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Decision 99-06-051 June 10, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Roseville Telephone Company (U 1015 C) to restructure intrastate rates and charges and to implement a new regulatory framework for telephone services furnished within the State of California.

Application 95-05-030
(Filed May 15, 1995)

Order Instituting Investigation into the rates, charges, service practices and regulation of Roseville Telephone Company.

Investigation 95-09-001
(Filed September 7, 1995)

In the Matter of the Application of Roseville Telephone Company (U 1015 C) for Authorization to Implement a Plan of Reorganization Which Will Result in a Holding Company Structure.

Application 95-05-031
(Filed May 9, 1995)

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OPINION

1. Summary

We deny the appeal by Roseville Telephone Company of the Assigned Commissioner's Ruling ordering a verification/nonregulated operations audit. We deny the motion of Roseville Telephone Company for evidentiary hearing on the need for the audit.

We order immediate commencement of the audit based on a revised audit scope described herein. The Office of Ratepayer Advocates will file and serve the completed audit by December 1, 1999 in Roseville's current new regulatory framework proceeding (Application 99-03-025).

Roseville Telephone Company shall fund the verification and nonregulated operations audit, but may apply for consideration of cost recovery for its payment of the auditor's costs of the nonregulated operations portion of the audit. That cost recovery may be requested as a Z factor adjustment in a Roseville Telephone Company new regulatory framework price cap filing.

We deny the motion of the Office of Ratepayer Advocates for an order by the Commission's President compelling Roseville Telephone Company's compliance with the Assigned Commissioner's Ruling. We deny the motion of the Office of Ratepayer Advocates to consolidate this proceeding with Roseville Telephone Company's new regulatory framework proceeding (Application 99-03-025).

We decline to apply a fine, but we place Roseville Telephone Company on notice that we will not tolerate any violations of Rule 1, any abuse of the regulatory process, and any contempt of the staff, Administrative Law Judge, Assigned Commissioner and Commission. These proceedings are closed.

2. Background

Decision (D.) 96-07-059 authorizes implementation by Roseville Telephone Company (Roseville) of a holding company structure, subject to certain conditions. One condition is that the Division of Ratepayer Advocates (DRA), or its successor, may move for an audit of Roseville, the holding company and its affiliates ("verification audit"). The purpose of the audit is to examine Roseville's affiliated transactions, thereby verifying Roseville's compliance with its affiliate transactions policies and guidelines, the conditions established in D.96-07-059, and other applicable Commission orders and regulations. (D.96-07-059, Ordering Paragraph (OP) 16.) We directed that the need for the audit be considered in a prehearing conference (PHC) during the last quarter of the third, fourth and fifth years following the date of the order (i.e., 1999, 2000, and 2001), or at a PHC in a Roseville new regulatory framework (NRF) review application.

D.96-12-074 approves a general rate increase, and orders an audit of Roseville's nonregulated operations, allocations and transactions ("nonregulated operations audit"). (D.96-12-074, mimeo., p. 49; OP 3, p. 144.) It also directs that the nonregulated operations audit shall be conducted simultaneously with the verification audit, and that the Office of Ratepayer Advocates (ORA--DRA's successor) may move for the audit as early as Roseville's first sharing advice letter (i.e., early 1998).

Roseville filed its first sharing advice letter on March 31, 1998. On July 9, 1998, ORA filed a motion to conduct the verification/nonregulated operations audit. On July 24, 1998, Roseville filed a response in opposition to ORA's motion. On August 7, 1998, ORA filed a reply to Roseville's response.

A PHC was held on October 6, 1998 to hear from the parties on ORA's motion. The Assigned Commissioner issued an Assigned Commissioner's Ruling (ACR) on October 26, 1998 generally granting ORA's motion. On

October 30, 1998, Roseville filed a motion for evidentiary hearing regarding the need for the audit. On November 6, 1998, Roseville filed an appeal of the ACR. On November 16, 1998, ORA filed a response in opposition to Roseville's motion for evidentiary hearing. On November 23, 1998, ORA filed a response in opposition to Roseville's appeal of the ACR. On November 30, 1998, Roseville filed a reply to ORA's response to Roseville's motion for evidentiary hearing. On February 25, 1999, ORA filed a motion to compel compliance with the ACR by an order from the Commission's President.

The draft decision of Administrative Law Judge (ALJ) Mattson in this matter was mailed to the parties on March 2, 1999, in accordance with Public Utilities (Pub. Util.) Code Section 311(g) and Rule 77.1 of the Rules of Practice and Procedure.¹ On March 12, 1999, Roseville filed a response to ORA's motion to compel compliance with the ACR. On March 22, 1999, comments on the draft decision were filed by Roseville and ORA.

On March 26, 1999, the President set a PHC to hear from the parties on the scope of the audit. The Ruling setting the PHC specifically directed the parties to meet before the PHC to determine whether a mutually agreeable revised audit scope could be jointly proposed at the PHC.

On March 29, 1999, Roseville and ORA filed reply comments on the draft decision. On April 7, 1999, ORA served a prehearing conference statement. Also on April 7, 1999, Roseville served a statement of its proposed audit changes.

A PHC was held on April 8, 1999. The parties reported that they were unable to reach agreement on a jointly proposed revised audit scope. The PHC was used, in part, to discuss several proposed audit tasks, with the goal of more

¹ All references are to the Public Utilities Code and the Commission's Rules of Practice and Procedure unless noted otherwise.

precisely defining the tasks and narrowing the parties' disputes. Roseville and ORA both clarified their positions. ORA was directed to consider several comments on the audit scope, and prepare a more detailed, refined audit scope. Further, ORA was asked to submit a status report by April 16, 1999, including, to the extent possible, a jointly proposed revised audit scope agreeable to both ORA and Roseville.

ORA requested, and was granted, an extension for submission of its status report. The report was served on April 19, 1999. Roseville requested, and was granted, permission to serve a response to ORA's status report. Roseville's response was served on April 20, 1999. On May 13, 1999, ORA filed a motion to consolidate these proceedings with Roseville's NRF proceeding (A.99-03-025).

We take the entire record and all pleadings into account, including the comments and reply comments on the draft decision, the prehearing conference statements, ORA's status report and Roseville's response to ORA's status report, in reaching today's decision.

3. Appeal of the Assigned Commissioner's Ruling

3.1 Authority of ALJ, Assigned Commissioner and D.96-07-059

Roseville appeals the ACR, asserting that the Assigned Commissioner lacked authority to order the audit. Rather, Roseville says the Commission reserved that decision for itself in OP 16 of D.96-07-059.

To the contrary, OP 16 directs that the assigned ALJ hold certain PHCs, determine whether the need for an audit exists, and, if so, schedule the audit. The authority to order the audit was delegated to the ALJ. That is, the ALJ was assigned the responsibility to hold certain PHCs and schedule an audit when determined necessary. The ALJ's determination of the need for an audit means weighing what may be opposing evidence and argument, as necessary, and

making a judgment. In this case, the Assigned Commissioner made the ruling, and it was fully within his authority to do so.

Moreover, OP 16 provides that ORA may move for the audit at one of several PHCs. Except in extraordinary circumstances, Commission practice is for ALJs to rule on motions. That was the intention here, and nothing directs any different practice for this motion.

Roseville contends that OP 16 provides different procedures depending upon whether Roseville agrees or disagrees with the need for the audit. If Roseville agrees an audit is appropriate, certain events occur. If Roseville disagrees an audit is appropriate, Roseville claims that the order directs ORA to move for a Commission order.

To the contrary, the direction regarding ORA moving for a Commission order is after a lengthy discussion that ends with consideration of a second verification audit at least three years after the first verification audit. It is the second verification audit to which we refer when addressing an ORA motion for a Commission order. We made that order since a second verification audit would need more thorough consideration than the first one addressed in D.96-07-059.

Roseville argues that the ACR denies Roseville substantive rights that were a factor in Roseville's decision to establish a holding company. That is, Roseville points out that it had 30 days to consider whether or not to accept the conditions placed upon formation of the holding company. (D.96-07-059, OP 35.) Roseville claims its acceptance of the conditions was based upon its understanding that the conditions were subject to later modification only by subsequent order of the full Commission.

Roseville is correct that it had 30 days to accept the conditions placed on its authority to establish a holding company. That, however, does not change

what is provided in OP 16. OP 16 delegates ruling on an audit motion to the ALJ, that was not changed by any subsequent order, and we do not change that here.

