant for the particular test[.]

(g) Leaks and failures noted and their disposition."

The mileage shown in the Decision Tree is not directly matched in the Reconciliation. We therefore prepared the following table using the reconciliation to illustrate our adopted ratemaking treatment.

SDG&E and SoCalGas	Pipeline Miles[(i)] Phase 1A/B	Pressure Testing & Replacement Cost Responsibility
Pre-1946 Pipeline	269	Ratepayers Pay for Pressure Testing and/or New Pipeline
1946 Through June 1961	511	Ratepayers Pay for Pressure Testing and/or New Pipeline
July 1961 Through November 1970	29	When SDG&E or SoCalGas Cannot Produce Records Shareholders Pay for Pressure Testing & Absorbs Undepreciated Balances; Ratepayers Pay for New Pipeline
November 1970 to Present	74	When SDG&E or SoCalGas Cannot Produce Records Shareholders Pay for Pressure Testing & Absorbs Undepreciated Balances; Ratepayers Pay for New Pipeline

(i) Reconciliation

As we discussed elsewhere, for any pipeline abandoned or replaced that was installed after July 1, 1961, shareholders must absorb the remaining undepreciated book value. And, as also discussed, ratepayers bear the revenue requirement of the net replacement costs as they benefit from having a new safe and reliable pipeline.

6.4. Safety Enhancement Reasonableness Applications

6.4.1. Minimum Filing Requirements

When SDG&E and SoCalGas file applications to demonstrate the reasonableness of Safety Enhancement they will bear the burden of proof that the

companies used industry best practices and that their actions were prudent. This is not a "perfection" standard: it is a standard of care that demonstrates all actions were well planned, properly supervised and all necessary records are retained. At a minimum we would expect that SDG&E and SoCalGas could document and demonstrate an overview of the management of Safety Enhancement which might include: ongoing management approved updates to the Decision Tree and ongoing updates similar to the Reconciliation. The companies should be able to show work plans, organization charts, position descriptions, Mission Statements, etc., used to effectively and efficiently manage Safety Enhancement. There would likely be records of contractor selection controls, project cost control systems and reports, engineering design and review controls, and of course proper retention of constructions records, retention of pressure testing records, and retention of all other construction test and inspection records, and records of all other activities mandated to be performed and documented by state or federal regulations.

6.5. Incentive Compensation

SoCalGas proposes to apply an 18.17% incentive compensation plan overhead loader to its management and associated direct labor costs, and SDG&E proposes a 17.79% incentive compensation plan overhead loader to its management and other direct labor costs. (Ex SCG-10 at 122.)

TURN argues (Opening Brief at 82) that incentive compensation plans usually are designed to reward utility management and employees for meeting specific financial goals that contribute to the shareholders' earnings. TURN goes on that regardless of whether or not it is appropriate for ratepayers fund incentive compensation plans in the normal course of business, incentives for the pipeline safety enhancement plan is clearly not in the ratepayers' best interests.

We note, however, that the usual practice for determining total compensation in the general rate case process for SDG&E and SoCalGas includes not just direct salary, but also various health benefits, retirement contributions, and incentive components. We are concerned here that Safety Enhancement is in large part remediation and we are confronted with the problem of reasonably compensating the workers, who follow the orders of the executives. But ratepayers need not reward management for this remediation. After careful consideration we believe that no employee at or above the level of vice president in any position, directly or indirectly associated with Safety Enhancement, in either SDG&E and SoCalGas, or positions allocated from their parent companies, should receive any incentive compensation for Safety Enhancement to be paid by ratepayers. Any Safety Enhancement incentive compensation for executives should be borne solely by shareholders. We do this solely because we do not want rank and file employees to avoid assignment to Safety Enhancement positions. We expect incentives to be sensibly established: e.g., an incentive for safely meeting schedules, or ensuring all work is performed to industry standards, etc.

We agree with TURN that this is a concern, that this is a remediation program; we are reluctant to include any compensation termed "incentive" and we conclude that no incentive compensation for executives, who as a body manage the companies and made decisions which led us to having to have a remediation program is warranted.

6.6. Pipeline Safety and Reliability Memorandum Accounts

Ordering Paragraph 3 in Dec. 12-04-021 in R. 11-02-019 allowed that:

> San Diego Gas and Electric Company and Southern California Gas Company must file a Tier 2 Advice Letter creating a

> memorandum account to record for later Commission ratemaking consideration the escalated direct and incremental overhead costs of its Pipeline Safety Enhancement Plan, as described in Attachment A to their January 13, 2012, filing, and costs of document review and interim safety measures as set forth in Attachment B to the January 13, 2012, filing.

