STATE OF CALIFORNIA

GEORGE DEUKMEJIAN, *Governor*

COMMISSION ON CALIFORNIA STATE GOVERNMENT ORGANIZATION AND ECONOMY
11th & L BUILDING, SUITE 550, (916) 445-2125
SACRAMENTO 95814

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Assemblyman

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Assemblyman

RICHARD C MAHAN
Executive Director

A STUDY OF THE ORGANIZATION AND COORDINATION OF ELECTRIC ENERGY PLANNING AND ELECTRIC UTILITY REGULATION IN CALIFORNIA

FEBRUARY 1984

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A Report
of the

COMMISSION ON CALIFORNIA STATE GOVERNMENT
ORGANIZATION AND ECONOMY

February 1984

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February 1984

Honorable George Deukmejian
Governor of California

Honorable James Nielsen
Senate Minority Floor Leader

Honorable David A. Roberti
President pro Tempore of the Senate
and Members of the Senate

Honorable Robert W. Naylor
Assembly Minority Floor Leader

Honorable Willie L. Brown, Jr.
Speaker of the Assembly
and Members of the Assembly

Dear Governor and Members of the Legislature:

In the early 1970's, this country was struck with an unprecedented energy crisis. Up until that time, Californians had enjoyed the benefits of abundant and inexpensive energy which effectively supplied all our daily needs. Consequently, energy policy was generally viewed as a relatively non-controversial subject.

By the mid-1970's, however, several conditions including fears of energy shortages forced our State government to focus a significant proportion of its attention on energy issues. The Legislature and the Administration concluded that it was the responsibility of State government to develop and implement energy policies with the objectives of reducing wasteful and unnecessary uses of energy and thereby reducing the rate of energy consumption. In 1974, the State created the California Energy Commission to address most of the State's energy policy issues -- conservation, development of alternative energy sources, assessments of energy needs, and the siting of new power plants. At the same time, the Public Utilities Commission has continued to fulfill its responsibilities in regulating utilities.

The Little Hoover Commission believed that it would be timely and useful to conduct an evaluation of the organization and coordination of energy planning and utility regulation. The Commission initiated this study for several reasons. First, although the electrical energy activities of the Public Utilities Commission and the California Energy Commission are not supported by general fund money, each of these organization's work affects literally billions of dollars paid each year by electrical energy ratepayers, including the State of California which spends approximately $250 million a year for its electricity bill. Second, the coordinated activities of these two commissions affect

private electric utility companies which are regulated by them and spend thousands of staff hours each year responding to these two agencies. Finally, California is at a critical turning point for many of the energy dilemmas our State faced during the 1970's. Implementation of State energy policy is critical to help ensure that future energy supplies meet requirements and are available to consumers at the lowest possible cost.

Our Commission has as part of its mandate the responsibility to determine whether government programs are organized in a manner that is not only efficient, but also ensures that government makes the best possible decisions and serves its citizens well. Based on our study, we believe that the organization and coordination of energy planning and electric utility regulation is inadequate. In general, the activities of these two commissions are poorly coordinated. As a result, there is virtually no linkage between the development of State energy policy, as conducted by the Energy Commission, and the implementation of that policy through the PUC's rate-setting process. Additionally, there is duplication and confusion about jurisdiction for some energy responsibilities. Specifically, our study found the following:

- The PUC's administrative procedures are inappropriate for effective energy policy formulation.
- The PUC commissioners have insufficient influence and involvement in the development of State energy policy.
- There is no identifiable unit at the PUC responsible for formally evaluating State energy policy as developed by the Energy Commission.
- California State energy policy as outlined in the Energy Commission's Biennial Report and other documents lacks authority.
- The Energy Commission lacks sufficient mechanisms to implement State electrical energy policy; the PUC lacks sufficient compulsion to implement policy proposed by the Energy Commission and endorsed by the Governor.
- The process of formal intervention in a rate-setting case has certain inherent deficiencies.
- The Energy Commission and PUC unnecessarily duplicate certain activities.

The Commission believes the State must continue to assess future energy and demand, and develop appropriate policies to ensure our energy future. However, the development of State energy policy only has purpose and meaning if the policy is meaningful and there exists a mechanism for its implementation. To improve the quality of the State's energy policy and ensure its appropriate implementation, we offer the following recommendations:

1. Communication and coordination between the two commissions at the highest levels must be improved by establishing formal structures and procedures for participation in each others proceedings.

2. The PUC should make every effort to determine and express in advance a policy construct for each of the major cases it considers.

3. The Biennial Report must be improved to reflect PUC's concerns for short-term equity and outline recommendations that are sufficiently specific to enable evaluation and implementation.

4. Duplication between the two commissions in the areas of load management, forecasting, and research and development should be eliminated.

5. The Legislature and the Administration should evaluate alternative methods to increase the number of PUC Commissioners and/or formalize the PUC's involvement at the Energy Commission.

Further findings and specific recommendations to address these problems are discussed within the attached report.

Respectfully submitted,

JAMES M. BOUSKOS, Chairman
PUC/Energy Commission Subcommittee

Mary Anne Chalker
Albert Gersten, Jr.
Richard S. Trugman
Jean Kindy Walker
Assemblyman Bruce Young

NATHAN SHAPELL, Chairman
Senator Alfred E. Alquist
Michael E. Kassan
Brooke Knapp
Senator Milton Marks
Mark Nathanson
Assemblyman Phillip D. Wyman

TABLE OF CONTENTS

EXECUTIVE SUMMARY i

RECOMMENDATIONS vi

I. INTRODUCTION 1

Background 2

Study Objectives and General Statement of Issues 4

Scope and Methodology of the Study 6

II. THE CURRENT SYSTEM FOR DEVELOPING AND IMPLEMENTING ELECTRICAL ENERGY POLICY IN CALIFORNIA 8

Organizations Responsible for Planning and Regulation 8

California Energy Commission 8

Public Utilities Commission 10

Electric Utility Companies 12

How the System for State Electric Energy Planning and Utility Regulation Works 13

California Energy Commission Planning and Policy Development 13

Ratemaking and Other Electric Utility Regulatory Activities Conducted by the PUC. 18

III. DEFICIENCIES IN CALIFORNIA'S ELECTRIC ENERGY POLICY DEVELOPMENT AND IMPLEMENTATION SYSTEM. 23

The PUC's Administrative Procedures are Not Designed for Effective Energy Policy Formulation 23

PUC Commissioners Have Insufficient Influence and Involvement in Policy Development 25

Limitations and Deficiencies in Relying Upon the Existing System for Considering Policy for Implementation 29

California State Energy Policy, as Outlined in the Biennial Report and Other Documents Developed by the Energy Commission Lacks Potency 35

The Energy Commission Lacks Sufficient Mechanisms to Implement State Electrical Energy Policy; The PUC Lacks Sufficient Compulsion to Adopt and Set Timetables for Implementation of State Energy Policy 39

Deficiencies in Electrical Energy Planning and Implementation May Have Resulted in Uncertain and Inconsistent Regulatory Decisions, Higher Long-Term Electricity Costs, and Operating Inefficiencies 42

IV. OPPORTUNITIES FOR IMPROVING EFFICIENCIES IN THE PUC OPERATIONS 44

Overlap and Duplication Between Energy Commission and PUC Activities 44

Forecasting 46

Load Management 49

EXECUTIVE SUMMARY

A STUDY OF THE ORGANIZATION AND COORDINATION OF ELECTRIC ENERGY PLANNING AND ELECTRIC UTILITY REGULATION IN CALIFORNIA

CHAPTER I: INTRODUCTION

The subject of energy policy development and energy utility regulation has been on the minds and agendas of California decision makers for almost a decade. Since 1973, California has been attempting to adapt to a world in which energy supply, prices and generation technologies have been in a constant state of flux. As early as 1974, the Little Hoover Commission was involved. In a December 1974 study of the California Public Utilities Commission, our Commission recognized the critical importance of the relationship between the PUC and the newly created California Energy Commission. That report stated that, "...the work of the Energy Commission will have a significant impact on the factors affecting rate determinations by the PUC for electric utilities. Close coordination between the two State agencies will be absolutely essential."

Since 1974, many critics from inside and outside of State government have observed that the PUC and the Energy Commission have failed to coordinate effectively, resulting in inefficiencies and diseconomies for both organizations, the public and the regulated utilities.

The possibility of the new administration proposing changes in the organization of regulatory government, the movement towards privately developed energy sources, and changes within the utility industry are likely to result in changes in our energy management institutions. For these reasons, an evaluation of the organization and coordination of energy planning and utility regulation is useful and timely.