3.2 De Novo Review

Roseville contends that the Commission should review the ACR *de novo* because, in Roseville's view, the ACR erroneously suggests Roseville could have participated in ORA's planning process or objected earlier and, having not done so, Roseville essentially waived its rights. Rather, Roseville says it relied on the procedural safeguards in OP 16 and waived none of its rights.

We decline to review the ACR *de novo* for two reasons. First, we agree with the ACR that Roseville could have participated in the process earlier, or, if foreclosed from participation, could have brought the matter to the attention of the Commission earlier. That is, ORA alerted Roseville in September 1997 of its plans to conduct the verification/nonregulated operations audit. If Roseville was concerned, Roseville could have sought active participation, insisted that ORA file a motion, or raised the matter with the ALJ, the Assigned Commissioner or the Commission.² It did none of these things. On February 17, 1998, ORA sent Roseville a copy of the Request for Proposal (RFP). If Roseville was concerned, Roseville could have insisted on participation consistent with OP 16 (i.e., consultation regarding the identity of potential contractors), could have insisted that ORA move for an audit, or could have brought the matter to the attention of

² Roseville claims that ORA stated Roseville could not participate in ORA's preliminary planning for the audit. The date that Roseville made a request to participate, and the date of any refusal by ORA, are not stated. Even if in September 1997, however, Roseville could have participated to the extent allowed by OP 16. That is, Roseville could have provided names of candidate firms to ORA. Moreover, Roseville could have brought its concerns to the attention of the ALJ, Assigned Commissioner or the Commission.

the ALJ, the Assigned Commissioner or the Commission. It did none of these things. In April 1998, ORA contacted Roseville regarding the parties who responded to the RFP. Again, Roseville could have insisted on a motion, or brought the matter to the Commission's attention. It did neither of these things. On May 7, 1998, ORA informed Roseville by letter that ORA had selected Overland Consultants. Again, Roseville did not insist that ORA file a motion or bring the matter to the Commission's attention. On May 28, 1998, Roseville representatives traveled to San Francisco to attend a meeting at the Commission to discuss protocols and other matters to facilitate the audit. Roseville did not object at that meeting. Only on May 29, 1998, nearly nine months after first learning of ORA's plan to conduct a verification/nonregulated operations audit, did Roseville raise the matter by letter to the Assigned Commissioner.³

While Roseville is technically correct that it did not waive any rights by its passive approach,⁴ we are disturbed that Roseville delayed for nearly nine months before acting. Roseville's inaction has resulted in both parties and the Commission spending limited time and resources on this matter inefficiently. Roseville knew the staff was undertaking an effort to hire a consultant. Roseville had an obligation to bring the matter to the attention of the ALJ, Assigned Commissioner or Commission before funds were committed if Roseville had reason to believe it would object. ORA should have filed its motion sooner, but

³ The proceeding is littered with reports of ex parte communications. We cannot base a decision on a report of an ex parte communication. (Rule 1.2 of the Rules of Practice and Procedure.) The letter, however, is attached to ORA's July 9, 1998 audit motion as Exhibit E.

⁴ In fact, we are not sure that Roseville did not actually concur with the audit until May 29, 1998.

Roseville shared a responsibility to bring the matter to the attention of the Commission. More importantly, Roseville's approach has resulted in an unacceptable delay in commencement of the audit. We take Roseville's actions into account in measuring Roseville's credibility in this matter.

Second, and more significant, however, we need not review the ACR *de novo* because the safeguards in OP 16 were fulfilled. That is, whether Roseville was or was not initially accepting of the audit or passive (until May 29, 1998), ORA filed a motion on July 9, 1998, and the process envisioned in OP 16 was accomplished. Roseville filed a response in opposition to the motion. ORA filed a reply. A PHC was held. Parties were given the opportunity to present all the information they felt necessary for consideration of the motion. The parties did that. In addition, Roseville could have at that time moved for evidentiary hearings. It did not. Roseville could have sought leave to file briefs. It did not. Roseville was given a full opportunity to present everything it wanted for complete consideration of the motion, and, when asked if it had anything more, said it did not. Thus, the provisions of OP 16 were fulfilled, and Roseville's rights were fully protected.

3.3 Affirm ACR

Even if we were to review the ACR *de novo*, we would reach the same conclusions reached therein. For example, Roseville argues that it was not consulted on candidate firms to which the RFP should have been sent. This is not exactly true, since ORA sent Roseville a copy of the RFP on February 17, 1998. Thus, Roseville knew the RFP was going to be issued, and could have advised ORA of potential contractors Roseville wanted ORA to consider. (OP 16, D.96-07-059.) Even if Roseville did not do that, and even if ORA failed to solicit that advice from Roseville, the RFP was sent to 12 firms and notice of the RFP was published in the State Clearinghouse publication. Proper state contracting

notice requirements were followed. Thus, even if an exact consultation as envisioned in OP 16 of D.96-07-059 did not occur, no errors were made that justify reissuing the RFP.

Roseville also seeks review of the ACR because Roseville argues that its sharable earnings are so far below the benchmark rate of return (where sharing takes place) that no conceivable reallocation of costs to nonregulated operations as a result of the audit would put Roseville in a position to share earnings. Even if true, we agree with the ACR that the audit has several purposes. While one purpose is to undertake timely and reasonable regulatory review to ensure that the sharing calculations are correct, another purpose is to ensure that correct accounting policies, practices and procedures have been implemented, and are being used accurately, not only for 1997, but also for 1998, and in place thereafter, for holding company and nonregulated operations. Another purpose is to provide information as part of the Commission's review of Roseville's NRF, including consideration of whether to suspend sharing. Another purpose is to ensure that the California Cost Allocation Manual (CAM) ordered in D.96-12-074 conforms with Commission rules and procedures, and is reasonable. A further purpose is to ensure that the conditions established on the holding company are being implemented. Thus, there are many reasons beyond the sharing calculation for the audit.

Roseville contends its holding company structure is young, nonregulated revenues and costs are relatively small, and there are limited allocations and affiliate transactions to audit. Rather, Roseville says there will be more to audit in 1999 or beyond, and the audit, if ordered, should be deferred. We disagree. Even if there are few transactions now, we agree with the ACR that it is reasonable and desirable to ensure without delay that Roseville is complying with affiliate transactions policies and procedures, the conditions placed on the

holding company in D.96-07-059, and other applicable Commission orders and regulations. If an audit reveals corrective steps are necessary to fulfill Roseville's compliance with Commission orders, doing so sooner rather than later will be more likely to mitigate adverse effects and costs.

Moreover, we take the extra step here to remind parties that ORA must manage the audit reasonably.⁵ If the auditor has fewer matters to audit, the cost of the audit may be less than it otherwise would be. To the extent Roseville is right, we expect ORA to reject unreasonable requests for reimbursement from the auditor for needless auditing of nonexistent activities.

Roseville says the verification/nonregulated operations audit may cost as much as \$280,000, while Roseville's annual financial audit of its entire operations will cost \$225,000 in 1998. Roseville argues that the ACR errs when the ACR concludes that because the verification/nonregulated operations audit will cover three years its cost is reasonable in comparison to the annual audit. In particular, Roseville says nonregulated operations over three years are still much smaller than the company's operations in a single year.

To the contrary, while Roseville may be right that the total dollars of company operations in one year exceed the total dollars of nonregulated operations over three years, that was not the only factor considered in the ACR. The ACR also considers the fact that the verification/nonregulated operations audit is a regulatory investigative audit, which is typically more costly than a routine financial audit. We concur with that reasoning.

Roseville asserts that the time allocated to certain tasks by the winning contractor demonstrates that the scope of the audit is excessive, and that the

⁵ ORA has "the ultimate authority and responsibility for ... monitoring and supervision of the contractor." (D.96-07-059, OP 16.)

results will not provide the Commission with information necessary to regulate Roseville and further the public interest. Roseville says that the ACR errs in dismissing this argument when the ACR states it is inappropriate to micro-manage the audit section by section.

To the contrary, we affirm the ACR when it finds the cited tasks are necessary to assess whether accounting policies and procedures are in place to properly account for nonregulated operations; to evaluate whether conditions attached to the authorization of the holding company are being fulfilled; to determine whether proper allocations are being made; to assess whether the California CAM is reasonable; and to determine reasonable and proper accounting policies, practice and procedures. We also agree with the ACR that we should not attempt to micro-manage the contract, but the auditors, under the supervision of ORA, should have reasonable latitude to apply necessary hours to various tasks in accomplishment of the desired result. Moreover, as we say above, we expect ORA to reject requests for reimbursement from the auditor that are unreasonable.