On April 20, 2012, SDG&E and SoCalGas submitted Tier 2 Advice Letters 2106-G and 4359 to establish Pipeline Safety and Reliability Memorandum Accounts. Those Advice Letters were approved on May 18, 2012, with an effective date of May 20, 2012. As adopted, these accounts allow SDG&E and SoCalGas to record the actual incremental costs (i.e., operating and maintenance and capital-related costs such as depreciation, income taxes, and return on investment.

7. Pipeline Safety and reliability Memorandum Account Recovery

SDG&E and SoCalGas along with the other respondents to R.11-02-019 were authorized to establish a Pipeline Safety and reliability Memorandum Account Recovery (Memo Account) in D.12-04-021:

> SDG&E and SoCalGas to create a memorandum account in which to record the incremental costs of implementing the Pipeline Safety Enhancement Plan. The Commission will consider whether such properly recorded costs are reasonable and incremental as well as which costs, if any, may be recovered from ratepayers in revenue requirement at a later time in the Triennial Cost Allocation Proceeding.

We believe that there is not a sufficient record on the costs recorded in the Memo Account to authorize recovery at this time. We find that the companies should not recover any management incentive compensation or any costs associated with searching for test records of pipeline testing.

SoCalGas should file an application with testimony and work papers to demonstrate the reasonableness of the costs incurred which would justify rate recovery.

8. Summary of Rate Design and Cost Allocation Issues

This application began as a conventional "phase 2" application to address rate design and cost allocation issues in a proceeding trailing the triennial general rate cases. As already noted Safety Enhancement issues were added to the scope of the proceeding and in addition, parties litigated the question of whether the Safety Enhancement costs required any variance to the existing cost allocation methodology – that is, not allocating the eventual new and higher costs of repaired or replaced pipeline components on the same methodology of the existing pipeline components but perhaps allocating them differently.

This section finds that parties reasonably entered into a settlement of the conventional issues and we therefore adopt it. However we are not persuaded that there is any merit to reallocating the costs of Safety Enhancement. Some parties suggest that safety is somehow a severable service from gas delivery: arguing in essence that the only reason we want the system to be safe is to not kill people if there is an explosion. We do of course want it to be safe and not kill people: but that is a prerequisite of having any pipeline. We therefore reject all proposed changes and find that the new costs of a safe system should be allocated exactly the same way the existing components to be repaired or replaced are allocated.

Additionally, a very limited scope settlement unopposed by any other party was offered between SDG&E and SoCalGas with Clean Energy Fuels Corporation on the appropriate Natural Gas Vehicle compression rate adder. It meets the same criteria that we discuss in detail for the comprehensive rate

design settlement (Attachment 3) with all other active parties. The Natural Gas Vehicle compression rate adder settlement is attached to this decision as Attachment 5.

8.1. Customer Charge

The parties correctly noted the proposed decision omitted discussion of a customer charge proposal made by SDG&E. Parties commented on this and we clarify now that we did not adopt a customer charge at this time. We note TURN's concerns that customer charges have a significant impact on the lowest usage customers, and they offset incentives for conservation and energy efficiency by altering the price signals to customers. We find SDG&E's argument that a $5 per month charge sends a significant "cost causation" signal for fixed costs is not persuasive when weighed against the dilution of conservation and energy efficiency price signals. The rate tables attached to this decision did not include a customer charge.

8.2. Conventional Issues Settlement

The active parties of this proceeding followed a consistent trend for San Diego and SoCalGas for a "phase 2 general rate case" by settling the conventional rate design and cost allocation issues that were the core of this original application (before adding in the Safety Enhancement issues). As discussed below we accept the settlement between these experienced and competent parties. An additional issue was raised by parties addressing the cost allocation of Safety Enhancement costs. There is no settlement on that issue and we will consider it separately.

SoCalGas, San Diego, DRA, TURN, Southern California Edison Company (SCE), Coalition, Indicated Producers, California Manufacturers and Technology Association, the City of Long Beach (Long Beach), and Southwest Gas

Corporation (collectively, Phase 2 Settling Parties) filed a motion on March 27, 2013 asking the Commission to adopt the Phase 2 Settlement Agreement[22] (Settlement) attached as Attachment III.[23] As a part of the Settlement the Settling Parties made the necessary recitals to comply with the Commission's settlement rules and summarized the key issues resolved in the settlement and provided all the necessary documentation to fully support an implementable settlement. Due to the length and complexity of the settlement we provide only a brief summary here but defer to the actual settlement as agreed to by the parties. Nothing in this summary interprets or limits the meaning of the settlement itself.

