

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Investigation on the Commission's Own Motion into the Operations and Practices of Pacific Gas and Electric Company to Determine Violations of Public Utilities Code Section 451, General Order 112, and Other Applicable Standards, Laws, Rules and Regulations in Connection with the San Bruno Explosion and Fire on September 9, 2010.

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(Filed January 12, 2012)
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Order Instituting Investigation on the Commission's Own Motion into the Operations and Practices of Pacific Gas and Electric Company with Respect to Facilities Records for its Natural Gas Transmission System Pipelines.

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Order Instituting Investigation on the Commission's Own Motion into the Operations and Practices of Pacific Gas and Electric Company's Natural Gas Transmission Pipeline System in Locations with Higher Population Density.

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**AMENDED REPLY BRIEF
OF THE CONSUMER PROTECTION AND SAFETY DIVISION
ON FINES AND REMEDIES**

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I. INTRODUCTION

Pursuant to the July 16, 2013 e-mail authorization of ALJ Yip-Kikugawa to file CPSD's Amended Reply Brief on the morning of July 16, 2013, the July 12, 2013 ruling of Administrative Law Judges (ALJs) Wetzell and Yip-Kikugawa, and to Rule 1.12(a) of the California Public Utilities Commission's (Commission) Rules of Practice and Procedure (Rules), the Consumer Protection and Safety Division (CPSD)¹ hereby submits its Amended Reply Brief to Pacific Gas and Electric Company's (PG&E) Coordinated Remedies Brief (dated May 24, 2013) (hereinafter "PG&E CBR"). As set forth in CPSD's Motion for Procedural Rulings to allow CPSD to file an Amended Reply Brief, which the ALJs granted: 1) the 2-page Remedies portion of CPSD's previous Reply brief (and its Appendix A and Appendix B) would remain and not count towards the 10-page limit in this Amended Reply Brief; 2) the revisions to the CPSD's Reply Brief in the Amended Reply Brief are intended to completely supercede the other sections of CPSD's Previous Reply Brief; and 3) the revisions to CPSD's position in its Opening Brief on Fines and Remedies (Opening Brief) would also be included within the 10 pages. Due to CPSD's revised position in its Opening Brief, CPSD felt compelled in its motion to provide Pacific Gas and Electric Company (PG&E) with an opportunity to respond, and the ALJs granted PG&E an opportunity to file a 10-page response.

PG&E will still be required to pay a total of \$2.25 billion towards its Pipeline Safety Enhancement Program (PSEP) costs. The key differences in CPSD's position in its previous Opening Brief and Reply Brief with its corrected position herein are: 1) CPSD submits that \$300 million should be the minimum fine paid to the General Fund; and 2) this would leave \$1.950 billion that should be applied to the costs required by the Commission D.12-12-030 when it mandated PG&E's PSEP. As discussed below, after the Commission disallowed costs in D.12-12-030, the Commission authorized PG&E to

¹ On January 1, 2013, CPSD officially changed its name to the Safety and Enforcement Division (SED). However, for the sake of convenience, we will continue to refer to SED as "CPSD" in this brief and through the remainder of this proceeding.

recover from ratepayers \$1.169 billion costs in Phase I of PG&E's PSEP. This \$1.950 billion should be sufficient to pay the costs in Phase I of PG&E's PSEP, including the ratepayers share of the costs, as well as the specified remedies in CPSD's brief,² with the remaining amounts to be applied to PG&E's Phase II for its PSEP costs. As discussed below, this amount includes \$635 million which the Commission disallowed in D.12-12-030 which should be reduced by \$200 million.