Roseville asserts that accomplishment of one task allocated 500 hours will require no more than 15 minutes. We disagree. At the same time, however, should this task reasonably require less hours than now estimated by the auditor, we expect the auditor to utilize and bill only necessary and reasonable hours, and ORA to reimburse the contractor for only the necessary and reasonable hours.

Roseville also asserts that the proposed audit is so unreasonably expensive that it will adversely affect the ability of Roseville's nonregulated affiliates to compete. To the contrary, we agree with the ACR that there is no reason to believe that the entire cost of the audit will be charged to nonregulated operations. Rather some, or all, of the cost of the audit may be charged to regulated operations. Further, of the amount charged to nonregulated

operations, there is no reason to believe it is unreasonable in relation to normal start-up costs of nonregulated entities part of a holding company dominated by regulated operations.

4. Rate Recovery

Roseville says that by agreeing to the conditions of the holding company decision, it agreed that Roseville's shareholders would pay the cost of the verification audit. By contrast, Roseville asserts it never agreed, and believes the Commission never ordered, that Roseville's shareholders pay the cost of the nonregulated operations audit. Roseville asserts that the ACR errs when it finds Roseville's shareholders must pay the entire cost of both the verification and nonregulated operations audit.

We disagree. D.96-07-059 orders that the cost of the verification audit be paid by Roseville's shareholders. D.96-12-074 does not change or disturb that recovery mechanism. In ordering that the nonregulated operations audit be conducted simultaneously with the verification audit, we intended that Roseville's shareholders pay the entire cost of the combined audit. Therefore, the ACR was correct. We now, however, reconsider.

To the extent there are extra costs by adding elements of the nonregulated operations audit to the verification audit, we now believe that Roseville's funding of the auditor's costs should be considered for Z factor recovery in a Roseville NRF price cap filing. We do this because, if there are extra costs, payment of these costs by Roseville's shareholders was not an explicit condition of the authority granted Roseville to establish a holding company, and not explicitly stated in the holding company order, which Roseville had 30 days to accept or reject.

On the other hand, general rates include recovery from ratepayers of reasonable regulatory costs. While cost recovery of the nonregulated operations

audit was not specifically litigated in the general rate proceeding, reasonable costs for this audit may or may not already be included in the adopted general rates. If Roseville can show in a Z factor filing that general rates cannot reasonably be used to recover the costs of the nonregulated operations audit, Roseville may seek that recovery in a Z factor adjustment.

To facilitate consideration of these costs, we direct ORA to secure from the auditor (Overland Consultants) separate statements of its costs for the two parts of the audit: the verification portion and the nonregulated operations portion. If the auditor is unable to prepare a reasonable statement of its costs separated between the verification and nonregulated operations portions of the audit, we will apply 50% of the total cost to each portion of the audit. Consistent with D.96-07-059, the costs for the verification audit will be charged to Roseville's shareholders. The funds paid by Roseville for the auditor's cost of the nonregulated operations audit, however, may be included by Roseville for consideration of recovery in a Z factor filing. Roseville must there address the extent to which its general rates recover regulatory costs by including a statement of the regulatory costs of which it sought recovery in the last general rate proceeding, and its understanding of the amount included in the authorized revenue requirement. Roseville shall also include a description of the programs and items that were included in its rate request for regulatory costs, and show whether or not costs of the nonregulated operations audit are reasonably included therein.

In comments on the draft decision, Roseville says it should not be expected to advance the cost of the nonregulated operations audit and seek recovery later. Roseville claims that the draft decision "recognizes that the rate case decision did not order that Roseville pay for the nonregulated transactions audit."

(Comments, p. 13.) Roseville says ORA should conduct the nonregulated operations audit at its own expense, or at the expense of ratepayers.

To the contrary, nowhere does the draft decision say that the rate case decision did not order Roseville to pay the cost of the nonregulated operations audit. In fact, the draft decision says, and we find here, that the ACR was correct in assessing the entire cost of the combined audit on shareholders. The draft decision recommended that we reconsider, and we do so here. We reconsider because payment of the nonregulated operations audit was not an explicit condition of the authority granted to Roseville to establish a holding company.

Moreover, the draft decision said, and we adopt here, the statement that general rates include recovery from ratepayers of reasonable regulatory costs. Reasonable regulatory costs may include the cost of the nonregulated operations audit, and we believe Roseville's rates already include recovery for this type of regulatory cost. Therefore, it is reasonable for Roseville to pay (or at least advance) the auditor's cost for this audit. At the same time, we allow Roseville the opportunity to seek recovery of that expense from ratepayers, as explained above.

5. Motion for Evidentiary Hearing

Roseville moves for an evidentiary hearing on the need for the audit. Roseville relies on OP 16 of D.96-07-059 for authority to file its motion for hearing. Roseville says the Commission has not ruled on ORA's motion for an audit, OP 16 does not limit when Roseville may file its motion for hearing, and its motion is timely.

To the contrary, Roseville's hearing motion is untimely. As explained above, the Commission need not rule on ORA's motion for an audit. ORA's audit motion was decided by the Assigned Commissioner. Roseville filed its motion for an evidentiary hearing after the ACR was filed and served. We

decline to review the ACR, and, therefore, we similarly decline to consider Roseville's motion for hearing.

Moreover, we point out that Roseville relies on the last part of OP 16 for authority to file its motion. As explained above, that portion of OP 16 deals with consideration of a second verification audit. We are not considering the second verification audit here.

At the same time, parties may generally make any reasonable motion in any proceeding. Thus, even without the direction in OP 16, Roseville could have moved for hearing. Roseville could have done so concurrently with its July 24, 1998 response to ORA's motion. Roseville could have filed such motion any time up to the October 6, 1998 PHC. Roseville could have made its motion at the October 6, 1998 PHC. Roseville could even have moved to set aside submission of the issue after the October 6, 1998 PHC, but before the October 26, 1998 ACR, for consideration of its motion. Roseville did none of these things. Roseville's October 30, 1998 motion for hearing—four days after the ACR—is untimely.

Roseville argues that it never waived its right to a hearing, and that it can make a motion for hearing at any time as long as it does not work a prejudice to the rights of other parties. Roseville contends that because the Assigned Commissioner lacked authority to rule on ORA's motion, and the Commission has not ruled on ORA's motion, ORA is not prejudiced and its motion is timely.

To the contrary, while one test is whether a prejudice is worked on any party, another test is abuse of the process. We cannot efficiently regulate utilities if parties abuse the process. Roseville had 89 days to make its motion (from the day after ORA filed its motion on July 9, 1998 to the October 6, 1998 PHC; Roseville had 108 days if we consider up to the day before the ACR was filed on October 26, 1998). Roseville's motion is untimely, and abuses the regulatory process.

Even if we were to consider the motion, however, we would reject it on its merits. That is, Roseville contends that evidence is needed concerning the level of affiliate transactions so that the Commission may determine whether an audit is needed now. To the contrary, we affirm the ACR's conclusion that an audit should be done now despite the level of affiliate transactions. It is reasonable to ensure that the correct policies, practices and procedures have been implemented, and are being used accurately, to properly account for nonregulated operations, allocations, and transactions, in conformance with Commission orders; that the California CAM is reasonable; and that Roseville is in compliance with its affiliate transactions policies and guidelines, the conditions in D.96-07-059, and other applicable Commission orders and regulations. These goals are sufficiently independent of the level of transactions to undertake an audit now.

6. Revised Audit Scope

Several important advances were made at the April 8, 1999 PHC. For example, Roseville withdrew its earlier request that the RFP be reissued. Roseville now accepts that the contract with Overland may proceed when modified to conform with a revised audit scope, if any. Roseville also renewed its agreement that the audit may proceed now, if the Commission chooses to order the audit. Further, Roseville stated that the time elapsed since the filing of the original ORA audit motion had somewhat mitigated Roseville's concerns about the timing of the audit. (Reporter's Transcript (RT), PHC 4, pp. 133-134.) In addition, by letter dated April 20, 1999, Roseville seeks to further facilitate resolution of the scope of work by commenting on, and proposing modifications to, ORA's revised audit scope (rather than continuing to request the opportunity to begin the process anew, and participate in the drafting of a new RFP). We

consider these steps to be important progress in resolving the matters now before us.