In addition to the settled contested issues fully summarized in the settlement and discussed below, the parties did not contest 28 specific recommendations offered by the Utilities and ORA. These are included with this decision as Attachment 4 to assist the Energy Division with the advice letters needed to implement the final tariffs and rules.

8.3. Settlement Summary

8.3.1. Demand Forecast

Settling Parties use, for the most part, the Applicant's updated demand forecast, including a complete update of 2011 demand data. This reflects a compromise between the litigation positions of various parties.

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[22] On April 15, 2013 Long Beach there was a further motion following approval by the Long Beach City Council to add Long Beach as a party.

[23] The settlement can also be found here: http://docs.cpuc.ca.gov/SearchRes.aspx?DocFormat=ALL&DocID=62909608

8.3.2. Cost Allocation

8.3.2.1. Long Run Marginal Cost

Settling Parties acknowledge that there exist numerous methodologies proposed by parties to determine marginal unit costs for the customer cost function. Through the negotiation process, however, the Settling Parties were able to identify certain outcomes that, if adopted as a package, would represent an acceptable resolution for each party involved in the settlement discussions. Accordingly, the Settling Parties have taken a "black box" approach to reaching settlement and have agreed to certain modifications to their original cost allocation and rate proposals that are expressly intended to achieve these preferred outcomes.

8.3.2.2. Transition Adjustments

The Settling Parties agreed to a transition adjustment process to reduce the effect of "rate shock" as cost allocation moves towards fully cost-based rates.

8.3.3. Rate Design

8.3.3.1. Transmission Level Service

Settling Parties agree that, for customers who elect service under the Transmission Level Service Reservation Rate Option, quantities in excess of a customer's Daily Reservation Rate Quantity be billed at 115 percent of the Class Average Volumetric Rate. In addition, Settling Parties propose removal of the current requirement to exclude any subsequently allocated base margin portions of the Integrated Transmission Balancing Account from the Reservation Rate Usage Charge. Finally, Settling Parties propose that SoCalGas/SDG&E include in their next cost allocation application data on actual revenues from service provided under the Transmission Level Service Reservation Rate Option and actual volumes provided under that Option.

8.3.3.2. Throughput Risk

Settling Parties agree that noncore transportation revenue requirement continue to be subject to 100% balancing account treatment.

8.3.4. Backbone Operational Issues

8.3.4.1. Reservation Charge

Settling Parties agreed to a reservation charge to be adjusted annually in SoCalGas' Annual Regulatory Account Update filings.

8.3.4.2. Backbone Transmission Balancing Account Rate Adjustments

Settling Parties propose that the SDG&E and SoCalGas Backbone Transmission Service rates be subject to Backbone Transmission Balancing Account rate adjustments.

8.3.4.3. Volumetric Interruptible Backbone Transmission Service Rate

Settling Parties propose that SoCalGas' volumetric interruptible Backbone Transmission Service rate equal its reservation charge Straight Fixed Variable rate.

8.3.4.4. Functionalization of the SDG&E System

Settling Parties propose that the SDG&E transmission system continue to be classified as backbone.

8.3.4.5. Backbone-Only Rate

Settling Parties agree that SoCalGas withdraws its proposal for backbone-only rates from this proceeding, but it may address the question in later proceedings.

8.3.4.6. Modified Fixed Variable Rate Option

Settling Parties agree that SoCalGas' Modified Fixed Variable Rate Option be maintained with the Modified Fixed Variable volumetric rate designed so that 100% load factor Modified Fixed Variable rate equals the Straight Fixed Variable "100% Reservation" rate for Backbone Transmission Service.

8.3.5. Storage

8.3.5.1. Honor Rancho Cost Recovery

Settling Parties propose that SoCalGas receive full rate recovery of its Honor Rancho Expansion Project costs.

8.3.5.2. Extension of the 2009 Phase 1 Settlement Agreement

Settling Parties propose extending the 2009 Phase 1 Settlement Agreement through the end of 2015.

8.3.6. Southern System

Settling Parties propose all Southern System issues be considered in a separate application filed by SDG&E and SoCalGas.

