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**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Petition of Black Economic Council, National  
Asian American Coalition, and Latino  
Business Chamber of Greater Los Angeles To  
Adopt, Amend, Or Repeal A Regulation  
Pursuant To Public Utilities Code § 1708.5

Petition 12-02-016  
(Filed February 23, 2012)

**PACIFIC GAS AND ELECTRIC COMPANY'S (U39E)  
REPLY IN OPPOSITION TO THE  
"RESPONSE OF THE UTILITY REFORM NETWORK  
SUPPORTING THE PETITION OF THE JOINT PARTIES"**

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Dated: April 5, 2012

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Pursuant to Rule 6.3(d), Pacific Gas and Electric Company (PG&E) files this reply in opposition to the “Response of the Utility Reform Network Supporting the Petition of the Joint Parties.”<sup>1</sup>

In its Response, TURN provides three reasons for granting the Petition for Rulemaking. First, TURN argues that there could be cost savings arising from putting auditing contracts out for bid. Second, TURN suggests that auditors could be affecting revenue requirements through compensation measures. And third, TURN claims auditors could be affecting revenue requirements by wrongly allocating costs among affiliates. In addition to these arguments, TURN asks that the Petition be “broadened to any other issues the CPUC deems reasonably pertinent to assessing the impact of unreliable utility financial audits on the CPUC’s exercise of its regulatory authority, as well as to preventing harm to ratepayers stemming from utility financial audits which are of compromised integrity.”<sup>2</sup> As discussed below, TURN’s comments in support of the Petition should be disregarded.

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<sup>1</sup> On February 23, 2012, the Black Economic Council, the National Asian American Coalition, and the Latino Business Chamber of Greater Los Angeles (Joint Parties) filed a Petition asking the Commission to institute rulemaking that would, among other things, require the utilities to rotate outside auditing firms every six years. PG&E, Edison, and SoCal/SDG&E all filed responses opposing the Petition, and TURN filed a response supporting the Petition.

<sup>2</sup> TURN, p. 5.

Like the Petition itself, TURN misunderstands the purpose of independent audits and their use in regulatory proceedings. The theoretical and indirect impacts that TURN speculates could impact customers from a deficient audit do not warrant the initiation of a rulemaking, especially when the Public Company Accounting Oversight Board (PCAOB) is currently undertaking a review of the same issues (i.e., whether audit quality would be improved by requiring rotation of independent auditors).

**I. NONE OF TURN’S THREE PRIMARY ARGUMENTS WARRANT THE INITIATION OF A RULEMAKING PROCEEDING.**

**A. TURN’s Arguments About Possible Cost Savings Are Without Basis And Should Be Addressed, If At All, In Each Utility’s General Rate Case.**

TURN conjectures that there could be cost savings arising from the Joint Parties’ suggested relief. TURN states, “if the utility occasionally put its auditing needs out to bid, it might obtain similar services at lower prices than those charged by the firm that has been providing services on a continuous basis for years” and that even though “there is cause to be dubious about the price-dampening effect that such a bidding approach might achieve, given the oligopoly power of the largest accounting firms” the CPUC, nonetheless “should consider whether the potential cost savings might be another factor warranting a change in practice for the utilities.”<sup>3</sup>

TURN’s conjectures are without basis. Considerations on granting a professional contract such as an independent audit are not based on costs alone. In addition, if the Commission were to conduct a Rulemaking on the relevance of contract bidding to cost reduction, the issues that would apply are hardly unique to auditing contracts. Utilities’ costs, including their forecasts of audit fees, are examined in each general rate case, which is the appropriate forum for considering this issue.

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<sup>3</sup> TURN, p. 4.

**B. TURN's Arguments About Compensation Measures Are Also Without Basis, As Compensation Issues Are Addressed In The Total Compensation Study Submitted For Each Utility's General Rate Case, Not In The Independent Audits.**

TURN suggests that the auditors could be affecting revenue requirements thorough compensation measures. Specifically, TURN asks the Commission to consider whether the auditing firms “could have an indirect impact on authorized revenue requirements in so far as the CPUC permits rate recovery of performance incentive payments” and “the work of the independent auditors feeds into the determination of either the target or actual level of financial performance.”<sup>4</sup>

To the extent the Commission has allowed cost recovery of utility incentive payments, it has generally done so based on the so-called “target” incentive amounts, not on actual results. To PG&E’s knowledge, no Commission decision has allowed recovery of incentive payments based on recorded earnings. Furthermore, the “targeted” amounts that are included in forecasted rates are determined based on providing competitive compensation to employees. In PG&E’s case, the competitiveness of employee compensation is supported by a compensation study jointly overseen by PG&E and the Division of Ratepayer Advocates, and is not based on the results of the independent audit. As there is no direct link between the independent audit and ratemaking treatment of incentive payments, this argument by TURN also does not warrant a generic rulemaking.