Consistent with Roseville's withdrawal of its request that the RFP be reissued, and for all the reasons stated above, we do not direct that the RFP be reissued. Also, for all the reasons given above, we affirm the ACR directing commencement of the audit now. In addition, however, we use the April 8, 1999 PHC convened by the President to further refine the scope of the audit. We specifically endorse the revised audit scope submitted by ORA on April 19, 1999, as clarified and modified below.

6.1 Task 1.3.a

Roseville asks that Task 1.3.a be modified to eliminate documentation of activities performed by each non-utility subsidiary on its own. Roseville says this is beyond the scope of the affiliate verification audit. Rather, the purpose of the affiliate verification audit, according to Roseville, is to ensure that cost allocations from Roseville to subsidiaries are made in accordance with California cost allocation rules and the holding company decision. Roseville asserts that reviewing activities performed by subsidiaries on their own will involve auditing thousands of transactions that the nonregulated subsidiaries handle themselves for their own nonregulated business operations, and may take weeks or months to accomplish. Roseville says this will increase the cost of the audit, and also involve an investigation of nonregulated processes and costs that have no effect on the cost of regulated services.

We disagree in part. Task 1 includes an overview for both portions of the combined audit (i.e., both the verification and nonregulated operations portions). Thus, Roseville's concern that this is beyond the scope of the verification audit fails to address the needs of the nonregulated operations audit.

Further, since many services and activities are potentially shared between regulated and nonregulated operations, the auditor needs to ascertain an overview of both operations to complete the job. Task 1.3.a includes assessment of several types of services and activities (e.g., management and operations, general and administrative services, employee benefits). We believe it is reasonable to allow the auditor to examine these services and activities in both the regulated and nonregulated areas to fully understand how Roseville treats these joint services and activities.

At the same time, however, we point out that this is not an audit of nonregulated affiliates. The auditor should document the activities and services performed and provided by a subsidiary on its own only as necessary to address compliance with the needs of the combined verification and nonregulated operations audit.⁶ We think it unlikely to be necessary to review thousands of transactions to complete this task. Rather, an overview of the structures, policies, practices and procedures, along with a sampling of transactions, is likely to be all that is necessary. ORA is responsible to manage the audit reasonably, and ensure that the audit does not examine affiliate activities unreasonably.

Thus, we decline to adopt Roseville's modified language for Task 1.3.a. At the same time, we provide the above guidance for the benefit of Roseville, ORA and the auditor.

⁶ The verification audit is to examine Roseville's affiliate transactions for the purpose of verifying Roseville's compliance with its affiliate transactions policies and guidelines, the requirements of the holding company order (D.96-07-059), and other applicable Commission orders and regulations. (D.96-07-059, OP 16.) The nonregulated operations audit is to examine cost allocations between regulated and nonregulated operations, including assessing the reasonableness of the California CAM. (D.96-12-074, mimeo., pp. 49-50.)

6.2 Tasks 1.3.c, 1.3.d, and 1.4.c

ORA's statement of these tasks shows this work will include a review that costs are properly identified and attributed. Roseville believes ORA's proposal leaves the definition in question. Roseville proposes that these task statements be modified to make clear the audit is to assess compliance with California cost allocation rules and the holding company decision. Roseville believes that future disputes can be avoided by defining the scope more clearly now.

We decline to adopt Roseville's proposed modification. The tasks already say that the purpose is to ensure that services and activities are properly identified, attributed, and allocated. "Proper" in this context means in compliance with California cost allocation rules and the holding company order. It also means Roseville's compliance with its own affiliate policies and guidelines. (D.96-07-059, OP 16.) We do not believe Roseville's proposed language provides sufficient, if any, incremental clarity.

In this, and other areas, Roseville would prefer a "bright line" rule, reducing or eliminating any future disputes. (RT, PHC 4, p. 163.) While a perfect definition is always desirable, it is not always practical or possible. Here, as in other areas, we apply a rule of reason. We are not convinced that Roseville's proposal provides additional clarity. As discussed more below, future disputes related to data requests during the course of the audit should be resolved using the Commission's Law and Motion procedure. (Resolution ALJ-164.)

6.3 Task 1.6

This task involves documenting any changes in accounting procedures, or affiliate relationships or transactions, that have occurred in 1999. Roseville proposes that the documentation be limited to 1998.

Roseville says ORA seeks here to increase the audit scope by an additional year. Roseville believes the audit should focus on 1998, and agrees it is not unreasonable for the review to begin with the formation of the holding company in 1996. Adding 1999 is inappropriate, according to Roseville, because it goes beyond the audit scope requested in ORA's motion, and would unnecessarily add to the expense of the audit.

We decline to adopt Roseville's recommendation. The delay in commencement of the audit is largely due to Roseville. We believe ORA's motion did not contemplate including 1999 because ORA expected the audit to be completed by now, just as did the Assigned Commissioner when he issued the ACR.⁷

Further, just as the ACR added 1998, we add the portion of 1999 that may be reviewed during the course of the audit. We do not intend, however, for the audit to be delayed until 2000 in order to review the entirety of 1999. Rather, the portion of 1999 that is available to review during the course of the audit, and within a total budget not to exceed \$280,000, should be included.⁸

⁷ The ACR directed that the final audit report be filed and served by May 1, 1999. The ACR authorized a delay in the date of the final audit report to allow inclusion in the audit of the entirety of 1998.

⁸ We think the existing budget should satisfy this expansion, especially with the elimination of Task 3.1 below. If the auditor cannot reallocate resources to audit 1996 through the available months of 1999 within a budget not to exceed \$280,000, however, ORA may file a motion for consideration of a budget augmentation. If a budget augmentation becomes necessary, the motion should be filed in Roseville's current NRF proceeding (A.99-03-025), because we close these proceedings below, and we direct that the audit be filed in Roseville's NRF proceeding. Among other things, the motion must demonstrate why additional funding is necessary even though Task 3.1 is eliminated. It must also show that all other reasonable means have been examined to reduce audit costs and remain within the budget. If the ALJ determines that the motion is not

Footnote continued on next page

6.4 Task 2

Task 2 involves reviewing changes in holding company and affiliate structures. ORA's April 19, 1999 revised audit scope adds an introductory paragraph to this task. The introductory paragraph states:

"ORA's work in this task area is not intended to critique the business advisability of plans under consideration by Roseville. ORA shall use the information for the purpose of determining the potential impact of the plans on Roseville's compliance with affiliate transaction and cost allocation rules and its holding company conditions. ORA shall maintain the confidentiality of all business plan information it receives from Roseville during the course of the audit."

Roseville acknowledges that ORA included the introductory paragraph in response to Roseville's concerns. ORA did not, however, make any changes to the specific items within Task 2, according to Roseville. Roseville says that everything in Task 2 appears to relate to the development of theories regarding possible future speculative business activity expansion for the purpose of determining the potential impact of these plans on Roseville's possible future compliance with various rules. None of this falls within the scope of the audit, according to Roseville. Rather, Roseville says the purpose of the audit is to verify Roseville's current compliance with Commission rules and procedures, not to theorize on the speculative potential impact of expansion plans on Roseville's possible future compliance. Roseville believes the audit scope should be limited to the implementation of current plans to determine if they have any effect on Roseville's compliance with appropriate rules and conditions.

properly before the Commission in A.99-03-025, the motion will be referred to another proceeding.

Further, Roseville is not convinced that ORA does not intend to have the auditor conduct a management audit as part of Task 2, despite ORA's statements to the contrary. In support, Roseville points to three examples within Task 2. In these areas, the auditor will analyze potential economies of scale and scope, the potential for economies from shared use of facilities, and the potential for diversion of resources from the utility. According to Roseville, these examples show that ORA is attempting to conduct a management audit and render an opinion on whether Roseville and Roseville's holding company are making the right management decisions regarding potential expansion opportunities and possible future economies of scale and scope. Roseville states that this is beyond the scope of the audit, which is to focus on whether the costs of actual joint and common services provided to non-utility subsidiaries are being properly allocated. Roseville proposes that ORA's introduction be retained, but all items within Task 2 (i.e., Tasks 2.1, 2.2 and 2.3) be deleted and replaced a new, more limited, Task 2.1.

