

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

Order Instituting Rulemaking on the Commission's
Own Motion to Adopt New Safety and Reliability
Regulations for Natural Gas Transmission and
Distribution Pipelines and Related Ratemaking
Mechanisms.

Rulemaking 11-02-019
(Filed February 24, 2011)

***Reply to PG&E's March 22nd Opposition to the Motion of the Joint Parties to Compel Testimony of
PG&E's Financial Audit Expert***

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So...keep going, Mr. Gnaizda.” (TR 759)

I. Introduction

PG&E, in its opposition to the motion of the Joint Parties , focuses exclusively on whether the Joint Parties have the right to cross-examine PG&E's auditor Deloitte & Touche following generally accepted accounting principles.

Subsequent to the Joint Parties raising the issue on March 19th as to whether the Deloitte & Touche audits were conducted independent of management interference and were in accordance with generally accepted accounting principles (GAAP), Senior VP Tom Bottorff admitted under cross-examination that the amount at issue over the next few years for the ratepayers could be \$11 billion. He also stated that it is the intention of PG&E to have all of these costs , or virtually all of these costs, paid for by the ratepayers.

As the ALJ stated in this case after PG&E's legal counsel attempted to halt the Joint Parties' cross-examination of Tom Bottorff relating to the PCAOB's findings criticizing Deloitte & Touche for failing to be independent of management and for failing to follow generally accepted accounting principles:

“Well, this goes to rate of return. And, that's the big issue here. So...keep going, Mr. Gnaizda.” (TR 759)

Given the unprecedented magnitude of the proposed rate increase and the recent disclosure that substantial ratepayer funds intended for gas safety were improperly diverted to executive bonuses, PG&E and its new CEO, who is committed to full transparency, should welcome any inquiry relating to the independence and accuracy of any of its audits. In particular, it should welcome them as to its primary auditor for the last ten years, Deloitte & Touche. (TR 760, “It's probably at least ten.”) See Consumer Protection and Safety Division Incidence Investigation Report dated January 12th, 2012 as discussed in detail in the San Francisco Chronicle article of January 13th, “State Calls PG&E Lawbreaker: Utility Diverted Safety Funds Into Profit.”

This independent audit and staff report released by the CPUC demonstrates that more than \$100 million in gas safety and operation funding collected from the ratepayers over a fifteen year period (the period in which, for the most part, Deloitte & Touche was the auditor) was improperly diverted for other purposes, including profits for stockholders and bonuses for executives such as its CEO.¹ This is

¹ For example, PG&E spent \$36 million annually on an incentive plan for executives and non-employee directors from pipeline safety funds, including major amounts for CEO Darbee. (San Francisco Chronicle, *id*) The PUC report also stated that before PG&E seeks additional ratepayer funds, it should:

-- Allocate \$95.4 million that the company under-spent on capital expenditures since 1997 - including pipeline replacement - for those purposes.

-- Use the \$430 million in additional revenue it collected since 1999 "to fund future transmission and storage operations."

-- Use \$39.3 million that it collected but failed to spend for pipeline-transmission operations and maintenance since 1997 for those purposes.”

demonstration enough that Deloitte & Touche may have been somewhat lax in its auditing oversight. ²

(San Francisco Chronicle, 1/13/12 “State Calls PG&E Lawbreaker: Utility Diverted Safety Funds Into Profit”)

The primary ground for PG&E’s opposition to requiring PG&E’s controller to respond to questions as to Deloitte & Touche’s independence and accuracy appears to be that Judge Wong, in the Sempra case, recently denied the Joint Parties’ request to subpoena an outside party, Sempra’s auditor, Deloitte & Touche. However, Judge Wong permitted the Joint Parties to fully examine the issue through their cross-examination of the two COOs of SDG&E and So Cal Gas and in their cross-examination of Sempra’s controller.

Thus, it would be more accurate for PG&E to state that the Sempra case is a clear precedent in favor of allowing the examination of a high ranking official within the company on this issue.

Should the controller or the other top in-house financial expert selected by PG&E be unable to adequately respond, the issue of whether the Joint Parties are bound by the Wong determination as to the calling of a Deloitte & Touche witness can then be determined.

Therefore, this Commission, out of an abundance of caution and respect for ratepayers in a very controversial case, should ensure that all audits of PG&E are made by independent and reliable CPA firms that use generally accepted accounting principles.

