

Decision 09-12-002 December 3, 2009

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

Application of Pacific Gas and Electric Company for Review of Entries to the Energy Resource Recovery Account (ERRA) And Compliance Review of Fuel Procurement for Utility Retained Generation, Administration of Power Purchase Contracts, and Least Cost Dispatch of Electric Generation Resources for the Record Period of January 1 through December 31, 2008 (U39E).

Application 09-02-008  
(Filed February 13, 2009)

**DECISION APPROVING PACIFIC GAS AND ELECTRIC COMPANY  
2008 ENERGY RESOURCE RECOVERY ACCOUNT COMPLIANCE**

**I. Summary**

This decision finds that Pacific Gas and Electric Company's (PG&E) utility-retained generation fuel procurement, administration of power purchase agreements, and least-cost dispatch power activities for the period beginning January 1, 2008 and ending December 31, 2008 were reasonable and prudent. We also find PG&E's procurement-related revenue and expenses recorded in its Energy Resource Recovery Account (ERRA) balancing account during the record period reasonable and prudent. PG&E is directed to work with Division of Ratepayer Advocates to develop internal auditing procedures to review its contract administration activities related to the 2010 ERRA proceeding. This proceeding is closed.

**II. Background**

Pub. Util. Code § 454.5(d)(2) provided for a procurement plan that would:

Eliminate the need for after-the-fact reasonableness reviews of an electrical corporation's actions in compliance with an approved procurement plan, including resulting electricity procurement contracts, practices, and related expenses. However, the commission may establish a regulatory process to verify and assure that each contract, and contract dispute which may arise are reasonably resolved.

In Decision (D.) 02-10-062, the Commission implemented Section 454.5 (d) by establishing Energy Resource Recovery Account (ERRA) balancing accounts for Pacific Gas and Electric Company (PG&E) and other utilities, requiring them to track fuel and purchased power revenues against actual recorded costs and to establish an annual ERRA compliance review for the previous year and an annual ERRA fuel and purchased power revenue requirement for the following year. The most recent Commission decision on a PG&E ERRA compliance application was D.08-10-002, for 2007.

In D.07-12-052, the Commission approved with modifications PG&E's long-term procurement plan for 2007 through 2016. Resolution E-4177, effective June 26, 2008, approved PG&E's conformed 2006 long-term procurement plan, which was the basis for PG&E's 2008 compliance activities.

On February 13, 2009, PG&E filed Application 09-02-008 for review of entries to its ERRA and compliance review of fuel procurement for utility retained generation (URG), administration of power purchase contracts, and least cost dispatch of electric generation resources for the record period of January 1 through December 31, 2008 (record period). PG&E served prepared testimony with its application.

A prehearing conference was held on April 14, 2009. The Scoping Memo was issued on May 5, 2009. The Scoping Memo identified four issues for this proceeding:

1. Whether the fuel procurement activities for PG&E's URG and allocated California Department of Water Resources (CDWR) contracts were reasonable.
2. Whether PG&E administers and manages Qualifying Facility (QF) and non-QF contracts in accordance with the contract provisions and follows Commission guidelines.
3. Whether PG&E achieved least cost dispatch of its energy resources, including day-ahead and hour-ahead transactions.
4. Whether the entries in the ERRRA balancing account and other balancing and memorandum accounts are appropriate.

The Commission's Division of Ratepayer Advocates (DRA) served testimony on July 1, 2009. PG&E served rebuttal testimony on July 31, 2009. An evidentiary hearing was held on August 19, 2009.

PG&E provided a public version of its prepared testimony and a confidential (unredacted) version submitted under Pub. Util. Code §§ 454.5(g) and 583. The public version is marked for identification as Exhibit PG&E-1 and the confidential version as Exhibit PG&E-2. DRA also provided a public (redacted) Exhibit (DRA-1) and confidential (unredacted) Exhibit (DRA-2). PG&E also served rebuttal testimony, marked as Exhibit PG&E-3. All exhibits are received into the evidentiary record for this proceeding. Exhibits PG&E-2 and DRA-2, the confidential testimony, shall be filed under seal and remain sealed for a period of three years from the effective date of this decision.