8.4. Applying the Settlement Rules

We find as required by Rule 12.1 of the Commission's Rules of Practice and Procedure (Rules),[24] the proposed settlement is reasonable in light of the whole record, consistent with law, and in the public interest. The settled positions are a balance between the positions as otherwise litigated in the prepared testimony of San Diego and SoCalGas, DRA, and the other parties that served testimony or otherwise actively participated in phase 2. We therefore adopt the attached settlement (Attachment I) without further discussion of the

[24] http://docs.cpuc.ca.gov/WORD_PDF/AGENDA_DECISION/143256.PDF

merits of the individual components. No item settled in this proceeding is dispositive of the appropriate rate treatment in subsequent proceeds. (Rule 12.5.)

We find that the parties had a sound and thorough understanding of the application, and all of the underlying assumptions and data included in the record. This level of understanding of the application and development of an adequate record is necessary to meet our requirements for considering any settlement. These requirements are set forth in Rule 12.1(a)[25] which states:

> Parties may, by written motion any time after the first prehearing conference and within 30 days after the last day of hearing, propose settlements on the resolution of any material issue of law or fact or on a mutually agreeable outcome to the proceeding. Settlements need not be joined by all parties; however, settlements in applications must be signed by the applicant….
>
> When a settlement pertains to a proceeding under a Rate Case Plan or other proceeding in which a comparison exhibit would ordinarily be filed, the motion must be supported by a comparison exhibit indicating the impact of the settlement in relation to the utility's application and, if the participating staff supports the settlement, in relation to the issues staff contested, or would have contested, in a hearing.

Rule 12.1(d) provides that:

> The Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with the law, and in the public interest.

Rule 12.5 limits the future applicability of a settlement:

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[25] All referenced Rules are the Commission's Rules of Practice and Procedure. (http://docs.cpuc.ca.gov/published/RULES_PRAC_PROC/70731.htm)

> Commission adoption of a settlement is binding on all parties to the proceeding in which the settlement is proposed. Unless the Commission expressly provides otherwise, such adoption does not constitute approval of, or precedent regarding, any principle or issue in the proceeding or in any future proceeding.

The parties clearly demonstrated that they understood the issues, and engaged in a negotiated "give and take" which satisfied the needs of their respective constituents. We therefore find that the proposed "phase 2" settlement comports with Rule 12.1(d), and it is "reasonable in light of the whole record, consistent with law, and in the public interest."

9. A Ruptured Pipe Delivers No Gas – Allocating Safety Enhancement Costs

9.1. Summary of Cost Allocation for Safety Enhancement

Several parties suggest that the Safety Enhancement costs do not contribute to gas delivery service; the costs only reduce the risk of death and injury to people who live or work adjacent to a pipeline should that pipeline rupture or fail. We observe that a ruptured pipeline delivers no gas – to anyone, business or individual – and as we discuss in the Safety Enhancement portion of this decision enhanced safety is also, equally, enhanced reliability. An un-ruptured pipeline (properly constructed and tested) can usually be expected to deliver gas in a reliable fashion to businesses or individuals. We therefore decline to modify any cost allocation to shift Safety Enhancement costs from one customer class to another. The cost of the new safe component should be allocated just as its predecessor was allocated; SDG&E and SoCalGas have shown no persuasive justification to deviate from the existing cost allocation and rate design principles.

9.2. Options for Allocating Safety Enhancement

SDG&E and SoCalGas propose that costs should be allocated to customer classes based on cost causality; we should avoid rate shock (i.e. rapid or large increases) and keep a customer perspective; and we should maintain consistency with current practice whenever possible. (Ex. SCG-12.) SDG&E and SoCalGas's witness specifically argued that the fundamental principle to be followed in allocating costs among customer groups is cost causation which:

> Cost causation seeks to determine which customer or group of customers causes the utility to incur particular types of costs. It is therefore necessary to establish a linkage between a utility's customers and the particular costs incurred by the utility in serving those customers. The essential element in the selection and development of a reasonable cost allocation methodology is the establishment of relationships between customer requirements, load profiles and usage characteristics, and the costs incurred by the utility in serving those requirements. (*Ibid.*)

As a general rule we would agree with SDG&E and SoCalGas, although we would list consistency ahead of avoiding rate shock as an allocation principle, which is more of a mitigation measure; i.e., we would always want to move to fully allocated costs even if we did so in incremental steps.

