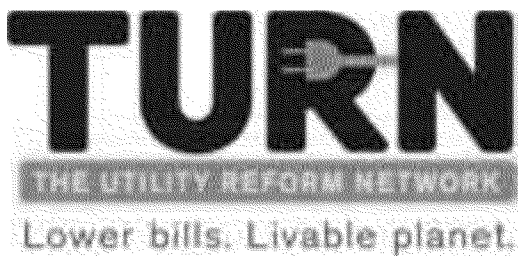


**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

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

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

**RESPONSE OF THE UTILITY REFORM NETWORK
TO THE PETITION OF BLACK ECONOMIC COUNCIL, NATIONAL ASIAN
AMERICAN COALITION, AND LATINO BUSINESS CHAMBER OF GREATER
LOS ANGELES TO ADOPT, AMEND, OR REPEAL A REGULATION
PURSUANT TO PUBLIC UTILITIES CODE § 1708.5**



March 26, 2012

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I. INTRODUCTION

On February 23, 2012, the Black Economic Council, the National Asian American Coalition, and the Latino Business Chamber of Greater Los Angeles (hereinafter Joint Parties) filed a petition asking the California Public Utilities Commission (CPUC) to issue an Order Instituting Rulemaking “regarding the verification of information by outside auditors,” particularly the four large firms who have been criticized by the Public Company Accounting Oversight Board (PCAOB) for their lack of independence and impartiality.¹ According to Joint Parties, those four firms are Deloitte & Touche, PricewaterhouseCoopers, Ernst & Young, and KMPG.² Joint Parties explain that Deloitte & Touche “is the auditor for both PG&E [Pacific Gas and Electric Company] and Sempra Energy, which includes San Diego Gas & Electric [Company] and Southern California Gas [Company],” while Southern California Edison Company (SCE) uses PricewaterhouseCoopers.³ The Joint Parties “urge an expedited Order Instituting a Rulemaking (OIR) to ascertain the impact, if any, of faulty independent audits” by these firms “on utilities with one billion dollars or more in revenue.”⁴ Joint Parties suggest that such impacts may include “the accuracy of rate increases, executive compensation and all other audits.”⁵

¹ Petition, pp. 2-3.

² Petition, pp. 3, 10.

³ Petition, p. 4.

⁴ Petition, p. 3.

⁵ Petition, p. 2.

Pursuant to Rule 6.3(d) of the CPUC's Rules of Practice and Procedure, The Utility Reform Network submits this response in support of Joint Parties' petition for rulemaking. Rule 6.3 requires that responses be filed within 30 days of the date that the petition was served, unless the assigned Administrative Law Judge sets a different date. Joint Parties served the instant petition on February 23, 2012, and the assigned Administrative Law Judge has not changed the deadline for responses. The thirtieth day fell on Saturday, March 24, which, according to Rule 1.15, makes the deadline for filing responses Monday, March 26, 2012. TURN's response is thus timely filed.

II. SUMMARY OF PETITION

Joint Parties propose that the CPUC examine and adopt "appropriate ground rules for future engagements of independent auditor CPA firms" by the CPUC jurisdictional utilities with "one billion dollars in revenue or more, or as little as fifty million in revenue or more."⁶ In support of their petition, Joint parties argue that the "financial audits relied on by the CPUC face serious concerns as to independence and impartiality."⁷ They point to the facts that "[b]oth PG&E and Sempra use Deloitte & Touche for data submitted to the CPUC," and "Deloitte & Touche has been singled out by the PCAOB for unreliable data, not following generally accepted accounting principles and being a pawn of management."⁸ They also assert that the PCAOB criticized PricewaterhouseCoopers, the firm used by SCE, in its report on 2010 audits.⁹ Further, Joint Parties explain that Sempra Energy has used Deloitte & Touche for more than fifty

⁶ Petition, pp. 16, 18.

⁷ Petition, p. 7.

⁸ Petition, pp. 7-8.