**C. TURN's Argument About Wrongful Allocation of Costs Is Also Misplaced, As Affiliate Transactions Are Subject to Significant Scrutiny Through DRA Audits, As Well As Annual Affiliate Transaction Reports.**

TURN suggests the auditors could be affecting revenue requirements by wrongly allocating costs among affiliates. In support, TURN states that the firms “may play a role in the authorized revenue requirements for utilities with more active holding companies and

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<sup>4</sup> TURN, p. 4.

unregulated affiliates” in that during the course of their work the auditors “adopt some allocation of shared costs among the entities and, one would presume, deem that allocation reasonable for auditing purposes.”<sup>5</sup> TURN then theorizes that the utilities’ authorized revenue requirements “may be impacted by this aspect of the auditor’s work, at least to the extent to which this allocation informs or directs the shared services cost allocation reflected in the utilities’ GRC and any other CPUC proceeding in which shared services costs effect the authorized revenue requirement.”<sup>6</sup>

TURN’s concerns are again misplaced. The role of an auditor is to independently verify that the financial statements are fairly stated in accordance with Generally Accepted Accounting Principles. Auditors do not “adopt allocations of shared costs” as TURN asserts. The Commission should not (and does not) rely on the independent audit to verify such cost allocations for ratemaking purposes. Instead, it conducts its own analysis (relying on DRA and outside consultants, as appropriate) as well as requiring utilities to file annual reports of affiliate transactions. Furthermore, it should be noted that PG&E no longer conducts material unregulated business operations and is not subject to these kinds of cost allocations. Thus, even if there were a legitimate concern on this issue (which PG&E does not believe there is), the matter is not generic and does not warrant the initiation of a rulemaking.

## **II. TURN’S RESPONSE ALSO FAILS TO IDENTIFY ANY RELATIONSHIP BETWEEN ITS SPECULATIVE CONCERNS AND THE PETITION’S REQUEST FOR A COMMISSION RULEMAKING ON ROTATION OF AUDITING FIRMS.**

In addition to the specific shortcomings of its arguments, TURN also fails to identify any relationship between its speculative ratemaking concerns and the objectives of the Petition to require firm rotation and other specified remedies. The focus of TURN’s response is on ways a deficient audit could theoretically impact customers. However, whether requiring firm rotation - the stated purpose of the Petition’s proposed rulemaking -- will *improve* or *reduce* the quality

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<sup>5</sup> TURN, p. 4-5.

<sup>6</sup> TURN, p. 5.

of audits, is currently under study by the PCAOB, the agency specifically tasked by Congress to examine this issue. The PCAOB could well find that requiring firm rotation may create costs that outweigh the benefits, or that other less extreme remedial measures should be implemented. As PG&E stated in its response to the Petition, at the very least the Commission should conclude that it should defer consideration of the OIR until the PCAOB completes its work.

Moreover, the misdirected concerns of TURN about how a deficient audit could *theoretically* impact customers demonstrate why these concerns are best left to specific ratemaking proceedings where this issue could be shown to be relevant. While one can theorize, as TURN has done, about speculative impacts, PG&E submits that these kinds of vague and unsubstantiated concerns do not warrant the initiation of a generic rulemaking. Instead, the appropriate time and place to address such a matter is in a specific proceeding where it can be shown that the independent audit is related directly to the rate relief being sought and there is reason to believe the audit was defective. Thus far, the Joint Parties have failed to make any such specific showing and the generalized concerns raised by the Petition (as supported by TURN) do not warrant a generic rulemaking.

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### III. CONCLUSION

For reasons set forth above, the Commission should find that TURN has failed to provide sufficient reason for granting the Petition. The Commission should, therefore, deny the Petition based on the Responses previously submitted by PG&E and the other utilities.

Respectfully Submitted,

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