Settling Parties suggest that there are two basic ways of allocating Safety Enhancement program costs. In their briefs they argue for their preference of these two methods as we discussed below it is apparent the parties argued based upon how they perceive the cost of Safety Enhancement affecting their rates.

The first of these two approaches is the functionalized approach where the costs are allocated to a particular component of gas service and then in turn finally allocated to different customer class based upon that class's use of each particular component of service. TURN and DRA argue for the functional

approach. Coalition argues for different methodology, it proposes that Safety Enhancement related are essentially a one-time remediation rather than an ongoing cost of providing service and should therefore be allocated differently. This party and others argue that the cost should be allocated on an Equal Percentage of Authorized Margin. They argue that Safety Enhancement is fundamentally different from SDG&E and SoCalGas's Transmission Integrity Management Program that they argue is an ongoing program and that Safety Enhancement should be allocated differently. The Coalition calls this an unintended negative consequence and further argues that a functional allocation leads to an inappropriate rate shock and anti-competitive result. (Coalition Opening Brief at 2.)

The Coalition also argues that some cost must be allocated to Backbone Transmission Service customers. It argues that the customers should receive an allocation regardless of whether we adopt a functional method or an equal percentage method because the Coalition believe that a significant portion of Safety Enhancement costs will be incurred on facilities that provide Backbone Transmission Service. (Coalition Opening Brief at 3.) They make a compelling point that this would benefit other customers regardless of the allocation methodology.

9.3. Retaining Existing Cost Allocation and Rate Design

Because no Safety Enhancement costs are directly incurred as a result of this decision, there is no immediate change to implement for cost allocation and rate design. However, we agree with the Coalition that Backbone Transmission Service customers should in the future be allocated Safety Enhancement-related costs to the extent that any pipeline components modified or replaced by Safety Enhancement are used to provide service to Backbone Service customers. Thus,

any Safety Enhancement costs that are functionalized as backbone transmission costs are to be allocated to the Backbone Transmission Service customer class consistent with the allocation of the existing rate design.

We disagree with the Coalition's assumption that Safety Enhancement is somehow a one-time cost. As required by Pub. Util. Code § 451, safe operation of a natural gas system is the operator's long-standing and continuing responsibility, not a one-time event. Moreover, an unreliable or ruptured pipeline delivers no gas to any class of customer. No persuasive justification has been presented to apply different cost allocation or rate design principles to Safety Enhancement costs and we decline to adopt a different approach. The cost of these new facilities that replace existing pipeline facilities should be allocated in the same manner as the old facilities were allocated.

10. Categorization and Need for Hearing

This proceeding was categorized as ratesetting and evidentiary hearings were held on phase 1. Safety Enhancement and phase 3, cost allocation issues for the costs of Safety Enhancement. Phase 2 cost allocation, marginal cost and rate design was settled without the need for hearings.

11. Comments on Proposed Decision

The proposed decision of the Administrative Law Judge (Judge) in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. The active parties filed timely opening and reply comments. A number of corrections, clarifications, and revisions have been made to this decision based on those comments, however, where the parties merely reargued their litigation positions we accord those comments no weight.

Specific changes were made to the ratemaking treatment of pipeline segments built between 1956 and 1961. In the proposed decision, based on the available record, a discretionary choice was made to impose the industry standard for testing and record retention beginning in 1956 and not a minimally compliant standard to the Commission's General Order, which did not reflect the change in industry standards until 1961. Based on the comments and reflection on the record we will not impose the 1956 industry standard on Phase 1; we will use instead 1961.

All other changes are intended to improve the clarity of the decision and facilitate SDG&E and SoCalGas' compliance with this decision. One example is where we further clarify here that the application process for SDG&E and SoCalGas to recover the costs in the authorized balancing accounts is subject to a reasonableness review, no costs for Phase 1A/B are preapproved.

Further, based on comments we clarify here that except where we specifically rejected a component of the Decision Tree process to plan and manage Safety Enhancement, SDG&E and SoCalGas may choose to utilize Transverse Flux Imagingin Phase 1A of Safety Enhancement so that this technique may be considered by the Commission in the Test Year 2016 general rate case application as an ongoing alternative to pressure testing or replacing pipeline segments. (Coalition Comments at 13, citing to Ex. SCG-04.) SDG&E and SoCalGas' choice to use Transverse Flux Imaging in Phase 1A would be as a part of demonstrating its reasonable behavior and the applicants may justify its use to recover costs included in the Safety Enhancement balancing accounts. We cannot, however, preapprove the methodology here because we have no record to demonstrate its efficacy.