⁹ Petition, p. 9, fn. 5.

consecutive years, while PG&E has used Deloitte and Touche for at least the last five years.¹⁰ Joint Parties were not aware, at the time of filing their petition, of the number of consecutive years SCE has used PricewaterhouseCoopers as an auditor.¹¹

Joint Petitioners explain that the PCAOB has a currently pending docket on auditor independence, in which it is investigating “[t]he rotation of firms on a regular basis to prevent cozy management relationships and promote independence”; “[w]hether a CPA firm can be independent when it does consulting work for management, while at the same time performing its independent audit work”; and “[c]reating greater competition among independent auditors that may include more diverse CPA firms.”¹² Similarly, Joint Parties suggest that the CPUC should open a rulemaking to consider the following issues:

- Whether CPA firms engaged in an independent audit should be barred from providing other paid services, such as management consulting to avoid perceived or actual conflicts of interest¹³;
- Whether CPA firm engagements should be limited to six consecutive years to maximize the independence of the auditors, promote competition, promote diversity pursuant to GO 156, and “prevent the lifetime ‘partnerships’ that appear at many companies who use their auditors for long periods of time”¹⁴;
- “What portions of a CPA audit are used to bolster proposed rate increases and/or executive compensation bonuses and incentives”¹⁵; and
- How the CPUC “can secure greater certainty as to the reliability of the data upon which rate increases are predicated or executive bonuses are determined.”¹⁶

¹⁰ Petition, pp. 8-9.

¹¹ Petition, p. 9, fn. 5.

¹² Petition, pp. 10-11.

¹³ Petition, pp. 16-17.

¹⁴ Petition, pp. 16-18.

¹⁵ Petition, p. 16.

¹⁶ Petition, p. 16.

III. RESPONSE OF TURN

TURN supports the efforts of Joint Parties to bring to the CPUC's attention the possibility that "independent" audits of utility financial data may not in fact be independent or accurate, due to the relationships between the auditing firms and utilities and/or the practices of those firms. Inaccurate or suspect financial audits, such as those of concern to Joint Parties, may impact a utility's proposed rate increases or the authorized revenue requirement in several ways, discussed below.

First, to the extent the costs of the audits and other services provided by the outside auditors are included in revenue requirement forecasts that serve as the basis for utility rates, the utilities' practices with regard to selecting and compensating their auditors have a direct bearing on rates. If the utility occasionally put its auditing needs out to bid, it might obtain similar services at lower prices than those charged by the firm that has been providing services on a continuous basis for years and, in some cases, decades. There is cause to be dubious about the price-dampening effect that such a bidding approach might achieve, given the oligopoly power of the largest accounting firms. Still, the CPUC should consider whether the potential cost savings might be another factor warranting a change in practice for the utilities.

Second, the work of the auditing firms could have an indirect impact on authorized revenue requirements in so far as the CPUC permits rate recovery of performance incentive payments. Each energy utility has a short-term incentive payment program that measures performance in substantial part based on the utility's financial performance, such as earnings from operations. To the extent the work of the independent auditors feeds into the determination of either the target or actual level of financial performance, that work can indirectly influence rates.

Finally, the independent auditing firms may play a role in the authorized revenue

requirements for utilities with more active holding companies and unregulated affiliates. The Sempra Utilities are the clearest current example. The auditors prepare separate financial statements for San Diego Gas and Electric Company, Southern California Gas Company, and the unregulated affiliates. In the course of that work, they adopt some allocation of shared costs among the entities and, one would presume, deem that allocation reasonable for auditing purposes. The utilities' authorized revenue requirements may be impacted by this aspect of the auditor's work, at least to the extent to which this allocation informs or directs the shared services cost allocation reflected in the utilities' GRC and any other CPUC proceeding in which shared services costs effect the authorized revenue requirement.

IV. CONCLUSION

For the foregoing reasons, TURN supports the Joint Parties' petition. The CPUC should open a rulemaking proceeding to consider the issues Joint Parties propose. TURN additionally recommends that the CPUC include within the scope of this rulemaking proceeding any other issues the CPUC deems reasonably pertinent to assessing the impact of unreliable utility financial audits on the CPUC's exercise of its regulatory authority, as well as to preventing harm to ratepayers stemming from utility financial audits which are of compromised integrity.

Date: March 26, 2012

Respectfully submitted,

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