Study Objectives and Methodology

The objective of this study is to improve the organizational integration of energy policymaking and planning with the regulatory decisions that determine activities of California electric utilities. The information that forms the basis for this study was collected by reviewing applicable statutes, files, and other studies; through extensive interviews with energy experts, most notably past and present PUC and Energy Commission commissioners and their staff; and testimony taken in two public hearings.

CHAPTER II: THE CURRENT SYSTEM FOR DEVELOPING AND IMPLEMENTING ELECTRICAL ENERGY POLICY IN CALIFORNIA

In the wake of the 1973 Arab oil embargo, the Legislature felt that a heightened State involvement and new approach to energy management would be necessary to assure reliable electrical energy to the people of California. Through the Warren-Alquist Act, the Legislature and the Governor expanded the State's role in developing energy policy by creating the California Energy Commission. This new State agency was charged with responsibility for a myriad of activities collectively focused on developing State energy policy. The Energy Commission proposes State energy policy through recommendations outlined in its Biennial Report, Electricity Report, and other mandated documents. Although the Energy Commission was given the authority to certify powerplants and related transmission lines proposed by electric utilities, the Warren-Alquist Act did not authorize the Commission to regulate several key policy aspects of utility operations, such as utility sponsored conservation programs, utility funded research and development programs, fuel purchasing policies, and utility practices regarding purchase of power from sources out of state and from third part generators within the state. State policy in these areas has been expressed through the rate-making authority which was retained by the Public Utilities Commission when the Energy Commission was created.

The Public Utilities Commission derives its authority over utilities from the State Constitution. The PUC has preeminent responsibility for the operational regulation of electric utilities, as well as various other utilities. It functions as a "surrogate marketplace," attempting to strike a balance between the needs of energy providers and the expectations of energy consumers; and between costs, service and rates. It functions in a reactive role, responding to utility applications for rate changes and adjustments. The Commission considers and reviews these applications in a process involving public hearings conducted by administrative law judges. Proposed decisions are adopted or amended by the commissioners.

Since the Warren-Alquist Act became law, both the PUC and the Energy Commission, individually or jointly, have been more successful than many states have been in testing and selectively employing alternative electric energy generation options, implementing conservation programs, and avoiding the construction of unnecessary electric generating capacity. However, coordination has been unsystematic, irregular, and ad hoc.

Significant opportunities exist to improve the State of California's system for developing energy policy, and integrating that policy into the electric utility regulatory process. Consideration and adoption of some or all of the recommendations presented in this report will streamline certain government operations and reduce operating costs, create a coherent approach to energy issues, reduce the cost to utilities which must respond to the State regulatory agencies and help ensure that, through more aggressive implementation of electrical energy policy, future rate increases are minimized.

CHAPTER III: DEFICIENCIES IN THE CALIFORNIA ENERGY POLICY DEVELOPMENT AND IMPLEMENTATION SYSTEM

Findings:

1. PUC's Organizational and Administrative Procedures Are Not Designed for Effective Energy Policy Formulation

The PUC's adversarial hearing process, in which issues of utility investments, programs, and rates are proposed and evaluated, is not designed for defining State energy policy, or for insuring that utility regulatory policy is consonant with comprehensive energy goals and objectives. The numerous filings by utility companies appear to have overburdened the PUC and limited its flexibility to investigate broader issues of regulatory policy. As a result, the PUC's present organizational structure and its procedures limit the results it can achieve.

The volume of economic regulatory activity for which the PUC is responsible, and the organization that has evolved to manage the task, place limits on the PUC's ability to exercise leadership in developing policy. Its role of "surrogate marketplace" forces upon it a reactive posture, and diminishes the predictability and reliability of the policy bases for its decisions.

2. PUC Commissioners Have Insufficient Influence and Involvement in Policy Development

Because of concerns about judicial challenges to PUC decisions on procedural grounds, PUC commissioners do not provide prospective policy guidance on pending cases.

Most often, they must react -- late in the process -- to the policy determinations made by Administrative Law Judges who are often neither policy specialists nor energy specialists.

PUC commissioners, individually and collectively, also do not influence energy policy making at the Energy Commission despite the PUC President's ex-officio membership. The volume and variety of their workload effectively prohibits participation or input to their sister commission's important procedures and policies.

3. Limitations and Deficiencies in Relying Upon the Existing System for Considering Policy for Implementation

There is no analytical process at the PUC for reviewing the Energy Commission's Biennial and Electricity Reports in toto, or their specific recommendations to the PUC, and incorporating them into the PUC's policy structure.

The Planning and Policy Division of the PUC, attempting to rededicate itself to policy analysis, has priorities which do not include systematic evaluation of Energy Commission policy documents. Unless a recommendation in one of the documents coincides with an issue of urgent importance to one of the

Public Utilities commissioners or one of the operating divisions, the Planning and Policy Division is unlikely to commit staff time to its evaluation.

The absence of regular, active participation by PUC staff in Energy Commission policy determination diminshes the practicality and credibility of the Energy Commission recommendations to the PUC, and impedes the objectives of the Warren-Alquist Act.

The Energy Commission may participate as an intervenor in PUC cases, but this is an unsatisfactory and piecemeal alternative because it limits the scope of policy input and permits major policy issues presented by the intervenor to be procedurally sidetracked. Additionally, principles of public administration and specific legislative findings made in the Warren-Alquist Act strongly suggest that conclusions of the Energy Commission, arrived at through a statutorily prescribed and exhaustive collaboration of publicly and privately employed experts, should be accorded greater weight than ordinary testimony.

4. California State Energy Policy as Outlined in the Biennial Report and Other Documents Developed by the Energy Commission Lacks Potency

Energy Commission policy guidelines and recommendations are, in effect, advisory rather than authoriative, even in cases where the recommendations are mandated by statute. Although the PUC has implemented certain Energy Commission recommendations, Energy Commission findings submitted through authorized testimony before the PUC have been rejected without justification by the Public Utilities Commission.

The Governor's endorsement of the policy contained in the Biennial Report, conveyed to the Legislature as required by the Nestande amendment to the Warren-Alquist Act, has not effectively earned "State Policy" status for the Energy Commission's findings and recommendations.

5. The Energy Commission Lacks Sufficient Mechanisms to Implement State Electrical Energy Policy; The PUC Lacks Sufficient Compulsion to Adopt and Set Timetables for Implementation of State Energy Policy

The Energy Commission's facility siting procedure, the principal means by which the Energy Commission can affect utility policy directly, has been largely eliminated as a mechanism for policy implementation because siting applications by the investor-owned electric utilities have dropped dramatically. The PUC's rate cases (including fuel adjustment clause cases) are now the preeminent regulatory "anvil," and will continue to be. In response to these changes, methods must be adopted to improve the linkage between energy policy development of the Energy Commission and regulation at the PUC.

Legislative responses have not kept pace with the rapidly changing energy picture. Except where specific statutory language has required implementation of a particular program, the PUC feels there is no requirement to adopt, and establish goals and objectives for the implementation of, State energy policy. If the legislative intent expressed in the Warren-Alquist Act, "to establish and consolidate the State's responsibility for energy resources..." is still valid, it must be acted upon.

6. Deficiencies in Electrical Energy Planning and Implementation May Have Resulted in Uncertain and Inconsistent Regulatory Decisions, Higher Long-Term Electricity Costs, and Operating Inefficiencies

The State Energy Commission has not articulated energy policy or outlined its recommendation with sufficient clarity. The PUC has not consistently or completely adopted energy policy. Consequently, the regulatory process has been unpredictable because of an absence of reliable policy bases for evaluating utility performance. Additionally, consumer electricity costs may be higher over the long-term because rate decisions have responded to current pressures rather than to long-term strategy. Finally, the PUC's absence of regulatory goals and criteria contribute to public and institutional frustration with its rate-setting processes.

CHAPTER IV: OPPORTUNITIES FOR IMPROVED EFFICIENCIES IN PUC OPERATIONS

Finding

Overlap and Duplication Exist Between PUC and Energy Commission Activities

Although the stated intent of the Warren-Alquist Act was to consolidate the state's authority over energy policy in general and electricity policy in particular, important pieces of the state's policy making and implementation responsibilities for electricity were left fragmented between the two commissions.

In circumstances that appear tailor-made to utilize the comprehensive and analytically based demand, supply, and fuel cost forecasts of the Energy Commission, the PUC chooses to adopt new numbers, based, in part, on utility data bases the sources of which are not fully known by the PUC.

The Public Resources Code requires the Energy Commission to adopt conservation and load management standards it finds to be cost effective. Further, the code requires the PUC to include in the rate base utility expenditures to achieve these standards. Despite this, the PUC staff reevaluates and often recommends rejecting the Energy Commission standards.