### **III. Positions of Parties**

PG&E requests the Commission find that in 2008 PG&E complied with its Conformed 2006 Long-Term Procurement Plan in the areas of fuel procurement for utility retained generation, administration of power purchase contracts and

least cost dispatch of electric generation resources in the record period. PG&E also seeks a finding that it made appropriate entries to ERRA.

DRA agrees with PG&E that its regular fuel and procurement activities and internal audit program for its URG facilities were reasonable for the record period. DRA's review of PG&E CDWR contract administration found that PG&E's contract management and administration during the record period were prudent and in compliance with the terms of those contracts and other relevant provisions. For QF and non-QF contract administration, DRA found PG&E's management and administration activities to be reasonable and prudent for the record period. DRA made no recommendation regarding least cost dispatch. DRA did not note any items of a material nature requiring adjustments to PG&E's ERRA balancing account.

There is only one topic in dispute between PG&E and DRA, regarding auditing of the ERRA funds.

In its testimony, DRA noted that:

PG&E'S Internal Audit Department has performed internal audits related to balancing account administration; however, the Internal Audit Department does not perform comprehensive internal audits of the ERRA Balancing Account. PG&E's ERRA revenues, costs, and expenses are material and have a significant rate impact on PG&E's customers. For 2008, PG&E's ERRA net revenues totaled almost \$3.9 billion and the ERRA net costs and expenses totaled almost \$4.1 billion.

DRA recommends that:

PG&E's Internal Audit Department should perform comprehensive internal audits of the ERRA balancing account, preferably annually, but not less than every three years. The scope of the internal audits of the ERRA balancing account should be comprehensive, covering financial, operational, and

regulatory compliance issues pertaining to the 26 tariff line items comprising the ERRA balancing account.

In rebuttal testimony, PG&E opposes DRA's recommendation that there be an internal audit of the ERRA balancing account at least every three years:

PG&E's Internal Auditing department does not conduct comprehensive audits of specific balancing accounts, ERRA or otherwise. Instead, Internal Auditing performs audits of controls in place for ensuring that balancing accounts are recorded accurately and according to rules specified by the Commission.

Internal Auditing periodically performs an audit of the Utility's controls for ensuring that balancing accounts are recorded accurately and according to rules specified by the Commission. The scope of this audit includes testing of controls over account reconciliations, account adjustment and allocations, and account analysis. It also includes an assessment of processes to ensure that new requirements stemming from Commission decisions and advice filing approvals are incorporated timely and accurately. In addition, Internal Auditing performs audits over controls in place over the business processes and functions that create the costs and revenues ultimately included in the 26 individual line items of the ERRA balancing account.

Internal Auditing is not the only assurance process in place over balancing accounts. PG&E's Sarbanes-Oxley process includes the documentation and periodic testing of key controls that support balancing accounts. PG&E's external auditors, Deloitte & Touche, attest to the accuracy of our financial statements. Another control in place is the Procurement Review Group, which reviews the strategies, contracts, and process for energy procurement. The audit DRA recommends goes against the role and objectives of Internal Auditing, as it seems to encompass audit activities currently performed by both Internal Auditing and PG&E's external auditors. The scope of the audit that the DRA recommends is more similar to the audit that the DRA itself performs on the ERRA balancing account.

DRA contends that an internal audit of PG&E ERRA balancing account is necessary and would benefit ratepayers and PG&E by providing more assurance of the reliability and integrity of the ERRA transactions record and of the account balances. DRA does not believe that “audits of controls,” “testing of controls” and/or “assessment of processes” are sufficient to assure the integrity of the funds processed through the ERRA balancing account. Nor does DRA believe that PG&E’s approach of reliance on a Sarbanes-Oxley process is a sufficient check on the ERRA balancing account. DRA contends PG&E takes an ad hoc approach to testing the ERRA balancing account instead of a systematic, disciplined approach to an account in excess of \$4 Billion.

