BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

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Order Instituting Rulemaking on the Commission's Own Motion to Adopt New Safety and Reliability Regulations for Natural Gas Transmission and Distribution Pipelines and Related Ratemaking Mechanisms.	Rulemaking 11-02-019 (Filed February 24, 2011)

COMMENTS OF DIVISION OF RATEPAYER ADVOCATES ON INDEPENDENT REVIEW PANEL REPORT

I. INTRODUCTION

In accordance with the Scoping Memo and Ruling of the Assigned Commissioner ("Scoping Memo")[1] issued on June 16, 2011 in the above-captioned proceeding, the Division of Ratepayer Advocates ("DRA") hereby submits its comments regarding the Report of the Independent Review Panel ("IRP Report")[2] released on June 9, 2011. The Scoping Memo provides: "Parties may file and serve comments on the Independent Review Panel's Report … Parties should include in their comments any recommendations as to procedural or substantive changes that should be made to the directives for the Implementation Plans."[3] DRA cautions against rushing to judgment and recommends against changing any current directives in this rulemaking or establishing any new natural gas pipeline safety requirements until the National

[1] Rulemaking 11-02-019, Scoping Memo and Ruling of Assigned Commissioner, June 16, 2011.

[2] Report of the Independent Review Panel, San Bruno Explosion, Prepared For California Public Utilities Commission, June 8, 2011, Revised Copy June 24, 2011. The June 24 revised copy of the report is available on the Commission's website at http://www.cpuc.ca.gov/PUC/events/110609_sbpanel.htm.

[3] Scoping Memo, p.4.

Transportation Safety Board ("NTSB") releases its investigation report on the root cause(s) of the San Bruno incident.

According to the IRP Report, the Interstate Natural Gas Association of America ("INGAA") analysis suggests a manufacturing defect by itself did not cause the incident, and the IRP's consultant conducted independent, parallel analysis to that by the INGAA that confirms the INGAA's findings.[4] The IRP Report states that both the IRP's consultants and the INGAA's analysis "support the theory there was an external force that triggered the manufacturing defect to propagate, causing the pipe to fail; the force that most likely put the increased stress on the longitudinal seam was the force from a 2008 sewer replacement project undertaken by the city of San Bruno that utilized pipe bursting technology."[5] Although the IRP Report states that "the opinions and evaluations contained herein reflect the unanimous views of the members of the Independent Review Panel,"[6] it has been reported in the San Francisco Chronicle that one of the panel's experts "has backed off his conclusion that a 2008 sewer construction project was the probable cause of the disaster, citing newly discovered details of the gas line's operating history."[7] These developments strongly reinforce the fact that the ultimate investigative body regarding the causes of the San Bruno explosion is the NTSB.

DRA offers the following comments on the IRP Report's discussions of one-way balancing accounts, the interaction between DRA and the Consumer Protection and Safety Division ("CPSD"), and other matters.

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[4] *See* IRP Report, Executive Summary, p. 6.

[5] IRP Report Executive Summary, p. 6.

[6] IRP Report Executive Summary, p. 2.

[7] Jaxon Van Derbeken, *San Bruno blast: Sewer work discounted as cause*, S.F. Chronicle, June 29, 2011, at A-1, available at http://www.sfgate.com/cgi-bin/article.cgi?file=/c/a/2011/06/29/MNER1K3KND.DTL.

II. COMMENTS

A. One-Way Balancing Accounts

DRA disagrees with the IRP Report's characterization of one-way balancing accounts because it is inaccurate. The Report finds that "[o]ne-way balancing accounts create a perverse incentive for the utility to spend exactly as the stakeholders have negotiated – spending no less or no more than is authorized for a given activity."[8] This statement reflects a misperception of the scope and mechanics of one-way balancing accounts that the Commission has authorized for particular utility activities. A one-way balancing account provides a mechanism to track actual expenses in specific, limited areas of a general rate case against authorized funding for that same activity and to credit back to ratepayers any amounts not spent as authorized. Therefore, the intent of the mechanism is to create an incentive for the utility to spend the funds authorized by the Commission for the particular activity and/or functional area. The level of funding authorized is based on the utility's representation and Commission determination that the amount requested is sufficient to perform required work and thus, by implication, prudent: "Much of what is authorized is based on the utility's depiction of its needs and associated costs."[9] The one-way balancing account is an incentive to ensure that the utility spends the amount authorized, but does not limit the utility from spending above that amount if necessary to continue to meet the utility's obligation to maintain a safe system.