In light of PG&E's extensive violations of its safety obligations under California law and regulations (as summarized in CPSD's Opening Brief, pp. 8-35, and established during the three OIIs), CPSD recommends that PG&E must pay a fine to the General Fund, which is larger than any fine ordered by the Commission in its history. The tragedy in San Bruno, which was directly caused by PG&E's unreasonable conduct and neglect for decades, was the worst disaster in the history of California electric and/or gas utilities. Therefore, CPSD is recommending a minimum fine of \$300 million that PG&E must pay to the General Fund. For PG&E's unreasonable and imprudent conduct in neglecting to repair and replace its aging infrastructure, CPSD also submits that it is unreasonable to expect PG&E's ratepayers to pay for all of the testing, repairs and replacements of PG&E's transmission system as ordered by the Commission in D.12-12-030, when it approved PG&E's PSEP. The Commission made clear that its order was subject to refund based upon the outcome of these OIIs. See D.12-12-030 at p.126, Ordering Paragraph (OP) 3. Therefore, CPSD submits that the size of the fine must be balanced against maximizing the ratepayers' benefits and holding PG&E shareholders responsible up to the maximum extent possible for the costs of bringing PG&E into compliance with the Commission's mandated PSEP. With this in mind, CPSD is recommending that the Commission order PG&E to pay a total of \$2.25 billion, with a minimum \$300 million fine paid immediately to the General Fund. The remaining \$1.950 billion should be used to pay for the disallowed costs of shareholders in

² The CPSD expects that these remedies should be relatively low in costs compared to the \$1.515 billion. The most costly remedy involves PG&E's Pipeline Records Integration Program, which the Commission in D.12-12-030 at p. 87 had disallowed, and, therefore, this remedy should not be borne by ratepayers.

D.12-12-030 and to decrease the burden on ratepayers from paying for any of PG&E's PSEP costs in Phase I, as well as the specific remedies CPSD's expert witnesses have recommended for approval. Any amounts remaining thereafter should be used for ratepayer relief for future Phase II costs.

II. PG&E SHAREHOLDERS SHOULD FUND ALL OF PG&E'S PSEP PHASE I AND A PORTION OF PG&E'S PHASE II COSTS, AS WELL AS PAY A SIGNIFICANT FINE TO THE GENERAL FUND

Because the Commission must take into account the utility's ability to pay, CPSD hired Overland Consulting to determine the maximum amount that PG&E can be required to pay without hurting its PG&E's creditworthiness, and Overland Consulting determined that this amount is \$2.25 billion. According to Overland Consulting: "A financially healthy utility is in the best interests of all stakeholders, including the CPUC, PG&E customers, and the company's stockholders and creditors." (Joint Ex. 51, p. 13.) It should be noted that the figure of \$2.25 billion is derived from Joint Exhibit 51, the August 2012 financial analysis report by Overland Consulting, which states that \$2.25 billion is an estimate of "the incremental external equity capital available to PCG" in order to "raise equity capital sufficient to fund a CPUC imposed fine" while maintaining the quality of PG&E's credit rating and ability to raise future capital. (Ibid.)

To clarify, Overland's figure of \$2.25 billion is "additional equity capital [Overland] believe[s] could be raised beyond the \$600 million PCG assumed in 2012." (Ibid.) The \$600 million raised by PG&E in 2012 includes \$200 million that PG&E raised to fund an anticipated fine by the CPUC in this proceeding, which was already incorporated into the PG&E forecasts that Overland used. (Joint Exhibit 53, p. 22.) In other words, PG&E has already raised \$200 million in 2012 to fund the payment of a fine, which does not impact PG&E's ability to raise an additional \$2.25 billion in equity capital going forward.

PG&E's estimated PSEP Phase I expenses total \$2.184 billion for the time period 2011-2014. The Commission determined that PG&E cannot recover all of this amount from ratepayers; instead, the Commission authorized PG&E to recover \$165 million in

expenses for 2011-2014 and \$1.004 billion in capital expenditures for 2011-2014. (D.12-12-030, Tables E-2 and E-3.) The difference between the requested amount (\$2.184 billion) and the authorized amount (\$1.169 billion) is the theoretical amount that shareholders must cover (\$1.015 billion).

The Commission, however, has determined that a portion of PG&E's requested PSEP costs consist of unreasonable requests; namely, PG&E's request for risk-based cost overruns in the amount of \$380.5 million was found to be unreasonable and therefore not recoverable. The Commission found that PG&E's projections of costs for the PSEP were "already biased to the high end of the expected cost range" and thus already "include an implicit allowance for unexpected cost overruns." (D.12-12-030, p. 98.) CPSD believes it is therefore unlikely that PG&E will actually expend \$380.5 million in cost overruns, and thus there will be no impact on PG&E's ability to raise equity capital to pay fines and future expenses.