We decline to adopt Roseville's proposal. The introductory paragraph clearly limits the scope of Task 2. Accordingly, ORA will not critique the business advisability of plans under consideration by Roseville. Rather, the purpose of Task 2 is to determine the potential impact of plans on Roseville's compliance with rules and conditions. We are confident that the audit will not venture into unnecessary areas, such as whether Roseville should engage in another line of business; whether future plans are reasonable; whether Roseville's management is making the right management decisions regarding potential expansion opportunities and possible future economies of scale, scope, and diversion of resources; and whether future plans might conflict with existing rules (other than to warn of possible concerns, as discussed below).

Rather, any examination of economies of scale and scope, economies of shared use of facilities, and diversion of resources to affiliates should be focused on the effect of those economies and resource diversions on proper cost allocations.⁹ Moreover, any consideration of the impact of future plans on cost allocations should be limited to identifying areas where Roseville and the Commission should pay particular attention for future compliance with existing rules, so we may both be aware of potential areas of concern.¹⁰ There is no dispute, of course, that the proper accounting of past and current costs of expansion and expansion planning are appropriately within the scope of the audit, to ensure that ratepayers of regulated operations are not paying the costs of planning, research and development of unregulated subsidiaries.¹¹

Further, Roseville would seek by its proposal to exclude specific tasks which relate to the holding company order. For example, Task 2.2.b relates to sources of financing. Similarly, Task 2.3.f addresses whether Roseville is funding affiliate plant expansion. Specific limitations are placed on Roseville's capital structure, capital requirements, dividend policy, and ability to guarantee securities. (D.96-07-059, OPs 20, 21, 22 and 23.) Tasks 2.2.b and 2.3.f are

⁹ Only with good reason would any expansion of this task be reasonable (e.g., a legitimate regulatory concern within the audit scope discovered during the audit).

¹⁰ For example, at the April 8, 1999 PHC, ORA stated that it would alert Roseville and the Commission to any concerns discovered during the audit regarding compliance with conditions and rules if future plans are executed. We think this is a legitimate area of inquiry as part of the audit, without also addressing whether the plan itself is reasonable. Only with good cause would any expansion of this task be reasonable (e.g., of a legitimate regulatory concern discovered during the course of the audit).

¹¹ See, for example, the disallowance of \$100,000 in the general rate decision of development costs for potential nonregulated businesses. (D.96-12-074, mimeo, p. 49.)

reasonable areas of inquiry given the conditions on Roseville's financing of nonregulated companies.

Thus, with this guidance and these observations, we decline to adopt Roseville's proposed revised audit scope.

6.5 Task 3.1

Task 3.1 compares Roseville's holding company conditions with those of other California utilities, compares conditions applicable to Roseville that are not applicable to other utilities, and considers whether changes in conditions applicable to Roseville are warranted. Roseville asserts that the holding company proceeding already reviewed conditions, and compared conditions with those of other California utilities. Roseville claims the only action that could result from this task would be the reopening of the holding company proceeding. Roseville concludes this is not a proper purpose of the audit.

We agree. We do not seek to relitigate the conditions on the holding company through the audit. Task 3.1 should be deleted.

6.6 Other Considerations

6.6.1 Law and Motion

We agree with ORA that the audit should commence now. We also agree with ORA that future disputes regarding data requests should be resolved using the Commission's Law and Motion procedure. (Resolution ALJ-164.) We hope there are no further disputes between the parties, and expect Roseville to fully cooperate with the auditor and ORA for a timely and successful completion of the audit.

6.6.2 Reasonableness of California Cost Allocation Manual

No audit task specifically states that the audit will address the reasonableness of the California CAM. That, however, is one goal of the audit. (See D.96-12-074, mimeo., pp. 49-50.)

Task 4.2 says in part: "Determine whether existing allocation procedures comply with the CPUC's order in D.96-12-074." Our order there included Roseville preparing a California CAM by applying the principles and rules from several decisions and resolutions. We understand from ORA that Task 4.2, if not other tasks, will address the goal of assessing the reasonableness of the California CAM.¹² Therefore, we need not direct specific language to that end. To the extent the audit report from the auditor does not address the reasonableness of the California CAM, we direct ORA to prepare and serve an assessment within 30 days of the date of the completion of the audit report.

7. Pattern of Behavior

We are extremely disturbed by Roseville's actions in this matter. For example, as explained above, we are not pleased that Roseville failed early in the process to resolve its concerns with ORA, or bring the matter to the attention of the ALJ, Assigned Commissioner or the Commission sooner.

Similarly, we are very concerned with Roseville's treatment of the validity of the ACR. ORA moved for an audit on July 9, 1998. Roseville's response to ORA's motion states:

"The holding company order specifically delegated to the Assigned Administrative Law Judge the responsibility to 'determine whether the need for a verification audit exists' and the Commission has not modified that order. This determination by the ALJ, not ORA, must be made before an audit can proceed." (Response dated July 24, 1998, p. 3.)

That is, Roseville said a determination by the ALJ must be made before the audit can proceed. Roseville did not limit that determination to only a denial of

¹² RT, PHC 3, pp. 110-111.

ORA's motion. Moreover, Roseville gave no indication that it would object to an ALJ Ruling on the grounds that Roseville believed the ALJ lacked authority to make such a ruling.

ORA's reply to Roseville's response makes clear that:

"ORA requests that the Assigned Commissioner and Administrative Law Judge issue an Order instructing ORA to conduct an Audit consistent with the terms of D.96-07-059 and D.96-12-074." (Reply dated August 7, 1998, p. 8.)

Roseville was given an opportunity to comment on ORA's motion at the October 11, 1998 PHC. Roseville raised no objection to ORA's request for a ruling from the Assigned Commissioner and ALJ. Further, the ALJ specifically told the parties that he would prepare an ACR. Roseville did not object.

The ACR was issued on October 26, 1998. Roseville first asserted that the Assigned Commissioner lacked authority to rule on ORA's motion as a footnote in its October 30, 1998 motion for hearing. Roseville filed its appeal of the ACR on November 6, 1998, asserting that the Assigned Commissioner lacked authority to order the audit.

Roseville's late assertion that the Commission must rule on ORA's motion misled the ALJ, the Assigned Commissioner, and thereby the Commission. Roseville's response to ORA's motion can reasonably only mean that Roseville expected an ALJ, not a Commission, determination. Roseville did not comment on ORA's motion at the PHC regarding an ALJ Ruling or an ACR. Roseville did not object at the PHC when the ALJ stated that an ACR would be prepared. The ACR ruled against Roseville. Parties are not welcome to raise procedural arguments late only after an unfavorable ruling. Roseville's late appeal of the ACR on the basis that the Assigned Commissioner lacks authority to rule on the motion abuses the process, just as Roseville's late motion for hearing abuses the process.

As we have often said, we do not ordinarily entertain interlocutory appeals of rulings of the presiding officer. (See, e.g., D.98-05-061, mimeo., p. 4; D.98-03-073 citing from D.87070 (81 CPUC 389, 390); D.90-02-048, mimeo., p. 4.) Nothing in the Public Utilities Code, or in our Rules of Practice and Procedure, authorize interlocutory appeals as a right of the parties.¹³ Interlocutory appeals delay the orderly functioning of the Commission and are not tolerated.

Even if we elect to entertain an appeal of an ACR in an extraordinary circumstance, an appeal does not stay the effectiveness of the ACR. Further, Roseville did not file a motion asking that the ACR be stayed. In neither case was the ACR stayed.

Roseville, however, has refused to allow commencement of the audit. No utility, including, Roseville, is welcome to simply disregard an unstayed ruling it does not like.

Many attempts were made by the Assigned Commissioner to resolve the parties' disputes. Those efforts included asking ORA in December 1998 to visit Roseville for the purpose of assessing the cost of the audit. Roseville understood the visit to include investigating the possibility of limiting the scope of the audit. (RT, PHC 4, pp. 128-129.) Nonetheless, Roseville refused to allow this visit.¹⁴

¹³ Rule 65 provides that a Presiding Officer may refer a ruling on the admissibility of evidence to the Commission for review when prompt decision by the Commission is necessary to promote substantial justice. While a ruling may be referred to the Commission by the Presiding Officer, there is no provision for an appeal of rulings by the parties, except when referred by the Presiding Officer.

¹⁴ ORA says it was refused entry. Roseville says it understood the Assigned Commissioner's request to be that the auditor visit Roseville, not ORA. Roseville refused entry to the auditor. Whether it was ORA or the auditor that was refused entry is not important, however. What is noteworthy here is that the Assigned Commissioner made an attempt to help resolve the matter, and Roseville was uncooperative.