The IRP Report states:

> Most utility gas rate cases are resolved through settlement, often after the completion of evidentiary hearings. The CPUC approves a rate settlement if it is 'reasonable in light of the whole record, consistent with the law, and in the public interest.' The CPUC has recently approved settlements that establish PG&E's transmission and storage rates for the 2011-

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[8] IRP Report, p. 107.

[9] D.11-05-018, Decision on Pacific Gas and Electric Company Test Year 2011 General Rate Increase Request, p. 29.

> 2014 rate cycle and set PG&E's revenue requirement for its gas distribution services for the 2011-2013 rate cycle (GRC 2011).[10]

As a point of clarification, whether a utility rate case application is resolved through settlement or litigation, the Commission approves or rejects either outcome based on the same legal and public interest standards. The IRP Report appropriately does not assume that there is a correlation between negotiated rates and compromised safety. As discussed below, the settlement approved by the Commission in PG&E's gas transmission and storage rate case included amounts for gas safety and reliability programs nearly equal to the levels requested by PG&E in its initial application.

In Decision ("D.") 11-05-018, the Commission authorized PG&E to track in a one-way balancing account its distribution integrity management program ("DIMP") costs incurred during the 2011-2013 general rate case cycle. The balancing account has a cap of $60 million, and any net unspent DIMP funds at the end of the GRC cycle are to be returned to customers in the next GRC cycle.[11] Similarly, the Commission in D.11-04-031 authorized a one-way balancing account to track PG&E's transmission integrity management expenses for the 2011-2014 rate case settlement period, to reflect the differences between authorized revenue requirements and recorded expenses and provide a mechanism for returning to customers amounts not spent during the rate cycle for pipeline integrity.[12]

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[10] IRP Report, p. 104, citing CPUC Rule of Practice and Procedure Rule 12.1(d).

[11] *See* PG&E Advice Letter ("AL") 3209-G, Gas Preliminary Statement Part CQ, Gas Distribution Integrity Management Expense Balancing Account, filed May 31, 2011.

[12] *See* PG&E AL 3200-G, Gas Preliminary Statement Part CL, Integrity Management Expense Balancing Account, filed April 22, 2011.

As discussed in previous DRA comments[13] and noted in the IRP Report,[14] the amount authorized and adopted in D.11-04-031 for the one-way balancing account for Integrity Management O&M expense based on the settlement was 92% of the amount PG&E had requested and was subject to annual escalation for the rate case period. For the capital expenditure dollars, D.11-04-031 authorized 100% and 98% of PG&E's original requested amounts for pipeline Integrity Management and Safety and Reliability work for the 2011 through 2014 rate cycle. It is only the O&M expense dollars for pipeline integrity management and not the capital dollars that are subject to one-way balancing account treatment. The objective of the one-way balancing account is to encourage the utility to perform ongoing maintenance deemed necessary to keep its pipelines safe and reliable, by spending at a minimum the amount authorized. As such, an underlying reason for the one-way balancing account treatment for PG&E's O&M expense account is to ensure that PG&E is focused on maintaining public safety.

Another example is the one-way balancing account the Commission has authorized for PG&E's vegetation management program.[15] The results of the Commission's investigation (I.94-06-012) into the failure to exercise reasonable tree-trimming practices and procedures of electric utilities within the Commission's jurisdiction led to the adoption of tree-trimming standards in D.97-01-044 and D.97-10-056, and ultimately to the adoption of one-way balancing account treatment for PG&E's vegetation management program to ensure that the safety standards are maintained.