Edison suggests in its comments that the decision errs in describing the unsafe, and therefore unusable, pipeline that must be replaced as "abandoned" rather than "retired." Edison then compares the abandoned pipeline to electric poles that did not fulfill the forecast useful life. Further, Edison argues the only acceptable use of "abandoned" is when plant never quite enters service. We note that the Federal Energy Regulatory Commission's Uniform System of Accounts uses and defines certain words like retirement and abandonment for specific types of accounting transactions. But this proposed change is unneeded here: an unsafe pipeline must be abandoned and removed from service promptly and safely pursuant to the Safety Enhancement plan adopted herein. SDG&E and SoCalGas even refer to abandoning pipelines in-place, i.e., not digging them up and removing them, but leaving the steel in the ground. You "abandon" a sinking ship; you do not "retire" it. Nor is there a relevant distinction here based on whether utility plant is abandoned before or after it enters service. If Edison's concern is whether ratepayers or shareholders absorb remaining "abandoned" or "retired" plant costs (pipeline, poles, or other,) the concern is misplaced. The relevant facts, circumstances, and the law drive cost recovery applicable to the specific situation. Here, similar costs are recovered differently over time based on the relevant facts, circumstances, and the law.

12. Assignment of Proceeding

Michel Florio is the assigned Commissioner and Douglas Long is the assigned Judge and Presiding Officer in this proceeding.

Findings of Fact

1. SDG&E and SoCalGas are public utilities that operate natural gas pipeline transmission systems subject to the jurisdiction of this Commission.

2. There is an identified need to enhance the safety and reliability of the natural gas pipeline transmission systems operated by SDG&E and SoCalGas. This may include the testing and/or replacement of many segments of these systems.

3. In D.11-06-017, the Commission declared an end to historic exemptions from pressure testing for natural gas pipeline and ordered all California natural gas system operators to file Natural Gas Transmission Pipeline Testing Implementation Plans.

4. Decision 12-12-030 requires that natural gas pipelines must be made safe and reliable.

5. As of July 31, 2011 there were 385 miles identified in the Decision Tree that lack documentation of pressure testing.

6. Industry standards for testing and record retention changed as of January 1956.

7. The Commission's General Order did not adopt the industry standard until 1961.

8. SDG&E and SoCalGas did not consistently follow industry standards until General Order 112 was revised.

9. SDG&E and SoCalGas did not present sufficient project details and cost justification for their proposed ratemaking treatment of Safety Enhancement costs.

10. The Safety Enhancement cost forecasts are inadequate for cost recovery preapproval.

11. The proposed ratemaking to allocate all Safety Enhancement costs to ratepayers was not justified.

12. Balancing accounts will allow SDG&E and SoCalGas to begin Safety Enhancement testing, maintenance, and new construction.

13. Balancing accounts will allow SDG&E and SoCalGas an opportunity to recover reasonable costs for Safety Enhancement.

14. The companies proposed inclusion of incentive compensation in the costs of Safety Enhancement.

15. Incentive compensation is an integral part of employee compensation for SDG&E and SoCalGas.

16. Executive incentive compensation for Safety Enhancement paid by ratepayers is not justified.

Rate Design Settlement

17. The active parties in phase 2 have reached a settlement on all outstanding disputed rate design issues except the rate design proposals for Safety Enhancement costs and SDG&E's customer charge proposal.

18. There is an unopposed related settlement that resolves the Natural gas vehicle Compression rate adder.

19. The rate design settlements comport with the Commission's settlement rules and resolve all issues except the rate design proposals for Safety Enhancement costs and SDG&E's customer charge proposal.

20. The parties memorialized 28 specific uncontested issues.

21. SDG&E proposed a customer charge for recovery of some fixed costs.

22. A customer charge dilutes the price signals for conservation and energy efficiency.

Cost Allocation for Safety Enhancement

23. The proposed allocation of costs of the new pipeline, which replaces the existing pipeline, would reallocate costs between customer classes with no change in service.

24. The existing cost allocation, as settled, allocates costs to customer classes based upon the costs incurred to serve those customers.

25. Safety Enhancement does not change the service provided to customers although it does likely improve reliability by replacing existing pipelines with new pipelines that meet industry and Commission required safety standards.

