Further comments and questions after 4-9 action on San Bruno Proceedings

At this point, I have to ask myself two questions as to how effective our efforts have been.

- Has PG&E developed a safety culture that is effective throughout the organization?
- Can our theories of deterrence – our system of penalties and remedies – assure an effective safety culture in a utility?

The Independent Review Panel on the San Bruno Explosion reported on June 24, 2011 that, “In the gas transmission business, the [nota bene: PG&E] company management made a faulty assumption. It did not make the connection among its high level goals, its enterprise risk management process and the work that was actually going on in the company. We think that this failing is a product of the culture of the company – a culture whose rhetoric does not match its practices.”

The panel listed a number of issues contributing to this dysfunctional culture, including excessive levels of management, appearance-led strategy setting, insularity and an overemphasis on financial performance. The report found that the CPUC also failed to maintain a strong safety-oriented culture and emphasized that this erosion took place over “a decade or more” and that “actions to rebuild these organizations will take time as well.”

Assessing these questions are important not only to the issues we’ve been dealing with at PG&E, but also to measure our own progress in re-establishing and strengthening our own safety programs. That assessment will certainly apply to PG&E, but perhaps also to all utilities and industries where we have authority.

*Has PG&E been able build a thorough and organization-wide safety culture?*

PG&E has certainly made some large expenditures on improvements and replacements of aging pipelines. Those efforts have added more safety to PG&E’s gas system. PG&E’s approved total spending in relation to our Pipeline Safety Enhancement decision was $870 million through 12/31/2014, and covered a variety of actions, including pipeline modernization (which includes pressure testing, inspection and replacement), pipeline records integration, valve automation, and other improvements.

I’ve gone out to see some of these safety investments: I visited new gas control centers for both low pressure local distribution and high volume gas transmission systems in San Ramon, made a field visit to a gas distribution upgrade program in Sacramento, and saw PG&E’s crews respond to a serious rupture in a six inch local pipeline due to a dig-in accident on a road building project. During a meeting and update from PG&E senior managers and executives, they described an effort to break through the multiple levels of management by having field personnel at every level join in a weekly call with top gas program managers to go over their observations.

These are good efforts; necessary steps, and I’ve always been very impressed by the hard work and attention to detail that I’ve seen in the PG&E line crews I visited. But during one briefing on gas distribution efforts, I told PG&E execs that what I saw was uneven across their organization, and that it
concerned me deeply. And, while, PG&E has added new board members with gas utility and operations experience, it is not clear yet whether those additions have penetrated the many layers of the organization, or forced change across the state, or that the Board of Directors, with oversight of two different businesses, gas and electric, and operating a nuclear power plant, offers the same accountability along all lines of business...

Despite major public attention, ongoing CPUC investigations (OIs) and rulemakings (OIRs) into PG&E’s actions and operations, including the investigations we voted on today, federal grand jury, and California Department of Justice investigation, continued safety lapses at PG&E continue to occur.

- The Kern Gas Plant Demolition includes two separate accidents involving the same contractor and occurring roughly a year apart.
  - The first incident took place on June 19, 2012 involving a death. No PG&E onsite supervisor.
  - The second incident took place on August 13, 2013 (same subcontractor). No PG&E onsite supervisor.

Both incidents took place subsequent to the San Bruno explosion

- Recently, the Commission opened an investigation into PG&E’s gas distribution record keeping practices. The Commission may impose penalties for record-keeping violations related to the following events:
  - Carmel residential gas explosion March 3, 2014 ($10.8 million fine). When the Commission issued a citation and $10.85 million fine for safety violations last November, it noted that the ticket failed to note Aldyl-A liner in pipe.
  - Milpitas failure during gas pipe replacement on October 10, 2012. Bad engineering on pipeline pressure and work crew failed to monitor pressure valves.
  - Mountain View pipeline tap on July 30, 2013. Ticket failed to note plastic insert.

All appear to share similarities to the Rancho Cordova incident in 2008.

- Metcalf Substation:
  - The Substation was attacked from a distance with high-powered rifle on April 16, 2013.
  - August 26-27, 2014, perimeter breached at two locations, and site burglarized, even with onsite security team. Monitors in off-site security center ignored alarms.
  - November 25, 2014 - PG&E fired the security firm several months later.

Recently, the West Park Substation near Bakersfield suffered two separate attacks in one night.
So, I still cannot say that I know whether PG&E is developing a company-wide effective safety culture, or whether it is merely in the process of working out the kinks. The following chart illustrates this concern.

Number of Violations Identified During Utility Inspections by Year and Utility (2006 to 2013)

Are the theories of deterrence that underlie our enforcement programs effective toward assuring a safety culture at PG&E?

We currently have three tools for safety assurance at the CPUC: enforcement and penalties, remedies and corrective actions, and now, risk assessment, which is an incentive to link risk reduction to rate structures.
The theory advanced in our decisions in the San Bruno explosion and fire, recordkeeping, and class location OIIs is that we levy fines and monetary penalties against utilities to deter non-compliance and to serve as an example to others. Here are a few quotes from our various investigations and proceedings:

“Our decision to use a mix of penalties and remedies is based on our intention to penalize PG&E for its violations and to deter similar behavior and violations in the future.”

Also, “In setting the penalty, we have considered a variety of factors, including the need to deter PG&E from committing future violations…”

Also, “8. The purpose of fines is to deter further violations by the perpetrator and others.”

Also, “23. The purpose of a penalty is to deter future violations by the company and others.”