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[13] *See*, *e.g.*, R.11-02-019, Response of the Division of Ratepayer Advocates to Motion of Pacific Gas and Electric Company to Establish Memorandum Account, May 20, 2011, p. 3; A.09-09-013, Reply Comments of the Non-PG&E Settlement Parties in Response to September 15, 2020 Assigned Commissioner and Administrative Law Judge's Ruling to Address Whether Proposed Settlement Is Adequate in terms of Pipeline Safety, Integrity, and Reliability Efforts, Sept. 30, 2010.

[14] *See* IRP Report, p. 105.

[15] *See* PG&E AL 3849-E, Electric Preliminary Statement Part BU, Vegetation Management Balancing Account, filed May 31, 2011; *see also* D.00-02-046.

DRA strongly disagrees with the implication that, because "[t]here is no provision for PG&E to recover expenses that exceed authorized amounts, even if prudently incurred,"[16] the one-way balancing account then functions as a "perverse incentive" for PG&E to keep its system safe. It is in PG&E's interest to make the appropriate investments in operations, maintenance and capital investment to ensure the safety of its pipeline system: "[D]espite any financial implications of exceeding authorized cost levels, the utility does have the responsibility to spend what is necessary to ensure safe and reliable service."[17] If less than the authorized amount is spent, then the unspent amount will be refunded to ratepayers, making those monies no longer available for the intended program and, thus, the incentive is for the utility to spend the amount authorized, if not more. One-way balancing accounts do not limit prudent utility decision-making regarding safety. Utilities have the flexibility to spend more than the amount of the "cap" in a one-way balancing account. If a utility determines that more funds are needed for a particular program, the utility can reprioritize its budget to enable more spending towards an activity. The Commission has recognized that "it is the utility management's prerogative and responsibility to provide safe and reliable service by reprioritizing and deferring activities as necessary, [but] the Commission must be assured that the process is reasonable."[18] In PG&E's 2011 GRC, for example, those assurances came in the form of reporting requirements imposed on PG&E, "as a step in ensuring that any reprioritization processes are reasonable and result in the best use of ratepayer funds."[19]

The IRP Report states: "A key characteristic of one-way balancing accounts is that they preclude the utility from recovering integrity management expenses that exceed

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[16] IRP Report, p. 105.

[17] D.11-05-018 p. 29.

[18] D.11-05-018, p. 29.

[19] D.11-05-018, pp. 29-30.

authorized forecasted amounts, even if those costs are prudent."[20] As explained above, this statement shows a limited understanding of the purpose for such an account. The establishment of one-way balancing accounts in limited areas does not change the overall general rate case funding level, the balance of ratepayer/shareholder interests, and the opportunity for a utility to earn its authorized rate of return. The one-way balancing account is typically adopted because it is in the public interest to encourage the utility to spend the authorized level of expenses in limited areas of a rate case which are typically related to safety and reliability, such as pipeline integrity and vegetation management.

Contrary to the IRP Report's characterization, the one-way balancing account does not preclude the utility from recovering costs that exceed authorized forecast amounts. This is because there are literally hundreds of work categories and functional areas which are funded through the general rate case process. The utility may prioritize work as it deems necessary and if it spends more money than authorized in one area, such as integrity management, then it may be spending less in another area. For example, the change in tax law that provides for 100% bonus depreciation will serve to reduce utility costs relative to authorized levels. In that case, the lower costs will serve to offset higher costs incurred in other areas. This applies to literally hundreds of different accounts where the utility's actual expenses can either be below or exceed the authorized amounts. Ultimately, in nearly every area of a general rate case the actual costs will be either higher or lower than authorized levels, and pipeline integrity is no different than any other area in this regard. All these factors then serve to impact the actual rate of return a utility earns. This return may either exceed or be lower than the authorized rate of return, which already incorporates regulatory and business risks.[21]

Furthermore, the utilities are not precluded from seeking additional funds between rate cases for incremental work considered necessary for integrity management. PG&E's Cornerstone Improvement Project (Application 08-05-023) is a case in point. DRA

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[20] IRP Report, p. 191.