RECOMMENDATIONS

The Commission on California State Government Organization and Economy recognizes that there are varied approaches to correcting the deficiencies we have outlined in this report, and to improving the organization and coordination of energy policy development and electric utility regulation in California. After review and evaluation of several of these previously considered and newly developed ideas, the members of this Commission have concluded that the following recommendations, if implemented, would have a significant consequence in improving the integration of policy development and electric utility regulation.

1. Communication between the PUC and Energy Commission at the highest levels must be improved by augmenting current PUC participation in Energy Commission activities, and establishing a formal structure for Energy Commission participation in PUC activities. Specifically, the following should occur:

   a. Information systems at the PUC should provide a means by which individual Commissioners are made aware of Energy Commission recommendations, analyses, or pending agenda items which hold special interest for them, related to their lead-Commissioner responsibilities on pending cases, or to issues which may be the subject of upcoming rulemaking.

   b. A formal provision for more significant participation by Energy Commission commissioners in PUC activities is strongly urged. The forum for such participation could be either, (1) participation by individual Energy commissioners in PUC predecision policy conferences on energy-related decisions (proposed below), or (2) active participation by individual Energy commissioners in the PUC meetings at which decisions are adopted.

2. The legislature and the administration should consider the need to increase the number of PUC commissioners, and should evaluate methods to expand and formalize the PUC's involvement at the Energy Commission.

   The PUC's excessive workload limits the involvement by commissioners in all phases of PUC business and policy level decision making. It also virtually prohibits the ability of the PUC president to comply with the Warren-Alquist Act and serve as an ex-officio member of the Energy Commission. Not only would an increase in the number of commissioners relieve them of certain workload demands, but it would also allow greater personal involvement in PUC policy decisions and operations. Furthermore, an increase would allow for a larger role in Energy Commission proceedings.

We believe there are several alternative approaches to increasing the number of commissioners, and formalizing the interface. Possible alternatives include the following:

- Simply increase the number of PUC Commissioners from five to seven.

- Increase the number of full-time PUC Commissioners from five to six; decrease the number of Energy Commission Commissioners from five to four; and appoint one floating commissioner who would serve as a member of both commissions (issues such as voting rights, selection of the delegate-commissioner, and appointing authority would have to be determined). This proposal, alone among the alternatives, would also provide for the timely consideration of Energy Commission policies and perspectives in PUC's decision-making process.

- Designate a member of the PUC President's staff, who presumably shares a confidential, advisory relationship with the President, to represent the PUC at the Energy Commission when the president himself cannot.

- Appoint a PUC Commissioner to serve as a voting member of the Energy Commission, as currently occurs at the California Transportation Commission.

An expansion in the number of PUC Commissioners should be accompanied by increased use of Commission committees, improved division of labor, and some degree of specialization. Additionally, an expanded PUC membership, under any alternative, would allow greater involvement in the Energy Commission's processes, and an improved understanding of Energy Commission initiatives and recommendations.

3. The PUC should make every effort, within the constraints of the Constitution and relevant case law, to determine and express in advance a policy construct for each of the major cases it considers. Such a policy preview would identify and prioritize major issues for the benefit of all participants, indicate the guidelines the Commission will use in making its judgments, assist the Administrative Law Judge in his or her deliberations, and help direct the work of PUC staff.

4. In order to have greater credibility at the PUC, the Energy Commission's Biennial Report process must acknowledge PUC short-term concerns to a greater degree.

   a. Biennial Reports must reflect, and respond to, specific PUC objections and concerns -- particularly on issues of cost-effectiveness, and timeliness of analytical data. The Energy Commission should be statutorily authorized to continually update its data for PUC use during the period between Biennial Reports.

b. A presentation of the Biennial Report to the PUC (after formal adoption), highlighting the recommendations that affect the PUC, should be a regular feature of the Biennial Report process. Personal familiarity of PUC Commissioners with objectives and rationale of Biennial Report recommendations will promote its usefulness.

5. Energy Commission participation as an intervenor in Public Utilities Commission cases should be given greater weight. Testimony offered by the Energy Commission in areas where their recommendations have been statutorily mandated should be given the weight of rebuttable presumptions, shifting the burden of proof on those issues to participants who disagree, and requiring them to disprove the Energy Commission's contention.

6. Given the volume and economic importance of the PUC's overall workload, there is no satisfactory justification for their redudant analysis of issues given full and fair consideration in the Energy Commission's Biennial Report work.

   As required by law, the PUC should approve utility expenditures to meet the Energy Commission's load management standards. PUC staff work in load management should be limited to evaluating the degree to which each utility's proposed expenditures conform with adopted standards, and providing input to the Energy Commission's process for adopting standards.

7. The Senate and Assembly Energy Committees should conduct a special interim hearing at which time the Energy Commission would present the Biennial Report. Such hearings would clarify the planning objectives of the Biennial Report and the recommendations proposed. Energy legislation could be guided and improved.

8. The Energy Commission should adopt an overall philosophy of incrementalism in its approach to recommendations. Each Biennial Report should contain fewer recommendations, each supported by sections of the text which present realistic appraisals of the status of the issue and what can be accomplished in the following two years. Each successive Biennial Report should evaluate the progress made toward the objectives of those recommendations not yet fully implemented.

9. The Chairman of the Energy Commission, currently appointed by the Governor from among the incumbent commissioners every two years, should be made a member of the Governor's Cabinet. This would underscore the fundamental long-term importance of state energy policy, improve the coordination and coherence of energy programs throughout the Executive Branch, and most importantly for the purposes of this study, enhance the accountability and stature of Energy Commission policy throughout state government.

   The Energy Commission Chairman's appointment should be coterminous with the incumbent governor.

10. On a periodic basis, the PUC should prospectively state for the public and all interested parties its current goals, and the criteria the PUC will use in evaluating utility proposals. This statement could be presented through regulation, official policy statements, or an annual report. These goals and criteria should be expressed with sufficient specificity to provide a reliable foundation for utility proposals, and a basis for evaluating the degree to which its decisions conform to these goals and criteria.

11. The Energy Commission's demand and fuel costs forecasts, currently based upon a "Common Forecasting Methodology" required of utilities, should be used by the PUC whenever such projected values are considered, such as determinations of avoided cost for power sales agreements, approval of conservation expenditures, and in rate-making generally.

    The PUC should discontinue the use of utility-provided information unless the Energy Commission indicates that such information is consistent with its findings concerning such items as adopted demand forecasts, costs of generation technologies, fuel prices and level of conservation reasonably expected to occur.

A report which evaluates the linkage between two agencies with such closely related responsibilities must consider the issue of reorganization and merger.

Proposals to fundamentally restructure California's energy development and regulatory programs have been considered and rejected before. We have found no rationale which has not been previously presented that supports a realistic reorganization proposal.

Although much of the Energy Commission's activity is fundamental to the regulation of investor-owned utilities, a substantial portion is not related. Removal to the PUC of the Energy Commission's authority to site municipal utility facilities and privately-owned "qualifying facilities" over a certain size would raise significant legal, political, and logistical concerns. These facilities are exempted from regulation by the PUC by various provisions of Federal and State law.

Other Energy Commission programs -- affecting municipal utilities, transportation and agricultural sectors, the petroleum industry, and the construction and appliance industries; providing technical assistance to public and private energy developers; disbursing pass-through funds, grants, and loans; conducting demonstration programs, and others -- are not amenable to the PUC's regulatory structure and operation, and would fundamentally alter the PUC's focus on public utility service and rates.

Further, because the scope of the Energy Commission's statutory responsibilities is so encompassing and so interconnected, moving just the "utility part" of the Energy Commission's programs to the PUC would leave both parts truncated and unrelated to a coherent whole. Efficiency and program effectiveness would likely be lost, with no assured cost-savings.

Consolidating the state's energy management programs by moving the PUC's energy-utility regulatory authority to the Energy Commission has programmatic advantages, in terms of insuring the conformity of utility regulatory policy with overall state energy policy, and taking maximum advantage of the Energy Commission's forecasting and long-term resource plan evaluations. However, such a move also raises questions central to the PUC's Constitutional powers, and would require the development of a second rate-making and rate-design structure, duplicating that which the PUC would maintain to regulate the non-energy utilities.

Such radical reorganizations have prohibitive costs, and may be unnecessary if the more moderate proposals for program integration prove effective.

