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Decision 95-08-029 August 11, 1995

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
Order Instituting Rulemaking to review the time schedules for the rate case plan and fuel offset proceedings.

ORIGINAL

Summary

The June 6, 1995 petition by the Division of Ratepayer Advocates (DRA) for modification of Decision (D.) 95-04-072 is granted. Southern California Gas Company (SoCalGas) is directed to fund certain costs associated with the contracting out by the Division of an audit required by D. 95-04-072. Our order today resolves certain outstanding issues respecting this audit and the ability of the utility to recover all reasonably incurred costs in future rates.

Background

D. 95-04-072 issued April 26, 1995, suspended the requirement that SoCalGas file a test year (TY) 1997 general rate case (GRC), subject to several conditions. SoCalGas has been pursuing a performance-based ratemaking (PBR) mechanism to become effective January 1, 1997. The need for a TY 1997 GRC could be eliminated with approval of the proposed PBR mechanism.

In suspending the GRC requirement, the Commission ordered its Executive Director to make staff assignments as necessary to conduct an audit of SoCalGas in compliance with § 314.5. As the Commission stated, DRA notes that traditionally it has conducted connection with GRC proceedings, and anticipates it will be the staff organization designated to perform the audit. SoCalGas agrees it is likely that DRA will be given the responsibility, but would have no objection to any assignment the Commission deems appropriate. We intend that DRA will be responsible for performing the audit unless the Executive Director determines that the needs of the Code of Public Utilities are to the contrary.

1 All such references are to the Code of Public Utilities.

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"(t)his statute (sic) requires the Commission to inspect and audit the books and records of utilities serving over 1,000 customers at least once every three years. It further provides that the inspection and audit requirements are deemed fulfilled by an audit conducted in connection with a rate proceeding. SoCalGas last GRC was for TY 1994, and a TY 1997 GRC would therefore constitute fulfillment of the requirement. The expected PBR application will also initiate a rate proceeding, albeit not a conventional GRC. We will direct our staff to conduct the required audit in connection with the PBR proceeding." (D.95-04-072, p. 15.)

DRA's Petition

DRA proposes that the Commission require SoCalGas to fund certain costs of the audit, including the fees of an outside consultant who would assist DRA in performing the required audit. DRA also proposes that SoCalGas be authorized to establish a memorandum account for the purpose of allowing SoCalGas to seek rate recovery for such costs at the completion of the project.

DRA states that it does not have adequate staff resources to conduct a timely and comprehensive review of SoCalGas. It is DRA's view that the limited audit which it could perform with current resources is inconsistent with the Commission's goal of protecting ratepayers against the risk of unnecessarily high rates that could result from the suspension of the GRC filing requirement. (D.95-04-072, Conclusion of Law 2.) DRA believes

its Executive Director to make staff assignments as necessary to conduct an audit of SoCalGas in compliance with § 314.5. As the

2 DRA notes that traditionally it has conducted such audits in connection with GRC proceedings, and anticipates it will be the staff organization designated to perform this audit. SoCalGas agrees it is likely that DRA will be given the responsibility, but would have no objection to any assignment the Commission deems appropriate. We intend that DRA will be responsible for performing the audit unless the Executive Director determines that the needs of the Commission dictate otherwise. All such references are

that the only realistic way to ensure that a comprehensive audit is completed within the schedule anticipated in the PBR application is to provide it with the means of retaining an independent consultant. DRA proposes that SoCalGas be ordered to fund the cost of an outside consultant and DRA's incremental travel costs. DRA estimates that the total cost, including outside auditors' fees, travel, and report preparation (but excluding costs of responding to data requests and testifying) will be at least \$300,000. DRA suggests that the most expedient method of funding a consultant is a direct contract between the utility and the consultant. The consultant would be recruited, selected, and retained by DRA, and DRA would be named a third-party beneficiary of the contracted services. DRA would be solely responsible for managing the consultant's change orders.

DRA proposes that SoCalGas be allowed to recover the fees and expenses of the consultants and its own incremental travel costs. SoCalGas would be authorized to establish a memorandum account to track and accumulate these costs. Upon completion of the project, SoCalGas would be entitled to seek recovery of costs properly charged to the memorandum account.

SoCalGas filed its PBR application on June 19, 1995 (Application (A) 95-06-002). DRA therefore requests an expedited ruling on its petition so that the results of a comprehensive audit can be fully considered in establishing a start-up base margin for the PBR mechanism.

SoCalGas Response

SoCalGas filed a response on June 22, 1995. SoCalGas does not believe that as an ordinary matter the cost of Commission operations should be funded through the procedure proposed in DRA's petition. However, SoCalGas supports the petition under the best circumstances, subject to the following conditions. First, SoCalGas wants to be consulted regarding the identity of potential auditors for reasons such as avoiding conflicts of interest.

SoCalGas does not seek final decisionmaking power over auditor selection. Second, SoCalGas proposes a reasonable ceiling on the amount that can be spent without further Commission authorization. SoCalGas suggests that a reasonable maximum would be \$500,000. Third, SoCalGas seeks assurance that it will be able to obtain, not just seek, recovery of the costs (including interest) of the audit. SoCalGas agrees with DRA that there is a need for prompt action on the petition.