Roseville's many actions have effectively caused us to re-examine each and every decision made at each and every step in our ordering the audit, including our decisions in D.96-07-059 and D.96-12-074. We think the cost of that effort by Roseville, ORA and the Commission has far exceeded any benefit of that reconsideration.

Roseville has demonstrated an unreasonable distrust of the staff, the Commission and the regulatory process. Some skepticism may be healthy. The level of Roseville's distrust, however, has contributed to the difficulties and delays in these proceedings, has been largely (if not completely) unproductive, and has resulted in extra cost for parties and the Commission.

While any one action may be overlooked, we are disturbed by Roseville's pattern of behavior. By all its actions together (including misleading the Commission with regard to its desire for an ALJ ruling on ORA's motion, its disregard of the ACR, its late motion of evidentiary hearing, its refusal to cooperate with the Assigned Commissioner's attempts for the parties to meet in December 1998 to examine reducing the audit scope, and its misleading comments on the draft decision) Roseville has violated Rule 1, abused the process, and demonstrated contempt for the staff, the ALJ, the Assigned Commissioner and the Commission. This cannot, and will not, be tolerated.

8. Sanction

As a sanction for Roseville's actions, ORA recommends we order that Roseville's shareholders pay the cost of Roseville's preparing and filing its motion for hearing and appeal of the ACR because, according to ORA, they represent frivolous attempts to delay the audit. Roseville responds that there is no authority to make Roseville's shareholders pay the ordinary expense of Roseville's participation in regulatory proceedings that affect its interests.

Roseville asserts it simply made good faith efforts to exercise a right accorded in a Commission order.

Roseville is correct that ratepayers pay the reasonable ordinary expenses of Roseville's participation in regulatory proceedings, as included in rates when established through forecasted test year ratemaking or extraordinary adjustments (e.g., Z factors). What occurred here is not a reasonable ordinary expense of participation in a regulatory proceeding, and, for the reasons stated above, we do not believe it was simply a good faith effort by Roseville.

Nonetheless, we decline to direct that certain expenses be charged to stockholders. Determining the amount of those expenses would be difficult and controversial, and needlessly require that the parties and the Commission further utilize limited time and resources. Charging certain expenses to stockholders would reduce Roseville's expenses for regulated operations, and thereby increase its rate of return for regulated operations. Unless Roseville is on the cusp of sharing, however, this will have no real effect on Roseville's rates. Rather, if a sanction is warranted, we believe a direct fine would be more appropriate and reasonable.

A fine may be a penalty of not less than \$500, nor more than \$20,000, for each offense, with every day of a continuing offense a separate and distinct offense. (Pub. Util. Code Sections 2107 – 2108.) The ALJ's draft decision proposed a fine of approximately \$78,500.¹⁵ This fine was based on Roseville's pattern of behavior, and our most recent guidance on fines. (See D.98-12-075.)

¹⁵ The final amount of the fine depended upon the date Roseville complied with the ACR, or the date of this decision. Roseville has not yet complied with the ACR. Thus, if we applied this fine, it would total \$113,500 through today.

For all the reasons stated in the draft decision, that fine would not necessarily be unreasonable.

We might also consider a fine of \$49,000. That fine would be based on the number of days that Roseville misled the Commission in violation of Rule 1 regarding Roseville's position on the need for a Commission decision (rather than an ALJ ruling) on the audit.

That is, on July 24, 1998, in response to ORA's motion for the audit, Roseville said a "determination by the ALJ [of the need for the audit], not ORA, must be made before an audit can proceed." (Response, p. 3.) As explained above (see "Pattern of Behavior"), Roseville had many opportunities to clarify that it really expected a Commission decision, not an ALJ ruling. Not the least significant opportunity to clarify—or correct—its position was when the ALJ told Roseville at the October 6, 1998 PHC that he would prepare an ACR. Roseville did not raise any concern. Only on October 31, 1998, by a footnote in its motion for hearing, did Roseville state that the Assigned Commissioner lacked authority to rule on ORA's motion. Thus, for 98 days, Roseville mislead the Commission. At the minimum fine of \$500 per day, the fine would total \$49,000.

We decline, however, to adopt either fine, or both fines. Rather, the draft decision said that Roseville's response to the draft decision would be taken into account in assessing the fine. Based on Roseville's comments at the April 8, 1999 PHC, and subsequent comments by letter dated April 20, 1999, we think Roseville may now be cooperating with the Commission.¹⁶ We believe this may be a significant change, and we are encouraged.

¹⁶ We are concerned if this recent cooperation is only because of the intervention of the Commission's President. Roseville must cooperate with all Commission staff, and not "hold out" until they get the personal involvement of the President.

Nonetheless, we repeat our recent statement putting Roseville on notice that we will look closely at any potential or actual future Rule 1 violation.

(D.99-04-027, mimeo., p. 15.) We will similarly look closely at whether or not Roseville's recent cooperation continues. The previous abuse of the process and contempt of the staff, ALJ, Assigned Commissioner and Commission described above, if continued, will not be tolerated.

9. Schedule

The auditor originally estimated that the audit of 1996 and 1997 would take four months (from the initial data request and orientation visit in June 1998 to the final report in September 1998). The ACR added review of 1998 data, and extended the schedule to six months (from November 1998 through filing of the audit report on May 1, 1999). This extension allowed the closing of 1998 books in March 1999 before completing the audit of the 1998 data.

We here order immediate implementation of the audit. By motion made May 13, 1999, ORA says the audit can be completed by the end of November 1999 if it is permitted to commence the audit in June 1999. That is, ORA estimates a six-month schedule. We think six months continues to be adequate and reasonable for completion of the audit. Thus, we direct that the final audit report be filed and served by December 1, 1999.

We believe these proceedings have now reasonably addressed all issues that need resolution, and that these proceedings may be closed. We direct that the audit report be filed and served in Roseville's current NRF proceeding (A.99-03-025), and a notice of its availability be served on the service list for A.95-05-030, A.95-05-031, and I.95-09-001. ORA should include a statement with the filing of the audit report in the NRF proceeding showing how the audit report addresses issues in the NRF proceeding. In addition, ORA should file and serve the audit report in any Roseville proceeding(s) open in December 1999 wherein

the audit report may reasonably address an issue or issues, along with a statement how the audit report addresses the issue or issues in that proceeding.

If the audit report raises issues that are beyond the scope of the NRF proceeding, or any other open Roseville proceeding(s), ORA should send a letter to the Executive Director. The letter should identify all issues that ORA believes should be addressed by the Commission not already in an open proceeding, and should include a draft order instituting investigation (OII) or draft order instituting rulemaking (OIR) as an attachment. ORA should serve the letter on the service list for A.95-05-030, A.95-05-031, I.95-09-001, and A.99-03-025. Parties and persons receiving ORA's letter may serve responses within 15 days, with service of their response on the same service list used by ORA for initial service of the letter. The Executive Director will assign review of the letter and responses to the Telecommunications Division, or other appropriate staff, for consideration of whether or not to recommend that the Commission adopt an OII, OIR, or take other appropriate action.

If the audit report will be delayed for any reason, ORA will keep parties and the ALJ in the NRF proceeding informed of any delay as soon as ORA has determined a delay is probable. To accomplish this, ORA will serve a letter on the Executive Director requesting an extension of time to comply with the orders herein. (Rule 48.) The letter will be served on the service list for A.99-03-025, including the ALJ. If the audit report is delayed, the ALJ in the NRF proceeding may consider recommending that the Commission make no changes in Roseville's NRF until the audit is completed, close the NRF proceeding and order Roseville to file a new NRF application when the audit is completed, or any other appropriate action.

Roseville at various times has suggested that the Executive Director redirect supervision of the audit from ORA to Telecommunications Division. We decline to order that redirection.

The Commission has always had an advisory staff.¹⁷ In 1996, when the holding company order was issued, we could have directed that the audit be supervised by the advisory staff. We did not. We ordered that DRA (ORA's predecessor) "have the ultimate authority and responsibility for selection, direction, monitoring and supervision of the contractor." (D.96-07-059, OP 16.)

We provided some latitude to the Executive Director when we said:

"...the Division of Ratepayer Advocates (DRA, which, for purposes of this Ordering Paragraph shall mean DRA or such other staff organization that the Executive Director designates for the purpose) shall be the designed [sic] staff organization having responsibility for the audit unless the Executive Director determines that the needs of the Commission dictate otherwise." (D.96-07-059, OP 16.)