In its testimony, DRA also noted that:

DRA looked at the internal audit controls used by PG&E, to determine their adequacy to prevent or minimize errors and to assure quality and cost performance. DRA noted that during the record period PG&E did not perform an internal audit of contract administration.

Based on this finding, DRA recommends that the Commission should order PG&E to consult with DRA in the development of its 2010 risk-adjusted Internal Audit plan for contract administration activities. Specifically, DRA seeks an order that PG&E provide DRA with (a) timely advance notice of, (b) adequate opportunity to inquire about, and (c) a meaningful opportunity to comment upon, each step in the review and development of that Plan. However, DRA acknowledges that this recommendation is unnecessary if the Commission adopts DRA’s recommendation for an internal audit of the ERRA balancing account every three years.

#### **IV. Discussion**

As noted above, DRA conducted a review of the application. Upon our own review of the evidentiary record, we agree with DRA’s conclusions in its

review. Therefore, we find that PG&E's URG fuel procurement and administration of power purchase agreements for the record period were reasonable and prudent. We also have reviewed PG&E's least-cost dispatch power activities and procurement-related revenue and expenses recorded in its ERRR balancing account during the Record Period and find them to be reasonable and prudent.

The remaining outstanding issues involve audits of the ERRR balancing account. DRA recommends that PG&E's Internal Audit Department should perform comprehensive internal audits of the ERRR balancing account, preferably annually, but not less than every three years.

PG&E admits that it does not perform the requested audit, but contends that other auditing and control processes are adequate. DRA does not offer any specific shortcoming that would require an additional audit, other than a vague concern that the combination of its and PG&E's efforts may not have uncovered irregularities. There is no evidence to find PG&E does not have appropriate auditing and control processes in place to review the ERRR balancing account. We will not require an additional audit.

We note that DRA has the right to perform whatever investigation it feels is necessary. We remind PG&E that we will tolerate nothing less than full compliance with all Commission and other regulatory accounting requirements, as well as its cooperation with all regulatory inquiries by DRA or other Commission staff.

DRA also requests that we order PG&E to consult with DRA in the development of its 2010 risk-adjusted Internal Audit plan for contract administration activities. By contrast, PG&E contends it is not appropriate for DRA to insert itself into PG&E's Internal Audit plan itself, but is willing to

cooperate with DRA on the design of this audit so that DRA can have access to whatever output it needs. While accepting the semantic challenges of distinguishing between “design” and “develop,” we understand the basic point at issue.

DRA has statutory authority to request any information it needs from a utility in order to conduct its role under Pub. Util. Code § 309.5 to “represent and advocate on behalf of the interests of public utility customers.” Further, it is in the public interest to ensure transparency in understanding the contract administration activities under review in the annual ERRA proceedings. We will direct PG&E to confer with DRA prior to filing its next ERRA reasonableness review application (for the 2009 record period, expected to be filed in February 2010), to ensure that the audit performed is of appropriate scope and depth to allow DRA to meet its regulatory oversight responsibilities.

It is also in the public interest to ensure transparency in understanding the contract administration activities under review in the annual ERRA proceedings. We will direct PG&E to confer with DRA regarding its Internal Audit for contract management activities prior to filing its next ERRA reasonableness review application for the 2009 record period (expected to be filed in February 2010). In Reply Comments to the Proposed Decision, DRA clarifies that it does not seek authority to participate in any of PG&E’s decision-making or to exercise any authority that could be reasonably confused with “management” of PG&E’s internal audit plan or its development. Our direction is intended to be consistent with this clarification.

## **V. Categorization and Need for Hearings**

In Resolution ALJ 176-3229 dated February 20, 2009, the Commission preliminarily categorized this application as Ratesetting, and preliminarily

determined that hearings were necessary. Since a brief evidentiary hearing was held, the preliminary determinations made in Resolution ALJ 176-3229 should be ratified.