26. The ratepayers will be served by a safe and reliable system with new components that will operate for decades.

Conclusions of Law

1. As required by § 451 all rates and charges collected by a public utility must be "just and reasonable," and a public utility may not change any rate "except upon a showing before the commission and a finding by the commission that the new rate is justified," as provided in § 454.

2. Pub. Util. Code § 451 requires safe operation of a natural gas system. It is a long-standing and continuing responsibility, not a one-time obligation.

3. The burden of proof is on SDG&E and SoCalGas to demonstrate that it is entitled to the relief sought in this proceeding, including affirmatively establishing the reasonableness of all aspects of the application.

4. The standard of proof that SDG&E and SoCalGas must meet is that of a preponderance of evidence, which means such evidence as, when weighed with that opposed to it, has more convincing force and the greater probability of truth.

5. The Decision Tree analysis used to evaluate the existing pipeline network for safety, documentation, and reliability, is a reasonable but not final process.

6. Although industry best practices had changed by January 1, 1956, the Commission only adopted those standards in 1961.

7. The record for Phase 1 of Safety Enhancement supports the application of the July 1, 1961 adoption of the Commission's General Order 112 for testing and record-retention.

8. The analytical approach for Phase 1 in the Decision Tree management process, as fully described in testimony by SDG&E and SoCalGas, should be approved.

9. The Safety Div. should oversee Safety Enhancement to ensure public safety during the design, maintenance and construction phase as well as ensure safety in the future operations of the modified pipeline systems.

10. The Commission has the authority to delegate stop work order authority to Safety Div.

11. The Commission must ensure parties have timely procedural opportunities for a review of any action or stop work orders issued by Safety Div.

12. The proposed ratemaking for Safety Enhancement should not be approved.

13. It is reasonable for SDG&E and SoCalGas' shareholders to absorb the portion of the Safety Enhancement costs that were caused by any prior imprudent management. SDG&E and SoCalGas should absorb the costs of pressure testing where the company cannot produce records that provide the minimum information to demonstrate compliance with the industry or regulatory strength testing and records keeping requirements of industry standards beginning with the adoption of General Order 112 and its revisions, as

well as the requirements of 49 CFR, Part 192 and its revisions beyond the effective date of Part 192.

14. Where Phase 1 pipelines are replaced without testing SDG&E and SoCalGas should absorb an amount equal to the average cost of pressure testing where the company cannot produce pressure test records after the adoption of General Order 112, effective July 1, 1961.

15. SDG&E and SoCalGas should absorb the un-depreciated balances of any abandoned pipelines wherever they should have Phase 1 testing records after July 1, 1961, and do not.

16. The inclusion of executive incentive compensation in the costs of Safety Enhancement recoverable from ratepayers was not justified.

17. SDG&E and SoCalGas should be authorized to file annually after December 31, 2015 to recover the reasonable costs recorded in the Safety Enhancement balancing accounts.

18. Subsequent applications to review the Safety Enhancement Capital Cost Balancing Accounts and a Safety Enhancement Expense Balancing Accounts should be filed with sufficient detail to justify the work performed pursuant to the analytical approach embodied in the Decision Tree and the reasonableness of those costs. SDG&E and SoCalGas should be allowed to file annually for the costs of completed projects.

19. It is reasonable to require the ratepayers to pay for the costs to repair or rebuild the system that SDG&E and SoCalGas demonstrate are just and reasonable costs.

20. A valid record of a pipeline pressure test must include all elements required by regulations in effect at the time the test was conducted.

21. It is reasonable to require SDG&E and SoCalGas to comply with 49 CFR Part 192, subpart J pressure test specifications when conducting pressure tests pursuant to the plan approved herein.

22. SDG&E and SoCalGas have justified the concept of a Phase 1A and Phase 1B.

23. SDG&E and SoCalGas costs incurred prior to the effective date of today's decision should be subject to approval based on a reasonableness review of the Pipeline Safety and Reliability Memorandum Accounts.

24. The reasonableness issues identified by ORA and TURN will be addressed in the reasonableness review applications for the balancing accounts.

25. There is no justification for any executive incentive compensation component to be added into the costs of Safety Enhancement recovered from ratepayers.

Rate Design Settlement

26. The Commission has the authority to adopt a settlement when it is reasonable in light of the whole record, consistent with law, and in the public interest.

27. The proposed rate design settlement is reasonable in light of the whole record, consistent with law, and in the public interest and should be adopted.