That is, we assigned responsibility for the audit to our advocacy staff, or successor advocacy staff, unless the needs of the Commission dictated otherwise. No such need has yet justified that redirection, and we are aware of no compelling need to have the Executive Director redirect the audit to any other staff division now. Nonetheless, the Executive Director retains authority to redirect supervision of the audit to another staff division if the Commission's needs change.

10. Motion to Compel

On February 25, 1999, ORA filed a motion to compel compliance with the ACR. ORA asked that the Commission President issue an order directing

¹⁷ For example, before the Telecommunications Division, the Commission had the Commission Advisory and Compliance Division.

Roseville to allow commencement of the audit. On March 12, 1999, Roseville filed a response in opposition to ORA's motion.

Today's decision addresses all issues that need to be addressed. ORA's motion is, therefore, moot. For administrative convenience, we deny the motion on the basis that it is moot without requiring the President to issue a separate ruling.

11. Motion to Consolidate

On May 13, 1999, ORA filed a motion to consolidate the verification and nonregulated operations audit (in A.95-05-030, A.95-05-031 and I.95-09-001) with Roseville's NRF review (in A.99-03-025). The motion is moot given our closing of the general rate case and holding company proceedings, and is denied on that basis. While the ALJs or the Assigned Commissioners assigned to the proceedings could make this ruling, again for administrative convenience, we do it here.¹⁸

Findings of Fact

1. On July 9, 1998, ORA filed a motion to conduct a verification/nonregulated operations audit.
2. On July 24, 1998, Roseville filed a response to ORA's motion for audit saying, among other things, that an ALJ determination on the need for a verification audit must be made before an audit can proceed.
3. On August 7, 1998, ORA filed a reply to Roseville's response.
4. On October 6, 1998, a PHC was held on ORA's audit motion.
5. On October 26, 1998, an ACR generally granted ORA's motion.

¹⁸ The motion was denied with respect to A.99-03-025 at a May 17, 1999 PHC in that proceeding.

6. On October 30, 1998, Roseville filed a motion for evidentiary hearing on the need for an audit.

7. On November 6, 1998, Roseville filed an appeal of the ACR.

8. On February 25, 1999, ORA filed a motion to compel compliance with the ACR by an order from the Commission's President.

9. On April 8, 1999, a PHC was held at the request of the President on the scope of the audit.

10. On April 19, 1999, ORA served a revised audit scope.

11. On April 20, 1999, Roseville served a response to ORA's revised audit scope.

12. Payment of the extra costs, if any, of the nonregulated operations audit by Roseville's shareholders was not an explicit condition on the authority granted Roseville to establish a holding company.

13. General rates include recovery from ratepayers of reasonable regulatory costs.

14. Roseville could have filed its motion for hearing on the need for the audit with its July 24, 1998 response to ORA's motion for audit, any day up to the October 6, 1998 PHC, at the October 6, 1998 PHC, or could have moved to set aside submission of the issue for consideration of its motion before the ACR was filed on October 26, 1998.

15. The audit will address matters other than the level and number of affiliate and nonregulated transactions, such as whether the correct policies, practices and procedures have been implemented, and are being used accurately, to properly account for affiliate and nonregulated operations, allocations and transactions; whether the California CAM is reasonable; and whether Roseville is in compliance with its affiliate transactions policies and guidelines, the conditions

on the holding company in D.96-07-059, and other applicable Commission orders and regulations.

16. A hearing is not needed on the need for the audit.

17. Roseville was first contacted by ORA about the verification audit in September 1997.

18. Roseville first brought its concerns about the audit to the attention of the ALJ and the Assigned Commissioner in a May 29, 1998 letter to the Assigned Commissioner.

19. ORA asked for a ruling on its audit motion by the ALJ or the Assigned Commissioner, and the ALJ stated at the PHC that he would prepare an ACR.

20. Roseville did not object to either an ALJ ruling or an ACR on ORA's audit motion until after the filing of the ACR.

21. Roseville's late assertion that the Commission must rule on ORA's audit motion misled the ALJ, the Assigned Commissioner and the Commission.

22. Roseville did not file a motion asking that the ACR be stayed.

23. Roseville has refused to allow commencement of the audit.

24. Several important advances were made at the April 8, 1999 PHC, including Roseville saying it does not continue to ask that the RFP be reissued and a new contractor selected.

25. The Commission does not seek relitigation of the holding company conditions by way of the audit.

26. Roseville refused to allow a visit by ORA or the auditor at the request of the Assigned Commissioner in December 1999, to include investigating the possibility of limiting the scope of the audit.

27. Roseville has abused the process, misled the Commission, and shown contempt for the staff, ALJ, Assigned Commissioner, and Commission.

28. Beginning with steps taken at the April 8, 1999 PHC, Roseville may be cooperating with the Commission.

29. ORA says the audit may be completed by the end of November 1999 if it begins in June 1999.

Conclusions of Law

1. OP 16 of D.96-07-059 directs that the assigned ALJ hold certain PHCs, determine the need for an audit, and if the need exists, schedule the audit.

2. The Assigned Commissioner had authority to rule on ORA's audit motion, and a Commission order is not needed to order the audit.

3. *De novo* review of the ACR should not be undertaken because (a) Roseville could have participated in the audit process earlier or, if foreclosed, could have brought the matter to the attention of the Commission earlier, and, more importantly, (b) the procedural safeguards provided in OP 16 of D.96-07-059 were executed and fulfilled.

4. Roseville's appeal of the ACR should be denied.

5. Roseville should pay the cost of the nonregulated operations audit, subject to possible subsequent cost recovery of its funding of the auditor's costs.

6. Roseville should be authorized to apply for recovery of its funding of the auditor's cost of the nonregulated operations audit as a Z factor adjustment in a NRF price cap filing.

7. Roseville's advice letter seeking recovery of its funding of the auditor's cost of the nonregulated operations audit should include a showing that addresses the extent to which its general rates recover regulatory costs, states the amount of regulatory costs for which Roseville sought recovery in its last general rate case, states the amount Roseville understands are included in the authorized revenue requirement, describes the programs or items that compose the costs that were

included in its rate request, and addresses whether or not costs of the nonregulated operations audit are reasonably included therein.

8. Roseville's motion for evidentiary hearing on the audit should be denied.
9. An appeal of the ACR does not stay its effectiveness.
10. The final audit scope should be the revised audit scope provided by ORA on April 19, 1999, as clarified by the discussion in this decision, with the exclusion of Task 3.1.
11. Disputes regarding audit-related data requests should be resolved using the Law and Motion procedure (Resolution ALJ-164).
12. A sanction in the form of requiring Roseville's shareholders to pay Roseville's costs for preparing and filing its motion for hearing and appeal of the ACR should be rejected because determining the amount of those expenses would be difficult and controversial, needlessly require the parties and the Commission to use more limited resources, and, unless Roseville is on the cusp of sharing, would have no real effect of Roseville's regulated operations and rates.
13. To the extent that the final audit report from the auditor does not address the reasonableness of the California CAM, ORA should prepare and serve an assessment of the California CAM within 30 days of completion of the final audit report.
14. The audit should begin immediately, and the final audit report should be filed and served by December 1, 1999 in A.99-03-025 (Roseville's NRF proceeding), and in any other open Roseville proceeding wherein the audit report may reasonably address an issue or issues.
15. If the final audit report raises issues that are beyond those in A.99-03-025 or any other open Roseville proceeding, ORA should send a letter to the Executive Director identifying all issues that should be addressed, with a draft OII or OIR attached.

16. If the final audit report will be delayed for any reason, ORA should request an extension of time to comply with the December 1, 1999 deadline by letter to the Executive Director. (Rule 48.)

17. Supervision of the audit should not be reassigned from ORA to Commission advisory staff unless the Executive Director determines that the Commission's needs have changed.

18. ORA's February 25, 1999 motion to compel compliance with the ACR should be denied on the basis that it is made moot by this decision.

19. ORA's May 13, 1999 motion to consolidate A.95-05-030, A.95-05-031 and I.95-09-001 with A.99-03-025 should be denied on the basis that the first three proceedings are closed by this decision.

20. This order should be effective today so that the audit may commence without further delay.

O R D E R

IT IS ORDERED that:

1. The October 30, 1998 motion of Roseville Telephone Company (Roseville) for evidentiary hearing on the need for the audit is denied.