Concerns over the possible implications of radical reorganization options were evident when the issue of merger was presented during this Commission's hearings. None of the witnesses asked to respond to the question, including representatives of the three major investor-owned electric utilities and the President of the PUC, advocated merger of state-level energy regulation at the PUC. Although the question was not put directly, it can be presumed that there would be a similar lack of support for a merger into the Energy Commission.

Until the effectiveness of recommended programmatic and procedural changes can be measured, we believe that a fundamental realignment or consolidation of the PUC and the Energy Commission is inadvisable.

CHAPTER I

INTRODUCTION

The subject of energy policy development and energy utility regulation has been on the minds and agendas of California decision makers for almost a decade. Since 1973, California has been attempting to adapt to a world in which energy supply, price, and means of generation have been in a state of almost constant flux. The creation of the California Energy Commission in 1974, and a series of minor changes undertaken by the California Public Utilities Commission were clear and direct legislative and administrative responses to potential fuel shortages, inflation, an increasing concern for the environmental consequences of energy technologies. Such changes have also been in response to a general demand for a greater public participation in the energy policy and regulatory process.

As early as 1974, the Little Hoover Commission was involved. In our December 1974 study of the California Public Utilities Commission, the Little Hoover Commission recognized the critical importance of the relationship between the PUC and the brand new California Energy Commission. In that report, our Commission stated, "It is clear that some of the responsibilities of the new commission will have an important bearing on the functioning of the PUC. The PUC will no longer have exclusive jurisdiction over the siting of electric power plants. In general, the work of the Energy Commission will have a significant impact on the factors affecting rate determinations by the PUC for electric utilities. Close coordination between the two State agencies will be absolutely essential".

BACKGROUND

In almost every year since the creation of the California Energy Commission in 1974, the Legislature has introduced new initiatives to reform or reorganize the State's energy institutions. In 1976, the Senate Committee on Public Utilities Transit and Energy commissioned a report on the Public Utilities Commission by the firm of Cresap, McCormick & Paget. This report, prepared and submitted in two separate volumes in March and September of 1976, attempted to anticipate regulatory trends, identify emerging requirements for policy making and organizational changes at the Public Utilities Commission, and present specific recommendations for revision of internal processes. The Cresap, McCormick & Paget study was based upon the premise that California had begun a period of rapid change in its energy picture and that there was a clear need to recognize and respond promptly and effectively to the emerging needs of the present and future. As the report concluded, "In these times of rapid change, institutions must be prepared to shift with them." Further, the consultants felt that "in view of the increasing pressures on the Public Utilities Commission to meet new needs, the development of a body of articulate and articulated policy is an absolute requirement. Such a body of policy does not need to be a 'dead hand,' but should be constantly reviewed and changed in response to emerging needs."

The consultants queried whether the Public Utilities Commission could continue to extend itself and spread its organizational resources thinner and thinner as the cases brought before it became more complex and more demanding, while still producing a quality

product. The organizational and procedural recommendations of the report reflected a central theme: the PUC's premise that a well-developed body of policy is not a particularly necessary ingredient in its process is faulty, and should be abandoned.

In 1978 and 1979, the Joint Committee on Energy Policy and Implementation, chaired by Assemblyman Victor Calvo (currently a Public Utilities Commission Commissioner) and vice-chaired by Senator Alfred Alquist, then the Chairman of the Senate Public Utilities and Energy Committee, published its report entitled Energy Administration and Regulation in California: an Analysis. That report, which was mandated by Assembly Concurrent Resolution 177, Statutes of 1978, analyzed the (then) "Current Effectiveness of the State Energy Resources, Conservation and Development Commission" and proposed alternatives for reorganizing the Commission to provide for "increased clarity and cohesion in establishing State energy policy and implementing such policy."

That study found, among other things, that (1) energy policy was not well articulated and lacked clarity; (2) California agencies with energy-related authority frequently pursued policies that conflicted with one another; and (3) energy planning activities in California failed to provide guidance to public and private energy producers in California. The report went on to recommend bifurcating the California Energy Commission into a regulatory commission responsible for adjudicating forecasts, resource plans, siting proposals and conservation regulations; and a department of energy responsible for the preparation of the biennial report, development of long range forecasts, the development and promotion

of alternative energy resources and conservation techniques, and participation as an advocate in the PUC's ratemaking activities.

There have been other initiatives taken since those of the late 1970's. Focus on the State's energy regulatory structure was dramatically intensified during the past legislative session when ratepayer revolts spurred by increases in utility bills drew attention to the PUC and its process for determining the cost of energy to the consumer.

Now, the Deukmejian administration is beginning to grapple with the questions of energy policy. Early indications, in the context of budget discussions, indicate that the policies of the previous administration are likely to be changed. A new philosophy of governmental regulation and new approaches to the development of non-traditional energy resources may result in further changes in the organization and structure of the State's energy management institutions. For these reasons, an evaluation of the organization and coordination of energy planning and utility regulation is useful and timely.

STUDY OBJECTIVES AND GENERAL STATEMENT OF ISSUES

The objective of this study is to improve the organization and integration of energy policy making and planning with the regulatory decisions that determine the activities of California's electric utilities. The study evaluates whether reorganization of certain responsiblities and statutory changes can promote implementation of a California Energy Policy which will ensure the best possible decisions are made regarding California's energy future.

The study has attempted to meet these objectives through a four-phase evaluation process: (1) to evaluate the current energy planning process, (2) to evaluate the current energy utility regulatory process, how it operates and how it implements State energy plans, (3) to identify what, if any, inadequacies exist in the planning and regulatory process, and (4) to determine how the State can improve the quality and integration of the energy planning and regulatory processes.

Our inquiry has focused on three areas in which the activities of two commissions interface. First, is the area of policy development and implementation (goal identification, program design, and procedures to reach the identified goals). Are the objectives and administrative actions of both commissions, insofar as they affect the operations of California's electric utilities, clear, consistent, and credible? Second, are the Energy Commission's planning and analyses as represented in its Biennial Report, its Electrical Report, and other work products, being fully utilized in terms of improving the logic, predictability, and farsightedness of the regulatory decisions affecting utilities? Finally, are the activities of both commissions in areas of common or related responsibilities complimentary and efficient, or duplicative and discontinuous?

SCOPE AND METHODOLOGY OF THE STUDY

In early 1983, the Commission hired the firm of Grattan/ Gersick/ Karp to serve as consultants in an analysis of the organization and coordination of electric energy planning and electric utility regulation in California. Mr. Michael Gersick served as principal consultant.

The information that forms the basis for this study was collected in oral testimony presented at a May 6 hearing in Sacramento and a July 27 hearing in Los Angeles; and through extensive interviews with commissioners of both the PUC and the Energy Commission, staff from both commissions, legislative staff, and energy professionals of various backgrounds. Witnesses at the public hearings included the President and Chairman of the respective commissions, utility executives, past commissioners, and interested parties who have had a history of involvement in the energy regulation process.

In addition to the information gained through testimony and interview, the consultants have reviewed constitutional and statutory law, legislative histories, relevant studies, and the general literature on energy policy and energy utility regulation.

The first task was to develop a clear understanding of the respective mandates of the Public Utilities Commission and the Energy Commission, including a review of funding sources and budget analyses from recent years. The second step was to analyze the structure and organization that have been put in place to accomplish program goals. This portion of the study involved an identification of operational deficiencies which interfered with

optimal results, and the identification of areas of responsibility of each commission which overlap responsibilities of the other. On the basis of the tentative findings made, materials were prepared to form the basis for the first hearing, at which time opinions and views of critical participants in the energy policy-making and regulatory process were solicited. The insights and personal experiences of the witnesses, as well as those gleaned in personal interviews which were going on simultaneously with the preparation for the hearings, permitted us to continually refine the issues and potential recommendations for improvements.

In the second hearing, we asked witnesses to respond to an array of proposals for strengthening the role of policy in electric utility regulation, for coordinating the programs for which each commission was responsible, and for conceptualizing the optimal participation of each commission in the work of the other. On the basis of all of these inputs, the Little Hoover Commission has made a series of findings and conclusions and has developed recommendations to better integrate the valuable work of the two subject commissions.

This report does not include analyses of past rate cases conducted by the PUC as support for our conclusions and recommendations. At the beginning of this study, the Attorney General provided us an informal legal opinion stating that such analyses of rate cases is outside the authority of our Commission. Consequently, a significant portion of this report is supported by testimony and interviews with commissioners and staff at the respective commissions and elsewhere.