This results in a "true" disallowance³ of \$634.5 million (i.e., \$1,015 billion - \$380.5 million = \$634.5 million), that PG&E will have to cover from other means, such as raising equity capital. PG&E has already raised \$200 million in equity capital in 2012 to pay an anticipated fine (Joint Exhibit 53, p. 22), and, therefore, subtracting this \$200 million from the \$634.5 million, results in an approximate amount of \$435 million that PG&E must still raise for capital for its disallowed PSEP costs. Thus, PG&E's ability to raise capital is \$2.25 billion as estimated by Overland.

CPSD recommends that the \$2.25 billion be allocated as follows: 1) \$435 million to pay for the remaining disallowances for shareholders from D.12-12-030; 2) \$300 million as the fine to the General Fund; and 3) \$1.515 billion should pay for the ratepayers' share of PSEP Phase I costs with any remaining amounts helping pay for the ratepayers' share of PSEP Phase II costs. (Hereinafter, the "\$2.25 billion breakdown.")

³ The cost overruns (contingencies) were not truly disallowed, because they are only theoretical. The Commission found that they would not likely occur and thus did not allow PG&E to recover them.

III. THE COMMISSION HAS AMPLE AUTHORITY TO IMPOSE A PENALTY REQUIRING PG&E'S PAYMENT OF A FINE TO THE GENERAL FUND

As a matter of law, all PG&E fines and penalties derived from California Public Utilities Code §§ 2100, *et seq.*, must be paid directly to California's General Fund. The plain language of written statutes and case law requires this result. Section 2104.5 of the California Public Utilities Code explicitly mandates that “[a]ll fines and penalties recovered by the state....shall be paid into the State Treasury to the credit of the General Fund.”⁴

In PG&E's CRB, p.20, PG&E argues that the Commission has no authority to impose penalties because “this is not a case in which the State has recovered fines and penalties through an action in superior court in the name of the People, and Section 2104.5 does not apply.” But PG&E should know better. In *Pacific Bell Wireless, LLC v. Public Utilities Com.* (2006) 140 Cal. App. 4th 718, 737, the Court clearly held: “The only reasonable interpretation of the statute is that it requires the Commission to go to court to collect the fines it has imposed if those fines are not paid voluntarily.” In *Pacific Bell Wireless, LLC*, the Court discusses both sections 2107 and 2104 of the California Public Utilities Code for the proposition that the Commission may impose penalties on its own authority without invoking the state's judicial process, and the Court used the words “fines” and “penalties” interchangeably. *Pacific Bell Wireless, LLC v. Public Utilities Com.* 140 Cal. App. 4th at 735-37. Therefore, nothing in the holding in *Pacific Bell Wireless, LLC*, suggests that the Commission-imposed fines do not need to go to the General Fund. In fact, in the Commission's underlying decision, which was upheld in *Pacific Bell Wireless, LLC*, the Commission had imposed penalties, which were deposited in the General Fund. *See Cingular I*, 2004 Cal. PUC LEXIS 453 at * 101.

⁴ Sections 2104 and 2104.5 of the California Public Utilities Code are similar in that both sections provide that the Commission may bring an action in Superior Court to collect fines or penalties for violations of statutory provisions, regulations, or orders of the Commission, which shall then be paid to the credit of the General Fund. Section 2104.5 specifically applies when the violation of a statutory provision, regulation or order of the Commission involves safety standards for pipeline facilities or transportation of natural gas in California.

In *Pacific Bell Wireless, LLC*, 140 Cal.App. 4th at 736, the Court also stated: “The Commission itself has consistently determined that it has the authority to directly impose fines on public utilities, and that it is required to commence an action in superior court only to collect unpaid fines.” Significantly, all three Commission decisions, which were cited by the Court and which had reflected the Commission’s historical interpretation of Section 2107, had imposed fines that went to the General Fund.⁵ Therefore, PG&E has attempted to needlessly confuse the issue of whether the Commission may impose fines with the issue of where the fines must ultimately be deposited.