## **VI. Comments on Proposed Decision**

The proposed decision of the Administrative Law 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.

### **Assignment of Proceeding**

John A. Bohn is the assigned Commissioner and David M. Gamson is the assigned Administrative Law Judge in this proceeding.

### **Findings of Fact**

1. PG&E's application was accompanied by detailed exhibits and testimony in support of the reasonableness of its URG fuel procurement, administration of power purchase agreements, and least-cost dispatch power activities for the 2008 Record Period.

2. DRA conducted a review of the application and testimony and found no items of a material nature requiring adjustment to PG&E's ERRRA.

3. PG&E will perform a risk-adjusted Internal Audit plan for contract administration activities in 2010 in support of its required 2008 ERRRA compliance application.

### **Conclusions of Law**

1. PG&E's URG fuel procurement, administration of power purchase agreements, and least-cost dispatch power activities for the period beginning January 1, 2008 and ending December 31, 2008 are reasonable and prudent.

2. PG&E's procurement-related revenue and expenses recorded in its ERRA balancing account during the record period are reasonable and prudent.

3. PG&E's public (redacted) Exhibit PG&E-1, confidential (unredacted) Exhibit PG&E-2 testimony should be received into evidence in this proceeding, and PG&E rebuttal testimony, Exhibit PG&E-3. DRA's public (redacted) Exhibit DRA-1 and confidential (unredacted) Exhibit DRA-2 should be received into evidence in this proceeding. Confidential Exhibits PG&E-2 and DRA-2 should be filed under seal and remain sealed for a period of three years from the effective date of this decision.

4. It is in the public interest to ensure transparency in reviewing PG&E's contract administration activities in the annual ERRA compliance proceeding.

5. DRA should have a role in developing PG&E's risk-adjusted Internal Audit plan for contract administration activities in 2010, but not as a decision-maker or manager of PG&E's Internal Audit.

## **O R D E R**

### **IT IS ORDERED** that:

1. Pacific Gas and Electric Company's entries in its Energy Resource Recovery Account for the January 1, 2008 through December 31, 2008 record period are appropriate and are adopted for recovery.

2. Pacific Gas and Electric Company's testimony [Exhibit PG&E-1 and confidential Exhibit PG&E-2] is received into the record for this proceeding. Pacific Gas and Electric Company's rebuttal testimony [Exhibit PG&E-3] is received into the record. The Division of Ratepayer Advocates' testimony [public Exhibit DRA-1 and confidential Exhibit DRA-2] are received into the record for this proceeding. Pacific Gas and Electric Company's confidential

Exhibit and Division of Ratepayer Advocates' confidential Exhibit shall be filed under seal and remain sealed for a period of three years from the effective date of this decision. During that period, both Exhibits shall not be made accessible or disclosed to anyone other than the Commission staff except on the further order or ruling of the Commission, the assigned Commissioner, the assigned Administrative Law Judge, or the Administrative Law Judge then designated as Law and Motion Judge. If Pacific Gas and Electric Company believes that further protection of the information kept under seal is needed, it may file a motion stating the justification for further withholding of the information from public inspection, or for such other relief as the Commission's rules may then provide. This motion shall be filed no later than one month before the expiration date.

3. Pacific Gas and Electric Company shall confer with the Division of Ratepayer Advocates regarding its Internal Audit for contract management activities prior to filing its next Energy Resource Recovery Account reasonableness review application for the 2009 record period (expected to be filed in February 2010), including a substantial opportunity for Division of Ratepayer Advocates to comment upon and review development of the Internal Audit Plan<sup>5</sup>.

4. Resolution ALJ 176-3229 dated February 20, 2009, is ratified.

5. Application 09-02-008 is closed.

This order is effective today.

Dated December 3, 2009, at San Francisco, California.

MICHAEL R. PEEVEY  
President  
DIAN M. GRUENEICH  
JOHN A. BOHN

RACHELLE B. CHONG  
TIMOTHY ALAN SIMON  
Commissioners