² CPUC Staff Report Executive Summary states, “The Consumer Protection and Safety Division (CPSD) finds that PG&E violated the Public Utilities Code, several federal and state pipeline safety regulations and failed to follow accepted industry standards. The investigation revealed that the incidence was caused by PG&E’s failure to follow accepted industry practice when constructing the section of pipe that failed, PG&E’s failure to comply with integrity management requirements, PG&E’s inadequate record keeping practices, deficiencies in PG&E’s SCADA system and inadequate procedures to handle emergencies and abnormal conditions, PG&E’s deficient emergency response actions after the incidence, and a systemic failure of PG&E’s corporate culture to emphasize safety over profits. (emphasis added)

The burden must be and should be on PG&E to demonstrate such in a case involving \$11 billion or more in rate increases. This is particularly so in the context of the growing lack of confidence in the accuracy of any of PG&E's numbers or practices relating to gas pipeline safety.

Specific responses are set forth below to PG&E's opposition.

II. Ruling of Judge Wong

The ALJ in this case is not bound by ALJ Wong's ruling in the Sempra case. However, as set forth above, Judge Wong permitted the Joint Parties to examine four high ranking Sempra officials, including two COOs and its controller on the issue of Deloitte & Touche's accuracy. However, Judge Wong, partly for reasons relating to late filing and desire not to further extend the time period of cross-examination, ruled in favor of Sempra as to the Joint Parties' motion to cross-examine Deloitte & Touche's principal auditor in the Sempra case. Hopefully, the controller in the PG&E case will be more forthcoming and knowledgeable and there will be no need to call Deloitte & Touche. However, the Joint Parties reserve the right to do so, if necessary.

III. The Joint Parties Proposed OIR Is Not a Defense

PG&E argues that because the Joint Parties have proposed a future-oriented investigation relating to the auditors at PG&E, Sempra and Edison (OIR P.12-02-016) that this precludes moving forward in the present case.

First, the Commission (assigned commissioner in the OIR is President Mike Peevey) has not yet determined whether it will move forward on this OIR.

Second, the OIR, by its nature, will only affect future cases, not pending cases.

Third, the OIR relates to broader issues such as whether, as recommended by many experts at the PCAOB hearings March 21st and 22nd, auditors should be rotated every six years and that no auditor provide any paid management services.

IV. That The Matter Is Pending In the Sempra Case Is Not Relevant

The argument by PG&E that the ALJ should not examine the accuracy of Deloitte & Touche's audits at PG&E because a similar issue is pending in the Sempra case is hardly a defense. The PG&E case is unique and stands on its own.

However, in the PG&E case it is particularly relevant to examine the independence and accuracy of Deloitte & Touche's audits in light of previously referred to improper diversions of funds and the lack of confidence that this Commission and the public have expressed in the integrity of PG&E's practices and policies.

Should the public believe, as they may have grounds to do, that there have been no effective audits of PG&E in the past decade, ratepayer support for any substantial rate increase, much less an \$11 billion rate increase, may vanish.

V. The PCAOB Has Not Rejected Efforts to Use Its Study in Specific Cases

PG&E contends that the PCAOB has, in effect, opposed efforts to use its findings that almost half of Deloitte & Touche audits were deeply flawed because of its failure to follow generally accepted accounting principles and/or lack of independence from management.

This is incorrect. The evidence from the March 21st and 22nd PCAOB hearings demonstrates the opposite. In fact, the chairman of the PCAOB, based on the March 22nd PCAOB testimony of the Joint Parties, discussed with Faith Bautista (the NAAC's CEO) that he was pleased that the minority business organizations were using the findings in specific cases, including before the CPUC. He also stated to Ms.

Bautista that he was seriously considering the Joint Parties request to hold the second PCAOB public hearings on this subject in San Francisco, possibly in conjunction with the CPUC.

When Faith Bautista testifies before the CPUC next week relating to their survey of ratepayer attitudes and concerns relating to whom should bear the \$11 billion in proposed gas safety costs (see marked for identification Exhibit 22), Ms. Bautista will also make herself available for full cross-examination by PG&E on the PCAOB hearings and their applicability in this case.

Ms. Bautista has just informed President Peevey, as well as Commissioner Simon, of the interest of the PCAOB in conducting the second public hearing in San Francisco later this year. (Deloitte & Touche and PricewaterhouseCoopers performed audits for 91.3% of market capital value of public utilities nationwide; Deloitte & Touche is the auditor for PG&E and Sempra and PricewaterhouseCoopers is the auditor for Edison.)

VI. The Burden Is Not On the Joint Parties to Demonstrate In Advance Of Cross-Examination the Flawed Nature of the Deloitte & Touche Audits and Their Impact on Proposed Rate Increases or Improper Diversion of Ratepayer Funds

PG&E contends that because the Joint Parties do not have first-hand knowledge of the specifics of Deloitte & Touche's massive audits of PG&E that they may not question any PG&E financial official on the impact of the audits on the proposed rate increase.

First, this is an argument that PG&E can raise during the Joint Parties' cross-examination of PG&E's Chief Financial Officer or, if necessary, when Deloitte & Touche testifies.