In PG&E’s CRB, pp. 19-20, PG&E has strained mightily to argue that neither *Assembly v. Public Utilities Commission* (1995), 12 Cal. 4th 87 nor any other case requires one cent to go to the General Fund. PG&E’s argument in its CRB is contrary to the statement by the California Supreme Court in *Assembly*: “Existing statutory requirements authorize such a penalty proceeding, but require that any penalty must be deposited in the General Fund.” *Id.* at 102-103. PG&E’s CRB quotes out-of-context a key part of the California Supreme Court’s explanation in *Assembly* (*id.* at 103, n.10), where the California Supreme Court had noted that some statutory penalty provisions under the California Public Utilities Code expressly require that penalties collected by the Commission must be deposited in the General Fund, but a number of other statutory penalty provisions (e.g., § 2107) do not specify the use of the penalty funds.

In *Assembly*, 12 Cal. 4th at 103, n. 10, however, the California Supreme Court relied upon the Commission’s interpretation (i.e., *TURN v. PacBell*, D.94-04-057, 54 CPUC 2d at 131) for recognizing that “in accordance with the legislative policy

⁵ See *Pacific Bell Wireless, LLC*, 140 Cal. App. 4th at 736 citing, D.00-03-023 [2004 Cal.PUC LEXIS 127] Order Denying Rehearing of D.99-11-044 [1999 Cal.PUC LEXIS 875]] at * 26; *Re Communications TeleSystems Internat’l*, D.97-10-063, 76 CPUC 2d 214 Order Granting Limited Rehearing of D. 97-05-089, 72 CPUC 2d 621, 640; and *TURN v. PacBell*, D.94-04-057, 54 CPUC2d 122, 131.

expressed in sections 2100 and 2104, the penalties assessed under these provisions [§§ 701, 2107] must be deposited in the General Fund.”⁶

CPSD recommends a fine of a minimum of \$300 million. The basic reasons for the fine are as follows:

- i. The San Bruno explosion and fire killed eight persons, injured 58 others, destroyed 38 homes and damaged 70 other homes.
- ii. At any number of milestone events or times in the life of the pipe that failed, there were reasonable and prudent steps that PG&E could have taken, but did not take, that could have prevented the explosion and fire.
- iii. The violations of law in the three investigations constitute unprecedented and serious violations of PG&E’s safety obligations under the law that continued unabated for many years, and which demonstrate PG&E’s disinterest in compliance with the law. PG&E’s thousands of violations pertaining to strength test records for populated areas and SMYS records alone clearly demonstrate PG&E’s disinterest.
- iv. No other Commission case demonstrates the degree of culpability as has the three investigations combined. The Rancho Cordova case and decision against PG&E reviewed a very short list of violations and time period for violations. One person died, primarily because of negligence on two days (the day of the faulty pipe installation, and the day of the explosion). The Commission refused to accept a settlement of \$26 million to the General Fund, and instead directed PG&E to pay a \$38 million penalty.⁷
- v. CPSD believes that in view of how much more catastrophic PG&E’s San Bruno explosion was compared to the explosion caused by a distribution line leak in Rancho Cordova, that \$300 million has to be the minimum amount of the statutory fine, consistent with both past precedent and with the

⁶ *TURN v. PacBell* was one of the three Commission decisions, which *Pacific Bell Wireless, LLC*, 140 Cal.App. 4th at 736, had cited as reflecting the Commission’s historical interpretation of Section 2107, and which also had imposed fines that went to the General Fund.

⁷ See D.11-12-021, 2011 Cal. PUC Lexis 531.

Commission's future responsibilities as a law enforcement agency.

CPSD continues to recommend that, as computed from the \$2.25 billion breakdown (see page 4), the bulk of its recommended \$1.515 billion should be earmarked for easing the burden on PG&E's ratepayers for PG&E's PSEP Phase I and Phase II costs.