2. The November 6, 1998 appeal of Roseville to the October 26, 1998 Assigned Commissioner's Ruling is denied.

3. The February 25, 1999 motion of the Office of Ratepayer Advocates (ORA) for an order from the President to compel Roseville's compliance with the October 26, 1998 Assigned Commissioner's Ruling is denied.

4. The May 13, 1999 motion of ORA to consolidate these proceedings with Roseville's new regulatory framework (NRF) proceeding (Application (A.) 99-03-025) is denied.

5. The revised audit scope submitted by ORA on April 19, 1999 is approved, as clarified by the discussion in this decision, with the exception of Task 3.1. Task 3.1 is deleted. The audit shall commence immediately. Disputes regarding audit data requests shall be resolved using the Law and Motion procedure (Resolution ALJ-164).

6. The final audit report shall be filed and served in A.99-03-025 no later than December 1, 1999, and a notice of availability shall be served on the service lists for A.95-05-030, A.95-05-031 and Investigation (I.) 95-09-001. ORA shall include a statement with the final audit report filed in A.99-03-025 showing how the final audit report addresses issues in the NRF proceeding. ORA shall also file and serve the final audit report in any other open proceeding involving Roseville wherein the final audit report may reasonably address an issue, along with a statement how the final audit report addresses the issue.

7. If the final audit report raises issues that are beyond the scope of those in the NRF proceeding (A.99-03-025), or any other open proceeding reasonably involving Roseville, ORA shall send a letter to the Executive Director identifying the issues and attaching a draft order instituting investigation or draft order instituting rulemaking for consideration, with service of the letter on the service lists for A.95-05-030, A.95-05-031, I.95-09-001, and A.99-03-025. Parties and persons receiving ORA's letter may serve responses within 15 days on the Executive Director, with service on the same service list as used by ORA.

8. If the final audit report does not address the reasonableness of Roseville's California cost allocation manual, ORA shall prepare and serve in A.99-03-025 within 30 days of the final audit report an assessment of its reasonableness.

9. Roseville shall pay the cost of the verification and nonregulated operations audit, including fees and expenses of the auditor. Roseville shall also pay ORA's incremental travel costs for the verification audit (as previously ordered in

Decision 96-07-059, ordering paragraph 16). Roseville may apply for consideration of cost recovery for Roseville's payment of the auditor's costs of the nonregulated operations audit. Roseville may apply for consideration of that recovery as a Z factor adjustment in a Roseville new regulatory framework price cap filing.

10. The Office of Ratepayer Advocates will seek from the auditor separate statements for the costs of the verification and nonregulated operations portions of the audit. If the auditor is unable to prepare a reasonable statement of its costs separated between the verification and nonregulated operations portions of the audit, the cost of each shall be 50% of the total cost of the audit. ORA shall file that statement in A.99-03-025 within 30 days of the filing of the final audit report. The statement shall include accumulated costs through the filing of the final audit report, if total audit costs of the auditor are not yet final. It shall also include an estimate of total final auditor costs separately stated for the verification and nonregulated operations portions of the audit, and an estimated date for completion of the project and final total costs.

11. These proceedings are closed.

This order is effective today.

Dated June 10, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
JOEL Z. HYATT
Commissioners

I will file a concurrence.

/s/ RICHARD A. BILAS
Commissioner

I abstain.

/s/ LORETTA M. LYNCH
Commissioner

Concurring Opinion of President Bilas

On June 3, 1999, Roseville sent a letter of communication regarding the revised draft decision. This ex parte communication was sent to President Bilas, Commissioner Duque and Commissioner Neepier, with copies to their advisors. Ex parte communications are not part of the record, and need not be addressed. Nonetheless, due to the seriousness of Roseville's comments, I wish to address this matter in this concurring opinion.

Roseville's letter asks the Commission to modify the revised draft decision to reflect fairly the actions of Roseville in light of what Roseville believes to be ORA's inappropriate and improper actions. Roseville says it is concerned by what it believes to be harsh and unjustifiable criticism Roseville receives in the revised draft decision. According to Roseville, the revised draft decision sends inappropriate messages that regulated companies will be censured if they challenge improper actions of ORA, that ORA can act as it wishes without regard to Commission orders, and that anyone affected should simply go along with ORA's demands without question. Roseville concludes by noting that it was stunned to read the revised draft decision that minimizes ORA's inappropriate actions and paints Roseville in harsh terms for objecting to these inappropriate actions.

To the contrary, today's order affirms Commissioner Conlon's ACR. The ACR addresses ORA's actions. I point out, however, that ORA has its own authority to conduct investigations, with objections decided by the Assigned Commissioner. (Pub. Util. Code Section 309.5(e).) When Roseville first raised its concerns with Assigned Commissioner Conlon, he attempted to assist the parties to resolve the matter, requested that ORA and Roseville further attempt to resolve the dispute and, if resolution was not possible, that ORA file a motion. Soon thereafter, ORA filed its motion. Assigned Commissioner Conlon ruled on ORA's motion, and resolved objections in his ACR. To the extent ORA engaged an auditor before its motion for audit was granted, that only raises the issue of who would have paid the auditor's costs, not ORA's authority to conduct investigations.

Roseville says the revised draft decision essentially says ORA can act as it wishes and that anyone affected should simply go along. To the contrary, while regulated utilities must comply with legitimate ORA actions, utilities may exercise all rights contained in the Pub. Util. Code and the Commission's Rules of Practice and Procedure. For example, objections over production or disclosure

of information requested by ORA can be resolved by the Assigned Commissioner. (Pub. Util. Code Section 309.5(e).)

Roseville says the revised draft decision sends an inappropriate message that regulated companies will be censured if they challenge inappropriate actions of ORA. Regulated companies are not subject to censure for challenging the actions of ORA. Rather, regulated companies are welcome to challenge both ORA and the Commission. The concern expressed in this decision is with Roseville's pattern of conduct, along with its demonstrated unreasonable distrust of the staff, Commission and regulatory process. My belief is that some distrust and skepticism is healthy. In that sense, any one action is not usually unreasonably distrustful or skeptical. However, Roseville's pattern of behavior causes us concern and is unreasonable.

In its ex parte letter, Roseville asserts that if the revised draft decision is adopted as written, Commission oversight over ORA will not have occurred. This is not true. The decision considers the actions of both ORA and Roseville. The decision sets the appropriate oversight over both ORA and Roseville.

Roseville expresses its concern that an "unaccountable advocacy staff can unilaterally hire a favored consultant for an excessive budget when another bid was received for half the cost...." I note that the advocacy staff is accountable to the Executive Director and the Governor. I also note that the winning contractor was selected based on a standard competitive bidding process, and the bid to which Roseville refers did not qualify as a responsive bidder. As such, that bid was not eligible to be considered. Whether its cost was or was not half of the bid of the winning contractor is irrelevant. That the winning bidder has been used by the Commission before does not mean the consultant was in any way favored.

Roseville also expresses concern that in Roseville's view ORA flaunted the Public Records Act by refusing to reveal the reasons why the bidder at half the cost was rejected. To the contrary, the Commission (not ORA) explained in letters to Roseville dated January 11, 1999 and January 22, 1999 why the Commission could not release the information sought by Roseville. Moreover, the January 22, 1999 letter pointed out that Roseville could appeal the decisions in the letter by procedures explained in Sections 3.4 and 3.5 of General Order 66-C. Those sections provide an appeal to the ALJ, Commissioner or the whole Commission. No such appeal of Roseville's Public Records Act request was made.

A.95-05-030 etal.

D.99-06-051

I am pleased to note that Roseville now says the proposed order yields an audit scope that complies with Commission orders. I am also pleased that Roseville says it will cooperate with the audit. I optimistically look forward to seeing that cooperation.

Roseville asks that the draft decision be revised to fairly reflect what Roseville believes has transpired. I assure Roseville that the matter has been reviewed thoroughly and that the decision does fairly reflect what has happened. Roseville also asks that the draft decision be revised in order to give Roseville confidence that the results of the audit will be considered in a fair and open light. Again, I assure Roseville that the results of the audit will be considered in a fair and open light. Additionally, Roseville will have an opportunity to address any audit recommendations should they be considered by us for adoption.

In summary, Roseville should have full confidence that it will receive a fair and impartial review when the audit is completed.



RICHARD A. BILAS
Commissioner

San Francisco, California
June 10, 1999