Second, given all the questions that have recently been raised regarding the integrity of every aspect of PG&E's accounting and record keeping, it would seem obvious that the burden should be upon PG&E and its experts to convincingly demonstrate to the ALJ and this Commission, and ultimately to the

ratepayers, the integrity of all the accounting practices that affect, directly or indirectly, any proposed rate increases.

Third, the Joint Parties have retained expert Michael Phillips to respond subsequent to the cross - examination of PG&E's Chief Financial Officer. He was made available in the Sempra case, but Sempra declined to cross-examine him.

Mr. Phillips is presently in Japan, but has provided the Joint Parties with a brief overview of relevance of the audit to rate increases, which is attached. However, we do not believe it is necessary for the Joint Parties to bear the burden of proof.

Since it is clear that the auditing practices are relevant, the question is how relevant and in what ways. We would therefore suggest that once the cross-examination of PG&E's controller is completed that the ALJ secure comments from DRA regarding its January 12th study referenced herein, as well as comments from consumer experts such as TURN.

Further, since PG&E's integrity is being questioned even by its own employees, the appearance of its controller to defend the Deloitte & Touche audits should be welcomed, rather than opposed by PG&E and apparently its new CEO. (See, for example, "Welders question PG&E's gas pipeline work," San Francisco Chronicle, 2/8/2012, relating to two veteran PG&E welders' information to the PUC.)

VII. Calling Of NAAC Witness to Put In to Evidence the Ratepayer Study on Who Should Bear the Cost

The Joint Parties, on March 19th, had marked for identification Exhibit 22, a survey of 190 ratepayers by the National Asian American Coalition on behalf of the Joint Parties . The survey demonstrated that only six percent (6%) of the ratepayers in PG&E's service area support the ratepayers bearing the burden of future gas safety costs.

Since counsel for PG&E objected to the study being introduced into evidence without a sponsoring witness, the Joint Parties, in their motion of March 21st, requested that a time certain be set aside for the President/CEO of the NAAC, Faith Bautista, to introduce the NAAC's study into evidence and be subject to appropriate cross-examination. (It should be noted that this study was first made part of the record by ALJ Bushey on April 5th 2011 and, as set forth during the cross-examination of Senior VP Bottorff, was examined by senior management at PG&E, including President Chris Johns, who received a copy when it was filed with the PUC in April of 2011.)

Ms. Bautista will also be available for cross-examination relating to the PCAOB hearings, where she discussed with Chairman Doty and many other members of the PCAOB board, the applicability of their findings to specific cases, including the banking industry and rate increases at PG&E, Sempra and Edison. A declaration of Ms. Bautista to this effect can be filed should the ALJ wish such, but she is presently in DC and will not return until Tuesday, March 27th.

Dated: March 23, 2012

Respectfully submitted,

/s/ Len Canty

Len Canty, Chairman
Black Economic Council

/s/ Faith Bautista

Faith Bautista, President and CEO
National Asian American Coalition

/s/ Jorge Corralejo

Jorge Corralejo, Chairman
Latino Business Chamber of Greater Los Angeles

/s/Robert Gnaizda

Robert Gnaizda, Of Counsel

ATTACHMENT A:

Relevance of Deloitte & Touche Audits to Rate Increases

Statement by Michael Phillips

I am presently in Japan, but will be available for cross-examination beginning the week of April 23rd. My comments on the relevance of Deloitte & Touche are as follows:

1. Since there has been thousands of hours of interaction between Deloitte & Touche and internal utility personnel relating to thousands of elements of financial data, it is highly unlikely that Deloitte & Touche's practices, criticized by the PCAOB, have not had an impact on PG&E's financial statements relating to the proposed rate increase.
2. Rate hearings are based on cost data generated by computers and hundreds of financial projections over the future rate period. The idea that all of this massive data can be automatically assumed to be accurate and reliable is a bad assumption. It is an especially erroneous assumption when all parties proposing a rate increase and the audit firm jointly have financial interests in the outcome of the proceeding.
3. Additionally, it is an erroneous assumption because the long and intimate relationship between utility employees and audit personnel is much too intimate to be used for sound public judgment without further scrutiny. If a legislator and a lobbyist spent hundreds of hours working together on a personal one to one basis, few people would assume that the interaction was neutral and in the public interest.
4. Because rate hearings are based on projections of costs and employment numbers that can generate revenue increases to the utility in the range of billions of dollars, it is not reasonable to assume that a long-term, close audit relationship can be genuinely independent and not subject to outside scrutiny.

5. The PCAOB statement that a utility auditing firm failed to follow general accounting practices is such a disturbing pronouncement that full scrutiny of all auditing functions is clearly in the public and ratepayer interest.

6. I will verify this information in advance of my being called for cross-examination.