Here’s our bind: we are now reaching the upper end of the range of fines and cash penalties that the CPUC’s economic studies, cited in these just-adopted decisions, argue that we can make the utility pay without raising the cost to borrow capital, and thus raise costs to ratepayers. If, indeed, PG&E is failing to establish a safety culture, and we continue to see more accidents and violations of safety rules, what are our tools?

Procedurally, the model of instituting OIIs or issuing citations for violations compels the Commission to serially examine individual violations and safety incidents. Assessment of a safety culture, on the other hand, requires a systemic evaluation and identification of patterns of incidents and behavior (for good or for bad). While corporate leadership – at least at the executive level – has stated publicly that safety is accepted as an urgent matter at PG&E, it’s not clear that the organization is responding evenly.

Here are some of the questions I ask:

1. How is the utility being held accountable? What is the mechanism? Who specifically within the company will be deterred by our fines and penalties? Do shareholders, Board directors, executive officers, senior managers or line staff respond to fines and penalties? How?

   a. After the announcement of the Decision Different a month ago, PG&E share value went up 3%. Are shareholders discomfited? I signaled in this proceeding my intent to limit our penalties at $2.45 billion, so as to avoid raising the costs for PG&E to borrow to cover operations that will later be funded through ERRA or other balancing accounts. Clearly the market took this all into account, and so may have little incentive to get engaged on behalf of shareholders. Shareholders simply may be abdicating their responsibility to hold their Board of Directors accountable to state laws and rules, knowing that we have an interest in limiting our sanctions to levels that they, as owners, can live with, so as to avoid impacts on ratepayers, as well. Capital markets, then, are treating fines and penalties as a cost of doing business.
b. Do PG&E Board directors or executive officers feel CPUC sanctions directly? Is there any one with authority within the company who is accountable for our fines and penalties? What mechanism holds them accountable? The CEO who held that position at the time of the San Bruno incident, and during cuts in funding pipeline replacement and inspection programs, retired with a reported $38 million bonus.\textsuperscript{viii} The President of PG&E at the time of the San Bruno incident is still the president.

c. The utility buys and manages long lasting infrastructure. Are their executive incentive programs aligned with the public’s interest in PG&E acting as a patient capital manager maintaining this long-lived infrastructure, or do they compensate based on quarterly returns to the stock market?

We represent ratepayers, not shareholders, but are there ways that we can borrow from corporate governance practice – the body of theory and practice that institutional shareholders and activist investors use to hold Boards of Directors and senior officers accountable to their interests – to find remedies that might improve PG&E’s decision making, accountability and safety programs?

2. Would an effective theory of enforcement and deterrence include proceedings against individual corporate officers and decision makers who contribute to safety hazards and incidents? In our Rules, we seem to anticipate this possibility:

“In adopting G(eneral) O(der) 112, the Commission noted, public utilities serving or transmitting gas bear a great responsibility to the public respecting the safety of their facilities and operating practices... It is recognized that no code of safety rules, no matter how carefully and well prepared can be relied upon to guarantee complete freedom from accidents. Moreover, the promulgation of precautionary safety rules does not remove or minimize the primary obligation and responsibility of [gas utilities] to provide safe service and facilities in their gas operations. Officers and employees of the [gas utilities] must continue to be ever conscious of the importance of safe operating practices and facilities and of their obligation to the public in that respect.\textsuperscript{xix} (italics added)

Can we borrow from the Sarbanes-Oxley model by requiring senior executives and senior management to attest to the veracity and completeness of reports, and holding them accountable for untrue or misleading or incomplete statements? Should we require them to attest that their safety programs will be effective? How would we respond if they fail to build and manage a safe utility? Should we add “claw backs” to executive compensation or stock options, as has been suggested in the corporate governance literature?

3. Is the organization simply too large – spread across a sizeable portion of a large state, and encompassing diverse functions such as both gas transmission and gas distribution, as well as electric service – to succeed at safety? The Independent Review Commission noted the many layers between senior executives and field staff. Add to that the separate gas and electric businesses under the oversight of the PG&E Board of Directors, and with the same CEO and senior executive
team over both. The question may not be whether PG&E is too big to fail, but instead, “is the company too big to succeed?”

Proposals:

We need to keep an open mind as the facts and to the outcomes of pursuing these questions. We need to build solid factual basis on whether there is a comprehensive and effective safety culture at PG&E that encompasses all functions and all locations. And we may need to update our theory of deterrence a part of our Safety Plan so as to gain not only compliance but constant safety improvement above compliance for all the utilities we regulate.

a. I intend to ask the Commission to open an OII into the safety culture and practice of PG&E. Is it thorough and comprehensive across the scale of the organization? Is it effective? Is there effective accountability?

b. I will ask Legal Division to analyze and evaluate our policies regarding penalties and remedies, and makes recommendations for adoption as part of our Safety Plan. What should our theory of deterrence be? What can we learn from corporate governance theory? How do we evaluate the effectiveness of boards and senior execs for accountability and safety effectiveness? What are our remedies? How would different options affect the fiscal structure of companies and their cost of borrowing? Would these various efforts introduce operational barriers or reduce administrative efficiency?

---

4 Page 3, Decision Different of President Picker, March 13, 2015
8 see pages 194 and 195, Presiding Officer’s Decision Regarding Alleged Violations by Pacific Gas and Electric Company in Connection with the San Bruno Explosion and Fire.
Pipelines. (Also see page 36, Presiding Officer’s Decision Regarding Alleged Violations by Pacific Gas and Electric Company in Connection with the San Bruno Explosion and Fire)