CHAPTER II

THE CURRENT SYSTEM FOR DEVELOPING AND IMPLEMENTING ELECTRICAL ENERGY POLICY IN CALIFORNIA

ORGANIZATIONS RESPONSIBLE FOR PLANNING AND REGULATION

California Energy Commission

In the wake of the Arab oil embargo of 1973, the Legislature determined that the State needed new tools and new approaches to ensure that reliable and environmentally acceptable electrical energy supplies would be available to its residents during a time when experts were projecting electricity demand would far exceed current capacity and guaranteed fuel sources. In the Warren-Alquist Act (Public Resources Code, Section 25000 et seq.) the Legislature and the Administration concluded that:

- it is the responsibility of State government to ensure that a reliable supply of electrical energy is maintained at a level adequate to ensure the protection of public health and safety, promotion of the general welfare and environmental quality protection;
- a continuation of California's wasteful inefficient and uneconomic use of power would result in serious depletion of its resources and threats to its environmental quality;
- there was a pressing need to accelerate research and development of alternative sources of energy;
- it is the policy of California to reduce wasteful and unnecessary uses of energy and thereby reduce the rate of growth of energy consumption, conserve energy resources and ensure statewide environmental public safety and land use goals; and

- it was the intent of the State to establish and consolidate the State's responsibility for energy resources, for encouraging, developing, and coordinating research and development of energy supply and demand problems, and for regulating electrical generating and related transmission facilities.

To fulfill these responsibilities, the Warren-Alquist Act created the California Energy Commission consisting of five members appointed by the Governor for staggered terms of five years subject to Senate confirmation. The Governor designates a Chairman and Vice Chairman every two years.

Specifically, the commission was mandated by statute to (1) establish a biennial planning process for assessing "emerging trends related to energy supply, demand, and conservation and public health and safety factors, to specify the level of statewide and service area electrical energy demand for each year in the forthcoming 5-, 12-, and 20-year periods, and to provide the basis for State policy and actions in relation thereto..."; (2) act as a one-stop siting agency for new power plants; (3) encourage energy conservation; (4) adopt electricity load management standards for utilities; (5) recommend efficiency improvements to the Public Utilities Commission regarding rate structure; (6) develop and coordinate a research and development program (subsequently augmented by legislation in particular technological and resource areas); (7) develop energy shortage contingency plans; and (8) collect, analyze and report on various energy utility and oil company data affecting the State's energy supply.

The Energy Commission's budget for support of these activities in 1983-84 will be approximately $29 million, including $10 million in Federal dollars for federally mandated programs. There are 348 authorized positions for 1983-84. The Commission funds the majority of its programs through a surcharge of up to .20 mil ($0.00020), per kilowatt hour on electricity sold in California. This rate structure results in a larger financial contribution from those who consume the most energy. There is no general fund support for Energy Commission programs.

Public Utilities Commission

The Public Utilities Commission authority over electric utilities derives from the Constitution and the Public Utilities Code. In brief, the Constitution provides that private corporations which own and operate systems for the production, generation, transmission or furnishing of heat, light, and power to the public are public utilities subject to control by the Legislature and that the Public Utilities Commission may fix the rates, establish rules, examine records, take testimony, and prescribe a uniform system of accounts for all public utilities subject to its jurisdiction.

The PUC consists of five members, appointed by the Governor for staggered terms of six years and subject to Senate confirmation. One of the five is elected annually by the other commissioners to serve as President to the Commission.

The PUC has preeminent responsibility for the operational regulation of electric utilities, and over 1400 other privately owned public utilities and transportation companies. They regulate by designing rate structures, approving utility borrowing

and spending, and setting the rates -- on a regular basis -- which the utilities charge for their service.

Setting utility rates involves the determination of allowable expenses utilities may charge to their customers. This, in turn, requires decisions as to the type of activity, and the volume of each activity, which will be funded through rates.

In addition, the PUC issues certificates of public convenience and necessity for major utility construction projects (largely a vestigial function with respect to power plants and related transmission lines, since the creation of the Energy Commission with its siting authority), prepares its own one-year sales forecasts as part of the ratemaking process, evaluates utility research and development programs, and sets priorities for gas and electric service in case of supply shortages.

The PUC budget for 1983-84 is approximately $40 million, supporting 952 authorized positions. (It should be noted that for fiscal year 1983-84, and subsequently, the PUC will be funded through a system of user fees imposed on the regulated utilities in proprotion to the staff time and other resource commitments required to regulate it. These fees are directly passed through to ratepayers on a pro-rata basis, and appear as an itemized portion of the consumers utility bill. This fee-for-service concept brings the California Public Utilities Commission in line with most other states' utility commissions, and will place the burden of support for the PUC on those ratepayers whose interests are the object of PUC activity.) Municipal or public utility district ratepayers, served by utilities not subject to PUC

regulation, will no longer be supporting the Commission through the General Fund.

Electric Utility Companies

Until the early 1970's, the utilities enjoyed a period of robust financial health due to the availability of inexpensive fuels, improved efficiency of new power plants, and the economies of scale that flowed from affordable capital construction. As the decade of the 1970's unfolded, however, the utilities had to adjust to a dynamic and challenging social, political and financial environment. Public concerns about the environmental, public safety, and land use implications of various energy generating technologies became a significant factor in the government's response to utility resource planning. Simultaneously, the fuel costs for California's utilities -- which depend to a predominant degree on oil as a fuel -- increased dramatically as a result of the oil embargoes of 1973 and 1978. Inflation and increased interest rates led to higher costs for electricity from new or planned facilities than from facilities already on line, causing a projected trend of steadily increasing electricity prices.

The creation of the California Energy Commission assured the investor-owned utilities that a single agency would henceforth conduct an expedited siting process for proposed new facilities, thus avoiding the time consuming and arguably myopic approach of resolving land use and environmental issues, issue by issue, on the local level. The political bargain that was struck, however, also forced the utilities to acknowledge a State agency which would henceforth have the authority to identify and recommend

conservation and alternative energy initiatives, as well as to independently evaluate trends in energy demand and supply and make recommendations for their management.

HOW THE SYSTEM FOR STATE ELECTRIC ENERGY PLANNING AND UTILITY REGULATION WORKS

In the post-Warren-Alquist Act era, a clear delineation between the responsibilities of the Energy Commission and the PUC has not always been possible, in practical terms. This section will describe briefly the data collection, analyses, and planning activities of the Energy Commission, which generate a number of publications, and the financial and operational surveillance of investor-owned utilities conducted by the PUC, highlighted in the rate-making process.

California Energy Commission Planning and Policy Development

The Warren-Alquist Act established a biennial planning process to be conducted by the Energy Commission with the participation of all the State's electrical utilities, (including municipal utilities previously unregulated) and interested State and local agencies. This process, which culminates in a mandated report to the Governor and the Legislature, provides a public review and evaluation of the utilities long-range resource plans and forecasts of electricity demand. The Act directs the Commission to adopt an official energy needs "forecast or assessment" which "shall serve as the basis for planning and certification of facilities proposed by electric utilities". To certify a new electrical facility, the

Commission must find that the proposed facility conforms with the forecast or assessment of need contained in the most recent Biennial Report (BR).

The Act also directs the Commission to evaluate in each Biennial Report the potentially adverse social, economic, and environmental impacts which could result from continuing current trends of energy supply and consumption; alternative means for reducing growth in electrical demand; the extent to which demand can be reduced; and the effect such reductions could have on State resources and other State interests if such reductions are pursued in lieu of new power plant construction or other forms of energy supply. The Commission is required to use its 20-year forecast as the basis for long-term statewide conservation planning.

The second major planning document produced by the Energy Commission is the Electricity Report, a report of special significance to this study of the regulation of electric utilities. The detailed analyses of California's electricity supply system required by statute, and the analysis supporting the Commission's findings with regard to commercial availability of generation technologies also required under provisions of the Public Resources Code, are generally contained in the Electricity Report. This report is transmitted to the Governor and the Legislature along with the Biennial Report. The detailed analyses presented in the Electricity Report are intended by the Warren-Alquist Act to serve as the basis for recommendations by the Commission to the Governor, the Legislature, the PUC, and other appropriate public and private agencies concerning demand-reducing policies,

conservation of energy, development of potential new sources of energy, and other policies and actions designed to affect the rate of growth and demand for electrical energy.

The identification of major energy issues to be considered in the principal planning and policy documents of the Energy Commission is done by staff with the guidance of a committee composed of two commissioners. The issues selected respond both to the broad mandates of the Warren-Alquist Act and to specific legislation. Occasionally, legislative inquiry or direction, or specific requests from industry or the public, are the sources of issues for consideration in the documents.