28. The uncontested issues are reasonable in light of the whole record, consistent with law, and in the public interest and should be adopted.

29. The uncontested Natural gas Vehicle compression rate adder settlement is reasonable in light of the whole record, consistent with law, and in the public interest and should be adopted.

Cost Allocation for Safety Enhancement

30. The existing cost allocation methodology is reasonable for the costs of Safety Enhancement because these costs are necessary to safely and reliably supply natural gas to existing customers in the same manner as the existing system serves customers.

31. This decision should be effective today.

32. This proceeding should be closed.

O R D E R

IT IS ORDERED that:

1. We adopt the Phase 1 analytical approach for Safety Enhancement to ensure the safety and reliability of San Diego Gas & Electric Company and Southern California Gas Company as embodied in the Decision Tree (Attachment I) and Reconciliation (Attachment 2) and related descriptive testimony.

2. We authorize San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) to begin work as described in their Safety Enhancement Plans with costs recorded in balancing accounts and subject to refund pending a subsequent reasonableness review.

3. The Director of the Commission's Consumer Protection and Safety Division, or designee, (Safety Div.) is delegated the following specific authority to act in addition to all existing general authority delegated to staff:

(a) Safety Div. may inspect, inquire, review, examine and participate in all activities of any kind related to Safety Enhancement. San Diego Gas & Electric Company (SDG&E), Southern California Gas Company (SoCalGas), all of their contractors shall immediately provide any document, analysis, test result, plan, of any kind related to

Safety Enhancement as requested by Safety Div.'s staff or its contractors. Safety Div. must subsequently confirm all requests in written form, however all responses to must be immediate.

(b) Safety Div. may issue immediate stop work orders to SDG&E and SoCalGas, and all of their contractors when necessary to protect public safety. SDG&E and SoCalGas must comply immediately.

(c) The Commission's Executive Director, and the Chief Administrative Law Judge, together shall ensure that SDG&E and SoCalGas, and all other parties to this proceeding, shall have timely procedural opportunities for a review of any action or stop work orders issued by Safety Div. as may be feasible under the specific circumstances whenever Safety exercises its delegated authority.

(d) Safety Div. must formally file a copy of any Stop Work Order in this proceeding by the close of business on the workday following its issuance to either SDG&E and SoCalGas, or any contractors.

4. Within 30 days of the effective date of this decision San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) must file Tier 2 Advice Letters to establish a Phase 1 Safety Enhancement Capital Cost Balancing Account and a Phase 1 Safety Enhancement Expense Balancing Account to record the expenditures incurred pursuing the Safety Enhancement proposals adopted in Ordering Paragraph 1. These accounts may be effective as of the date of this decision.

5. San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) may file annually after December 31, 2015 for reasonableness review of the completed projects recorded in the Phase 1 Safety Enhancement Capital Cost Balancing Account and annually for the expenses recorded in the Phase 1 Safety Enhancement Expense Balancing Account.

SDG&E and SoCalGas may alternatively file for preapproval of specific projects seeking approval of a cap or for other specific guidance.

6. Cost recovery of the Pipeline Safety and Reliability Memorandum Accounts for San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) will be reviewed for reasonableness in a new application or applications. In addition to the other requirements to demonstrate reasonableness, SDG&E and SoCalGas are limited to the recovery of only those costs that directly contribute to the implementation of Safety Enhancement.

7. The comprehensive rate design settlement (Attachment 3) between San Diego Gas & Electric Company (SDG&E) and all active parties and adopts a rate design settlement between Southern California Gas Company (SoCalGas) and all active parties is adopted. This settlement resolved all contested issues except the rate design proposals for SDG&E and SoCalGas' Safety Enhancement costs. We also adopt for implementation the 28 uncontested issues included in Attachment IV.

8. The Natural gas Vehicle compression rate adder settlement is adopted.

9. We reject all proposed modifications to the existing cost allocation methodology proposed by San Diego Gas & Electric Company and Southern California Gas Company and the parties for Safety Enhancement costs. Safety Enhancement costs will be allocated consistent with the existing cost allocation and rate design for the companies.

10. Within 30 days of the effective date of this decision San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) must file Tier 1 Advice Letters to implement the rate design settlements and uncontested issues as contained in Attachments III, IV and V.

11. This decision denies San Diego Gas & Electric Company's request for a residential customer fixed charge.

12. Application 11-11-002 is closed.

This order is effective today.

Dated _____, at San Francisco, California.