[21] *See* D.07-12-049, p. 55, Conclusions of Law 23, 24 and 25.

generally opposes modification of funding levels between general rate cases because, as previously explained, there are hundreds of different areas funded in general rate cases where actual costs will vary from authorized. These factors all serve to impact the rate of return earned by a utility that, again, incorporates business and regulatory risks. In short, the one-way balancing account mechanism does not inhibit utilities from fulfilling their responsibility and obligation to ensure the safety of their systems and provide safe and reliable service.

B. Performance-Based Incentive Mechanism

The IRP Report recommends: "Upon thorough analysis of benchmark data, adopt performance standards for pipeline safety and reliability for PG&E, including the possibility of rate incentives and penalties based on achievement of specified levels of performance."[22]

DRA recommends against formally adopting such a policy at this time. DRA agrees, however, that the concept of a performance-based incentive-and-penalty mechanism for pipeline safety and reliability is worth further consideration, and suggests that this analysis be accomplished within the context of general rate case or other appropriate applications.

C. Interaction between Safety and Ratemaking Branches

One of the IRP Report's recommendations is to "[i]mprove interaction between the gas safety organization and the Division of Ratepayer Advocates of the CPUC so that there is an enhanced understanding of the costs associated with pipeline safety."[23] DRA has maintained a professional and cooperative relationship over the past several years with CPSD. The IRP Report does not recognize the level of cooperation that has occurred between DRA and CPSD in many general rate cases. Fortunately, DRA has been able to tap into CPSD's technical expertise and resources on many occasions and

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[22] IRP Report, p. 108.

[23] IRP Report, p. 108.

has had the privilege to work collaboratively with CPSD experts on various GRCs. For instance, in A.02-11-017, PG&E's Test Year 2003 GRC, CPSD assisted DRA with its Report on Storm Response and System Reliability in addition to providing technical information in the gas and electric operational and maintenance expense areas. In A.04-12-014, DRA worked collaboratively with CPSD on electric maintenance issues. In that case, the Commission approved a stipulation filed by DRA, Southern California Edison ("SCE") and The Utility Reform Network reflecting the development of a new maintenance program set forth in an SCE/CPSD agreement.[24] These are only a few examples of the cooperation between DRA and CPSD that has transpired over the years. In many other general rate cases, CPSD and DRA management have met to discuss issues while CPSD staff has provided DRA experts with valuable technical expertise and information. DRA welcomes the opportunity to increase the level of coordination with CPSD, including the sharing of reports on a regular basis.

The IRP Report observes that "ratemaking staff in the Division of Ratepayer Advocates may episodically challenge the level of spend[ing], but that challenge is not informed by integrity management results the safety staff is auditing."[25] Safety is very much a part of DRA's statutory mandate to advocate on behalf of public utility customers for the lowest possible utility service rates consistent with safe and reliable service levels. DRA is amenable and looks forward to receiving such CPSD audit reports when safety staff issues them. DRA and CPSD can work on internal procedures for increasing the cooperation and flow of information between the two branches. DRA agrees with the IRP Report that "[i]t is incumbent on the entire organization – safety and ratemaking branches – to understand the need for investments in safety and reliability, the goals expected from the investments, the alternatives considered, and the progress in system improvements."[26] Most importantly, in this regard, it is incumbent on the utilities to

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[24] *See* D.06-05-016, pp. 58-63.

[25] IRP Report, p. 103.

[26] IRP Report, p. 103.

provide the necessary facts and other supporting information within its rate case applications that appropriately justify and thoroughly support necessary safety related operational and maintenance expenses and capital investments.

III. CONCLUSION

DRA appreciates this opportunity to comment on the IRP Report. The IRP Report's recommendations should be carefully considered in the appropriate proceeding, whether it be this rulemaking or a utility-specific proceeding such as a general rate case.

Respectfully submitted,

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