Discussion

As we have noted, there is no opposition to DRA's petition. SoCalGas supports it with the indicated reservations. Notwithstanding the lack of opposition, we find that the petition raises two important questions which are likely to recur as the Commission strives to adopt to an increasingly changing regulatory environment. The first is the issue of contracting out for services or functions which, in a former time, might well have been conducted by the Commission's permanent staff. The second is the issue of funding and what may be described as a "fee for service" nature of the Division's proposals. As we shall explain, contracting out may become increasingly common. We are far less certain about the future of a "fee for service" type of funding mechanism and expressly decline to create a precedent in today's order on that subject. Contracting out: We begin with the proposition that a comprehensive audit is of critical importance both in complying with Section 314.5 of the Public Utilities Code and in establishing a sound performance based ratemaking mechanism for SoCalGas. Having said this, it is clear that our DRA lacks adequate internal resources to perform such an audit within the procedural schedule deemed essential by the utility. In yesteryear, it made a good deal of sense to assemble Commission staff resources so that we might internalize functions which would certainly recur in the course of a stable regulatory environment. Careers could be and

were dedicated to such endeavors. While it is not possible to preclude the return of a stable regulatory environment at some point in the future, it is generally accepted that we lack one today and for the foreseeable future. In such circumstances, we are called upon to reinvent regulation even as we seek to respond to technological innovation and attitudinal change within the marketplace. If stability was the watchword in the past, adaptability would appear to be the replacement value of greatest utility to those entities which are regulated and to the broad class of California consumers who depend upon such efforts. Contracting out the idea that government would seek the talent and resources available in the private sector to conduct carefully defined and targeted tasks, commends itself as a useful tool in these circumstances. The DRA petition presents a well defined occasion to act on this recognition. Accordingly, we will adopt DRA's proposal with certain revisions which reflect the utility's concerns as well as our own judgment. We recognize the concern of SoCalGas that procedures or proceedings required by statute should not be funded routinely on a fee for service basis. Yet, we also agree with the utility that it is a necessary and appropriate expediency in this case. The importance of completing a comprehensive audit before establishing the foundation of a performance based ratemaking mechanism has weighed heavily in making this decision. Terms and conditions: Because the outside contractor will be assisting DRA in meeting the Commission's obligation under Section 314.5, we agree that the Division should be given the ultimate authority and responsibility to select, direct, monitor and supervise the contractor. We concur with SoCalGas that DRA should consult with the utility regarding the identity of potential auditors before making its final choice of a contractor. We emphasize, however, that SoCalGas does not have veto or other authority in the selection process.

We decline to adopt the utility's proposal that we place a ceiling on the audit's cost. DRA's estimate of the project's minimum cost is, admittedly, tentative. Yet, we have no basis for determining whether the range of costs established by the utility's suggested cap is reasonable. In these circumstances, we prefer that the audit's cost be established through our normal procurement process.

In closing, we must address the recovery of costs. There is no dispute that the utility should be entitled to recover the costs of the audit from ratepayers. We direct the utility to track the direct costs, plus interest at the short-term commercial paper rate, until completion of the project. Since it is clear to all that the utility will be advancing ratepayer money for the purpose of conducting this vital procedure, the only limitation on the ability to pass those costs through in future rates must be the one of prudent incursion. Since the terms of the contract will have been established before it is formed, our interest will center on the conduct of the utility in cooperating with the auditors and in exercising prudence in the incursion of the internal costs for such cooperation.

Findings of Fact

In D.95-04-072, the Commission directed its staff to conduct the audit required by S314.5 in connection with the anticipated PBR proceeding.

On June 1, 1995, SoCalGas filed its PBR application, which was docketed as A.95-06-002.

DRA lacks adequate internal resources at this time to perform a comprehensive audit within the procedural schedule anticipated in A.95-06-002. We conclude that the contractor and supervisor the contractor should fund certain costs of the audit and the recovery of reasonably incurred costs in rates is an expedient method of effecting the audit required by S314.5 and is an appropriate under the circumstances.

Conclusions of Law

1. DRA's petition should be granted as provided in the following order:
2. This order should be made effective on the date signed to allow the commencement of the audit required by § 314.5 and coordination of the audit with timely processing of A.95-06-002.

ORDER

IT IS ORDERED that:

1. The petition by Division of Ratepayer Advocates (DRA) for modification of Decision (D.) 95-04-072 is granted as provided herein.

2. Ordering Paragraph 2 of D.95-04-072 is modified to read:

"2. The Executive Director shall make staff assignments as necessary to conduct an audit of SoCalGas in compliance with Public Utilities Code § 314.5. The Division of Ratepayer Advocates (DRA) shall be the designated staff organization having responsibility for the audit unless the Executive Director determines that the needs of the Commission dictate otherwise. SoCalGas shall provide funding for the costs of the audit, including the fees and expenses of an outside auditor or consultant and DRA's incremental travel costs, subject to the following:

DRA may contract with the outside auditor or consultant, or SoCalGas may contract directly with the outside auditor or consultant, in which case DRA shall be a third-party beneficiary of the contracted services. DRA has the ultimate authority and responsibility to select, direct, monitor, and supervise the contractor.

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- a. Prior to selection of an outside auditor or consultant, DRA shall consult with SoCalGas regarding the identity of potential contractors.

"c. SoCalGas is authorized to track in an account bearing interest at the short-term commercial paper rate the direct costs of the audit incurred as a result of the funding obligation ordered herein. Upon completion of the project, SoCalGas is further authorized to file an advice letter to recover, in rates the direct audit costs reasonably incurred and properly charged to the account. Direct costs include such costs as contract fees and DRA's incremental travel costs but do not include such costs as SoCalGas' management costs."

This order is effective today.
Dated August 11, 1995, at San Francisco, California.

DANIEL Wm. FESSLER
 President
P. GREGORY CONLON
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
 Commissioners

**I CERTIFY THAT THIS DECISION
 WAS APPROVED BY THE ABOVE
 COMMISSIONERS TODAY**

Wesley Franklin
 Acting Executive Director

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