To provide maximum input on issues and potential recommendations, the Energy Commission has made extensive use of advisory groups and committees. These committees are generally comprised of individuals from academia, private industry, and the public at large. For example, the 1983 Biennial Report Policy Advisory Counsel was comprised of representatives from the electric utilities, environmental groups, California builders and manufacturers, legislative committees' staff, the University of California, labor, the investment community, and the public at large. Additionally, this Advisory Counsel solicited participation from the Public Utilities Commission as well as other sister agencies including the Air Resources Board, the State Water Resources Control Board, the California Transportation Commission, Caltrans, the Department of Water Resources, the Waste Management Board, and the Coastal Commission.

Tentative recommendations in the Commission's major policy

documents are generally critiqued through a public hearing process. The analysis of both staff-generated and utility-generated electricity demand forecasts, for example, undergo an extensive technical and policy review by Commission staff and external examination by the utilities and other interested parties in public hearings before the Commission committees.

Benefit-cost analyses are an integral part of the Energy Commission's policy development activities. Based on results of preliminary analyses of conservation and alternative technologies, potential energy efficiency improvements (such as load management and RCS programs) are further screened, and those which appear attractive are publicly proposed, in the BR, for more detailed development. By statutory requirement, energy efficiency standards adopted by the Energy Commission must be cost effective; a major component of developing standards involves determining and documenting cost effectiveness. These benefit-cost analyses are subjected to rigorous examination by the Commission in public hearings before the standards or programs are adopted and implemented.

Based on the variety and quantity of work that the Energy Commission produces, one can conclude that there is an enormous capability for a range of analytical and theoretical activity bearing directly on the work of California's electric utilities. This analytical and theoretical activity culminates in recommendations presented in the Biennial Report in five categories: energy efficiency, energy alternatives, energy generation, transportation sector energy use, and oil and gas. Many of the recommendations

contained in the BR are self-directed, indicating areas where further activity by the Energy Commission will produce further energy benefits.

As provided by the Warren-Alquist Act, the Biennial Report also directs an extensive number of recommendations toward the Legislature, the PUC, the utilities, local governments, and other entities. In the 1983 Biennial Report, the Commission made most of its recommendations to itself; however, there were a large number made to the Public Utilities Commission as well. Specifically, the current Biennial Report presents some 36 recommendations made to the Energy Commission and 18 to the PUC.

Policy positions, expressed in terms of recommendations for action, must be well-defined before they can be adopted and effectively implemented. The Biennial Report does not satisfy this standard in all cases, as will be further discussed in Chapter III.

There are, however, a number of examples of recommendations which are specific and clear in their intent. Recommendations of this type give the BR credentials as an "action plan," comprehensive in scope, and useful strategically because it reevaluates statewide energy opportunities and reshuffles priorities on a workable, two-year cycle. Diverse examples of such recommendations are: (1) that the PUC authorize support for utility programs for direct weatherization for low-income residents housing; and (2) that the PUC adopt a statewide utility power-plant retirement policy, so that the least efficient power plants in California are the first to be retired.

Finally, the BR includes recommendations made jointly to the Energy Commission and the PUC, indicating a shared responsibility and willingness by the Energy Commission to undertake programs in a cooperative spirit. Examples include recommendations to (1) identify and quantify utility potential for cost-effective conservation in major service areas, (2) evaluate the implications of rate basing major conservation programs, and (3) continue to explore ways to better manage the electricity load, thus reducing the need for additional generating capacity.

Ratemaking and Other Electric Utility Regulatory Activities Conducted by the PUC

Article XII of the California Constitution creates the Public Utilities Commission, and establishes its authority to fix rates and establish rules for all "private corporations and persons" that provide utility services. That authority is amplified in the Public Utilities Code.

The historic function of the Public Utilities Commission has been economic regulation. The responsibility to set utility rates, on the basis of the cost to the utility of providing service in the public interest, is at the very center of the PUC's purpose. The general rate case is the method used to ensure that companies who have been granted a monopoly do not abuse their freedom from competition by charging unreasonable rates or providing poor service. In addition, the PUC must, by law, balance the interest of utility investors and utility customers. The PUC must ensure that utilities have sufficient financial health to be able to borrow, at reasonable interest rates, the large sums necessary to upgrade their systems and to provide energy for new customers.

Beyond charging the PUC with setting "just and reasonable" rates for a public utility's services, policy guidelines to be pursued by the PUC in the process of utility regulation are not readily apparent. There are no substantive standards or criteria, and few statements of legislative findings of contemporary public values to be protected or promoted by the PUC in its regulation of the State's franchised utilities. There are occassional specific mandates for extraordinary treatment -- such as the provision for lifeline rates, and the authorization to grant limited increases in a utility's rate of return on generating projects utilizing renewable resources in reducing pollution when such innovation reduces the marginal cost of energy (emphasis added) -- but the policy basis on which PUC decisions rest and the priorities which PUC decisions reflect to an energy-dependent society, are left to the Commission to formulate, case by case.

Section 11351 of the California Government Code expressly exempts the Commission from the requirement to submit substantive regulations of the kind which describe and objectify the decision-making process of other agencies in the Executive Branch of State government.

The Commission does adopt its own Rules of Practice and Procedure. These rules, found in Title 20, California Administrative Code, provide detailed guidance on the form and content of documents presented to the Commission, requirements for notice of proceedings, fees, and other matters of administrative detail. A description of the standards or guidelines used by the Commission in its review of the well-defined documents does not appear.

Further, standard rules of evidence covering such issues as burden of proof and sufficiency of evidence, which govern judicial hearings, are specifically waived with respect to the PUC by Section 1701 of the Public Utilities Code.

The rate-making process itself, among the most esoteric and complex in State government, has been summarized by the California Supreme Court as follows:

> "To determine with respect to a "test period" (1) the rate base of the utility, i.e., the value of the property devoted to public use, (2) gross operating revenues, and (3) costs and expenses allowed for rate-making purposes, resulting in (4) net revenues produced, sometimes termed "results of operations". Then, by determining the fair and reasonable rate of return to be fixed or allowed the utility upon its rate base, and comparing the net revenue which would be achieved at that rate with the net revenue of the test period, the Commission determines whether and how much the utilities rate and charges should be raised or lowered."

A utility initiates a rate case by filing an application with the PUC. This occurs every two years. A hearing is conducted by an Administrative Law Judge during which sworn testimony is presented and cross-examined. The decision, prepared by the Administrative Law Judge who has presided over the hearing, is then adopted or amended by a majority vote of the five commissioners. The PUC's decision is appealable only to the California Supreme Court.

The PUC has also developed special rate-making procedures which provide for rate adjustments outside of general rate proceedings. These procedures were initiated because rising fuel costs and inflation have complicated general rate proceedings to the point where utilities experienced what they felt to be an unacceptable lag time in PUC rate adjustments. (Fuel costs are responsible for two-thirds of the rate increases granted by the PUC since 1976).

These procedures, intended to ensure the stability of utility earnings as fuel costs rise, permit utilities to change rates in response to cost changes.

The Role of Administrative Law Judges

The Division of Administrative Law assists the five commissioners in discharging the quasi-judicial functions of the Commission. They perform a similar role in the quasi-legislative hearing process.

Each formal filing presented to the Commission is assigned to a lead commissioner and referred to an Administrative Law Judge (ALJ) who assists the assigned commissioner with processing the matter through the hearing process until a determinative opinion and order is signed by the Commission. Although filings may be heard by an ALJ and a commissioner, they are most often, indeed almost exclusively, heard by the presiding ALJ.

In the conduct of public hearings, ALJ's are required to advise parties of their rights, swear in and examine witnesses, issue subpeonas, receive testimony and other evidence, rule on various procedural matters, hear oral arguments, analyze pleadings, and finally, evaluate evidence and law.

At the conclusion of the hearing, the Administrative Law Judge presents a proposed decision to the Commission which purports to "resolve(s) all the contested material issues with a cogent discussion on the merits: apprising parties why they won or lost on litigated issues; explains Commission policy so that a non-utility-expert can understand the basis of the policy; explains

any departure from established Commission policy; and contains legally adequate findings of fact and conclusions of law."[1/] There is considerable disagreement as to whether some of the most controversial PUC decisions satisfy these self-imposed criteria.

The ALJ's are delegated great responsibility and given considerable autonomy by the commissioners. Their function is to perform as surrogate for the assigned commissioner in adjudicating the matter under consideration. Additionally, the ALJ prepares a proposed opinion which the assigned commissioner sponsors for consideration by all commissioners at its public decision-making conference. Further, the ALJ is expected to present the full Commission with his or her recommendations or proposed order in the event his conclusions differ from those of the assigned commissioner. In the vast majority of cases, the assigned commissioner does not contradict the ALJ's opinion.