IV. PG&E'S EXCESSIVE FINES ARGUMENT IS BASELESS

PG&E argues that the proposed \$2.25 billion fine is unconstitutional under the state and federal Excessive Fines Clause in view of the proportionality to other penalties. First of all, part of the \$2.25 billion penalty is the "disallowance" of \$635 million under the Commission's D.12-12-030, which PG&E did not challenge, and cannot now collaterally challenge. *See* Cal. Pub. Util. Code § 1709. Thus, PG&E's starting point is way too high for its challenge to CPSD's proposal (starting at \$1.815 billion), as well as to other intervenors, such as the Commission's Division of Ratepayer Advocates (DRA) (starting at \$1.5 billion) or The Utility Reform Network (TURN) (starting at \$1.46 billion)

Secondly, PG&E's reliance on other examples for proportionality is misplaced, because nothing is comparable to San Bruno, which had a rupture in a 30-inch transmission pipeline, causing an explosion and lengthy fire in a major metropolitan area, not in a rural area, like where El Paso Natural Gas Company's pipeline had exploded. Therefore, the San Bruno explosion and fire killed eight persons, injured 58 others, destroyed 38 homes and damaged 70 other homes. Moreover, CPSD has established numerous violations of pipeline safety regulations in three OIIS, which were very lengthy in time and endangered many other high consequence areas in PG&E's service territory. Under California statutes, each day constitutes a separate offense (*see* Cal. Pub. Util. Code § 2108.), for much of the time at issue fines could be set at a minimum of \$500 or a maximum of \$20,000 (*see* Cal. Pub. Util. Code § 2107) and fines can be compromised. *See* Cal. Pub. Util. Code § 2104.5. Indeed, the entire reason that CPSD retained Overland Consulting was to consider the maximum PG&E could afford without affecting

its creditworthiness rather than let the maximum fine keep multiply into tens or hundreds of billions of dollars. This is precisely why in *Hale v. Morgan*, 22 Cal.388, 401, the California Supreme Court distinguished *People v. Western Airlines* (1954) 42 Cal.2d 621, 627-28, which upheld Cal. Pub. Util. Code § 2107 despite the daily nature of the fine. Although, CPSD had informed PG&E of this matter in CPSD's Reply Brief in I.11-02-016. PG&E must have forgotten and cited *Hale v. Morgan* anyway.

Given that the statutes involved in other states, such as Pennsylvania, or the federal statute, had capped amounts allowed per accident, they simply reflect other legislatures' prerogatives. In *Quest Corp. v. Minn. PUC* (8th Cr. 2005) 427 F.3d 1061, 1069, the court found that two considerations in the grossly disproportional analysis are the legislative intent and the gravity of the offense relative to the fine. Minnesota had a statute, which allowed the PUC to impose up to \$10,000 a day for failing to report interconnection agreements. The Court upheld the daily fines therein due to the violation of the legislative intent and that it could affect millions of dollars in telecommunications competition in that state.

In California, since San Bruno, the Legislature has passed 11 laws reinforcing the duty of the Commission to ensure that utilities keep their pipelines safe, including amending Cal. Pub. Util. Code § 2107 so that each day the fine can be \$50,000 per day. Obviously, in view of the destruction that has occurred in San Bruno and could have occurred elsewhere, the fines are not so disproportionate as to rise to the level of them being unconstitutional.

Finally, although, PG&E has cited a Commission case about the Excessive Fine Clause, D.04-04-065, 2004 Cal. PUC LEXIS 207 At *46, PG&E neglects to mention that the Commission did not find it had violated the Excessive Fines Clauses. Indeed, in that case and all the cases cited by PG&E on the Excessive Fines Clause actual fines were imposed. In the present case, CPSD's position is now, that of the \$2.25 billion breakdown (see page 4), a \$300 million fine should be imposed and that PG&E should also be required to pay \$1.515 billion dollars of refunds and/or credits to relieve ratepayers to relieve them of the burden of PSEP Phase 1 and Phase II costs. Similarly,

the intervenors herein sought much smaller fines than the amount of refunds or credits which they have sought to help the ratepayers.

Yet, nowhere does PG&E cite a single case where a state regulatory utilities commission's refunds of dollars or disallowance of costs offends the Excessive Fines Clauses.

V. RESPONSE TO PG&E'S CLARIFICATION OF PROPOSED REMEDIES

A. CPSD's Detailed Reply to PG&E Concerning Remedies Is Contained in Appendix A to this Reply Brief

The extensive shortcomings in PG&E's safety systems and compliance with the law call for extensive changes to their operations. CPSD included a list of proposed remedies in its Opening Fines and Remedies Brief. PG&E responded to these remedies in PG&E's Coordinated Reply Brief, Appendix B, and the Proposed Remedies table. To ensure a clearly organized response to PG&E, CPSD created the attached table in Appendix A, by adding one column to PG&E's Appendix B. This column is entitled "CPSD Comments re PG&E Response and Edits." Entries in this column respond to PG&E's proposed edits to CPSD's original proposed remedy.

Where CPSD's response results in modification of CPSD's original proposed remedy, the modifications are indicated (underlined text is added, strikethrough text is removed) in Column 2, entitled "Revised Party Proposal".

Appendix B to this reply brief lists CPSD's finalized proposed text from Column 2 of Appendix A. These proposed remedies are the product of extensive analysis of the shortcomings in PG&E's operations and are considered necessary by CPSD to ensure the safety of the people of California. CPSD strongly recommends the Commission adopt the recommended remedies listed in Appendix B in their entirety.

B. The Commission Should Reject PG&E's Proposal to Apply the Government Auditing Standards

PG&E proposes modifying CPSD's auditing proposal so that it is consistent with the Government Auditing Standards issued by the United States Government

Accountability Office (“GAGAS”). (See PG&E Coordinated Reply Brief, p. 102.) For the reasons discussed below, CPSD opposes this proposed modification to CPSD’s remedies proposal.

The purpose of GAGAS is to audit the government, not PG&E. By its own wording, “[t]hese standards are for use by auditors of government entities and entities that receive government awards and audit organizations performing GAGAS audits.” (See PG&E’S Request for Official Notice, Exhibit 12, p. 5.)

Furthermore, GAGAS guidance for auditing does not contemplate recordkeeping audits. In fact, the types of GAGAS audits include financial audits and attestation engagements, neither of which is pertinent to the auditing of PG&E’s safety related records. (See PG&E’S Request for Official Notice, Exhibit 12, pp. 14-16.) The final type of GAGAS audit is for “Performance Audits,” but GAGAS lists a number of types of professional standards that mesh with it, none of which include recordkeeping standards. (See PG&E’S Request for Official Notice, Exhibit 12, pp. 17, 23-24.)

Fundamentally, it is within this Commission’s discretion to choose whatever audits it wishes to employ. We are aware of no Commission precedent endorsing the use of GAGAS for any audits. Using a recent and pertinent example, Commission Resolution L-436 does not require using GAGAS, even though it requires disclosure of safety related auditing records. (See Resolution No.: L-436, p. 1.)

In short, it is up to the Commission, in its own discretion, to determine the appropriate scope of audits. Here, GAGAS is not appropriate, given PG&E’s specific auditing needs that must be carefully considered.

C. CPSD Accepts PG&E’s Clarification That It Will Take Up to Three Years for PG&E to Achieve Compliance with Generally Accepted Recordkeeping Principles, Level 3, as CPSD Has Recommended

PG&E agrees to undertake to achieve Level 3 information maturity scores under the Generally Accepted Recordkeeping Principles (“GARP”), but clarifies that it will take the Company up to three years to do so. CPSD agrees with PG&E’s proposed clarification and recommends that the Commission require PG&E to meet this deadline.

CPSD reserves the right to audit PG&E during the intervening time, in order to ensure PG&E is on schedule to achieve this commitment. CPSD provides additional response to PG&E on this point in Appendix A.

VI. CONCLUSION

For the foregoing reasons, CPSD respectfully requests that the ALJs take into account the corrected version of CPSD’s position in its fines and remedies briefs.

Respectfully submitted,

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