1/ 1989 Public Utilities Commission Annual Report. P.23

CHAPTER III

DEFICIENCIES IN CALIFORNIA'S ELECTRIC ENERGY POLICY DEVELOPMENT AND IMPLEMENTATION SYSTEM

FINDINGS:

The PUC's Administrative Procedures are Not Designed for Effective Energy Policy Formulation

The central feature of the Public Utilities Commission's organization and regulatory activities is its rate and service review procedure. Essentially, this process involves collecting data from the applicant utility and evaluating that data against certain evolving criteria. Although this procedure provides the PUC with the capability of reviewing and processing rate applications and determining whether rates are fair and service is adequate, the resources, procedures and analytical approach the PUC uses in this effort are not designed for determining the direction that utility regulatory policy should take, or the objectives which that policy should pursue.

In the previously discussed 1976 study conducted for the Senate Committee on Public Utilities Transit and Energy, the highly regarded consulting firm Cresap, McCormick and Paget concluded that "there is little provision (at the PUC) for a thorough examination of the underlying regulatory policy issues as the basis for generic rather than incremental decisions." Elsewhere their report states, "The PUC must find more effective ways to arrive at broad regulatory policy than through case decision-making and the adversary procedure... An overriding need is for research, planning and analysis capability that can take the lead in identifying policy gaps... and in developing ways to correct them. So that the PUC may respond to public and company needs for greater predictability

and speedier action, there is need for consideration and adoption of fundamental regulatory policies that can be applied more flexibly as circumstances warrant."

The consultant's report continues, stating that the numerous filings by utility companies appear to have overburdened the PUC and limited its flexibility to investigate broader issues of regulatory policy. The unfortunate conclusion is that the PUC's organizational structure and its procedures place limits on the results it can achieve.

We must agree with Cresap, McCormick and Paget that the Commission's adversary process severely constrains its ability to bring leadership, innovation, or even consistency to the issues of utility management. In its quasi-judicial mode, the PUC is a fact-finder and arbiter. As characterized by President Grimes in his testimony before the Little Hoover Commission, the PUC plays the role of "surrogate marketplace", attempting to strike a balance between the needs of energy providers and the expectations of energy consumers. It is not a passive role, but it is a reactive role. Unfortunately, such an approach frustrates the public desire to understand the particular directions in which utility regulatory policy is moving. Each successive PUC decision reflects only the current determination of balance. Thus, a sampling of PUC decisions may reveal this year's expression of utility regulatory policy, and what it has been in the past, but not necessarily what it will be in the future.

In fact, although the PUC claims to set utility regulatory policy through its decisions, it concurrently declines to establish standards for utility performance in critical areas, avoiding what might be perceived as a usurpation of the discretion of the investor-owned utilities' management.

This scrupulous aversion to imposing the public will on a regulated utility is illogical in a number of respects. First, it appears that, in some areas at least, the major California energy utilities would welcome guidelines and standards of the kind which the commission has been reluctant to provide. In testimony before this Commission on May 6, utility witnesses recommended "providing direction as to the types of resources that will be used" to provide reliable service. In another cited example, PG&E suffered a "rather significant disallowance on fuel costs" because they "misread or misinterpreted, or at least didn't understand the guideline that the PUC felt it had spelled out". Throughout the testimony, there are requests for "clarity", adoption of data generated by the Common Forecasting Methodology, and other objective "definables", such as guidelines for a least-cost fuel purchasing sequence.

Second, the Commission seeks to protect the public interest by evaluating the management of utilities after the fact, but will not prescribe the standards for evaluation beforehand. That is, although they will not set standards for utility performance, there are provisions for penalizing the utilities for poor performance in conservation, and other areas, in subsequent rate cases. Unfortunately, this reactive approach to exercising regulatory jurisdiction can result in an uncertain environment for the utilities, and deferred benefits to the public.

PUC Commissioners Have Insufficient Influence and Involvement in Policy Development

Management theory states that organizations generally operate through a "top-down, bottom-up" process: That is, organizational policy and direction is set at the top and flows down. Staff with-

in the organization conduct the work which flows back up the organization to management for approval.

On the basis of this classical model, one would presume that the guiding philosophy, the allocation of resources and the determination of the pace and texture of Public Utilities Commission activities would be made by the five commissioners who sit atop the organizational structure. This is not the case. The PUC commissioners are, in many ways, captives of the organization which they ought to control.

PUC commissioners were appointed to develop and implement Public Utility Commission policy by shaping and guiding the work of the commission's support staff. In practice, however, the commissioners react -- often quite late in the process and even then, selectively -- to the policy determinations made by the commission's staff.

Much of the managerial strategy which the Commission applies to its energy responsibilities has been delegated to, or has been assumed by, the Energy Management Committee composed of the Commission's division chiefs and General Counsel. This committee meets weekly to review pending cases and issues, determine what information the commissioners need to properly resolve questions before them, and make staff assignments. This function of general management on energy matters ranges from broad strategy to specific cases before the Commission. Minutes of the meetings are circulated to Commissioners and their advisors so that, time permitting, commissioners might stay abreast of the priorities and staff allocations that the Energy Management Committee has agreed upon.

Once a year, the committee brings before the Commission a list of energy issues that are emerging and will likely appear on their agendas during the succeeding months. The ensuing discussion forms the basis for guiding the many interim decisions the committee makes. Even this guidance permits an unusual degree of latitude to staff. "That's where policy is formed, without constraints," said a current commissioner. "Sometimes I feel that the committee is the real Commission."

To a large extent, the sheer volume of the workload at the Public Utilities Commission forces the kind of delegation that the PUC commissioners have made to senior staff people. In some instances, the assigned commissioner turns a pending matter over to his advisory staff and lets them process the case. Advisors have the time to filter the various information, and act as liaison with the technical staff. In the vast majority of cases, the commissioners don't see the matter under consideration until all the evidence is submitted, the ALJ has done the analysis, and the evidentiary hearing is closed.

As discussed in the previous chapter, the Administrative Law Judges find fact, compile and evaluate testimony, and determine "just and reasonable" conclusions affecting literally billions of dollars of investment.

The people who make these decisions are adjudicators by function, but not necessarily by training. They are customarily not policy specialists; moreover, because of the mutiple regulatory responsibilities of the Public Utilities Commission and its Administrative Law Division, ALJ's presiding over energy cases are often not energy specialists. Because of the Commission's reliance on an

adversarial process, ALJ's must rely on the PUC staff and other participants to present the information which becomes the substantive basis for each ALJ decision.

In many ways the commissioners act as an appellate court; they do not see much of the evidence presented in the hearing. Beyond the occassional and informal contact with the lead commissioner on a particular case, the ALJ can only infer where the Commission as a body would like to go with a particular decision, or the changes in utility operations which the Commission would like to encourage. Because their collective judgment is only applied after a decision has been constructed by the Administrative Law Judge, the commissioners cannot give direction to an inquiry, nor identify the policy issues which they feel are key, nor shape the decisions. Additionally, because they do not participate in the taking of testimony, and the discussion of issues as they develop, the commissioners cannot influence the hearing in ways that that would be informative and revealing of thinking at the very top of the PUC. Past commissioners expressed the opinion that their policy input was "largely post hoc." Indeed, most policy determinations are made by the ALJ's with substantial input from senior staff.

Given the Administrative Law Judges' case-by-case view of the world and the constraints which the Commission feels prevent prior policy guidance, the ALJ's have little policy basis for their decisions (and the numerous judgments, small and large which lead to decisions) other than that established by Public Utility Commission decisions of the past. As a result, policy is established by looking backward rather than forward.

Thus, the absence of stated policy goals by the Commission not only creates something of a dilemna of uncertainty for the utilities, in terms of their proposed expenditures, but also makes each successive decision at the PUC part of the past rather than part of the future.

The strangulating effect of PUC procedures is an important issue to the commissioners. Current PUC commissioners told us that the central issues, in terms of PUC's effectiveness, were the the procedures, the process, and the way the PUC goes about making decisions. These issues, and the relationship between commissioners and staff, are high on their list of priorities for systems improvement. These improvements, however, will take time. A commissioner said that, "the PUC has so many pressing short-term responsibilities that we never have the time to step back and see what we're doing, and <u>how</u> we're doing."

Obviously, one of the reasons that the commissioners feel that they don't get a look at the whole energy "forest" is because there are so many large "forests" to keep in view. Electric energy is, after all, just one of the regulated areas over which the PUC has jurisdiction.

Limitations and Deficiencies in Relying Upon the Existing System for Considering Policy for Implementation

The current system for analyzing, considering, and implementing State electric energy policy is inadequate because (1) there is no analytical process at the PUC for considering energy policy developed by the Energy Commission or generated internally, and (2) there are deficiencies in the "intervention" process as a means of presenting Energy Commission policy to the PUC.

The PUC Does Not Use an Analytical Process for Reviewing Policy

President Grimes, in his written testimony presented to the Little Hoover Commission's May 6 hearing, asserts that "PUC's staff members, in making their recommendations in formal (PUC) proceedings, often make substantial use of CEC work such as the Biennial Report." However, there is no evidence that a formal process or structure exists at the PUC for reviewing the Biennial Report, the Electricity Report, and other critical policy documents. Neither is there a formal review by the PUC of the specific recommendations made in the documents, nor are they acknowledged as foundations for PUC decisions. As one past PUC commissioner told us, "On occasion, the PUC considers the CEC position on energy matters, but, for the most part, establishes its own priorities and emphases."

Our findings indicate that, while some of the data in the Biennial Report may indeed be useful to PUC staff, any concurrence between the recommendations made to the PUC by its staff and the policy positions of the Biennial Report are incidental rather than causal. Interviews with top staff at the PUC indicate that the Biennial Report is reviewed on an informal basis and "where it has good ideas, our people are stimulated to do that kind of thinking." Other staff persons have indicated that the Energy Commission documents are "widely disseminated here" but there is no indication that the specific recommendations made to the PUC in the Biennial Report, accompanied by their significant body of supportive data, analysis, and rationale, are ever formally presented to, and considered directly by, the Public Utilities Commissioners except through interventions by the Energy Commission in pending cases. Participation by the Energy Commission in PUC cases is useful, but

both the mechanics of intervention and the adversary nature of the PUC's hearings create impediments to effective policy making (see below).

In its first report to the Senate Committee, Cresap, McCormick and Paget asserted that new methods for arriving at policy would be needed in order to alleviate some of the costs inherent in using the PUC's adversary process for nearly every assessment of policy. Such new methods, the report concluded, should also draw the commissioners' attention more sharply to their policy-making responsibilities.

Currently, the primary attempt to analyze internally or externally generated policy at the PUC occurs in the Policy and Program Development Division. This division consists of seven professional staff and clerical support. The Division is being revitalized and encouraged to address key issues in the development of PUC policy. Under capable new leadership, the Division may soon organize itself better to "get ahead of the issues", help the Commission coordinate its policy research and analysis, and identify the ramifications of its policy options. As yet, there is no such strategy or program.

This is not to say that research and analysis activities are not performed or that select policy issues are not reviewed, and analyzed by the staff; such work is being conducted. However, the Commission's research and analysis of the effect of regulatory policies on the public and on the economy of the State are still limited and fragmented. Further, they tend to arise out of the cases rather than to provide a context for them.

Deficiencies in the PUC Intervention Process

Although there is no system or process in place to provide a direct route to the Public Utilities commissioners for the Energy Commission's recommendations and policy rationale, an indirect route does exist: participation as interveners in the Public Utilities Commission's quasi-judicial and quasi-legislative processes. The earlier referenced Cresap, McCormick & Paget report states that this alternative is an unsatisfactory, inefficient and piecemeal alternative, lacking the ability to inform Public Utilities Commissioners' thinking on the broader conceptual approaches to energy utility regulation.

We do not believe the "intervention process" provides adequate consideration of State energy policy, because it limits the scope of testimony, fails to accord any special consideration to laboriously developed state policy recommendations by the statutorily authorized planning agency, and places the logistical and budgetary burden of participating in the PUC's adversary process squarely on the intervening agency.

The nature of the adversary process limits the scope of the interveners testimony to the issues presented in the case and to the individual applicant whose petition is being evaluated. The adversary process permits key policy issues presented by the intervener to be procedurally sidetracked, or deferred for later consideration, without evaluating the intervener's position on the merits.*

* A prime example is the controversial Energy Commission intervention in the PG&E 1981 rate case. In that intervention, the key component of the Energy Commission testimony was a proposed system of utility management incentives for developing "preferred resources." The PUC response, in its decision on that rate case, was succinct. "Finding 19. A system of management incentives to encourage investments into preferred alternative resources and cost-effective conservation programs requires further study."

A reasonable question exists regarding whether their finding satisfies the criteria established in Public Utilities Code Section 1705, requiring PUC decisions to contain separately stated, findings of fact and conclusions of law by the Commission on all issues material to the order or decision.", and in Supreme Court dicta, as below:

"Findings (in PUC decisions) are essential to 'afford a rational basis for judicial review and assist the reviewing court to ascertain the principles relied upon by the commission and to determine whether it acted arbitrarily, as well as assist parties to know why the case was lost and to prepare for rehearing or review, assist others planning activities involving similiar questions, and, serve to help the commission avoid careless or arbitrary action.' (cites omitted)." Calif. Manufacturers Ass'n v. Pub. Util. Comm'n, 24 Cal. 3d 251, 258-9, 155 Cal. Rptr. 664 (1979).

Further, the adversary process does not adapt well to the Energy Commission's responsibilities to make recommendations to the Public Utilities Commission for improving the very process by which rates are determined.

It may be persuasively argued that there are types of testimony presented by the Energy Commission to the PUC in the hearing process which should be treated identically with the testimony of any other intervener; that is, subject to the same burden of proof and the same rules of evidence. For example, judgments or interpretations by Energy Commission staff on issues that have not been squarely addressed and adopted by the Energy Commission in the BR, and endorsed by the Governor, carry no special weight and deserve no special treatment. However, to subject oral or documentary testimony expressing policy positions and findings of a fundamental nature -- such as those which the Energy Commission is statutorily mandated to produce -- to the same degree of challenge, is to disregard the collective judgment of the many established professionals in both the public and private sector who participate in the lengthy, complex and extensive BR process. Further, it disavows the clear intent and mandate of many sections of the Public Resources Code.

We received considerable testimony from the Public Utilities Commission affirming and reaffirming the PUC's interest in receiving Energy Commission testimony, as an intervener, in any matter before the PUC. It is very clear, however, from the testimony and from information collected in our interviews that no special weight or value is given to this testimony, regardless of the means by which the position expressed was determined. As described by

President Grimes in his May 6 testimony before the Commission, "they (Energy Commission) come in like any other intervener... they do not come in with an extraordinary position, they come in on the same level that the other interveners come into the case. So their burden of proof, if you will, is on them."

Unfortunately, the frequency of Energy Commission intervention in PUC proceedings -- acknowledged by both President Grimes and Chairman Imbrecht to be the predominant means of introducing Energy Commission recommendations into PUC deliberations -- has declined dramatically. In fiscal year 1982-83, the Energy Commission committed a total of 2.9 person years, (.18 percent of their total authorized budget) to efforts directed at implementing CEC recommendations at the PUC, down from 6.3 person years (.4 percent of the total authorized budget) in 1980-81. Energy Commission officials say the number of interventions has fallen due to both budgetary constraints and a conclusion that their efforts were ineffective.

Although both President Grimes and Chairman Imbrecht expressed hopes for increased communication in the future, the status quo results in a very constricted flow of input on fundamental energy policy to the PUC from the agency whose responsibility it is to recommend such policy. This, combined with the absence of a coherent, politically endorsed strategy for energy development and regulation generated from within the PUC leaves that organization -- with tools and resources suited to financial analysis, audits, and performance evaluations -- in the position of defining an energy strategy on a case-by-case basis.

California State Energy Policy, as Outlined in the Biennial Report and Other Documents Developed by the Energy Commission Lacks Potency

Policy making at the Energy Commission is, in effect, more advisory than conclusive. That Energy Commission policy recommendations lack authority and potency is illustrated by the following testimony presented during our Commission's first hearing:

Commissioner Bouskos:	I'm curious, is there an official State energy plan that you look to to make your decisions? If so, where is it?
President Grimes:	Well, the nearest thing to it would be the Biennial Report...
Commissioner Bouskos:	Do you use that as your guideline for energy planning in your decision making?
President Grimes:	It enters into our deliberations in the work that we do now. I think it would be a mischaracterization to say that it is "the" guideline.

Despite what may have been the intention of many who supported the creation of a central state agency to comprehensively plan for California's energy future, the Energy Commission's Biennial Report is not a compelling document. The Energy Commission has attempted to develop "a comprehensive report designed to identify emerging trends related to energy supply, demand, and conservation... and to specify the level of Statewide and service area electrical energy demand for each year in the coming 5, 12, and 20-year periods, and to provide the basis for State policy and actions in relation thereto, including, but not limited to approval of new sites for additional facilities..." Nevertheless, absence of procedural linkages in the Warren-Alquist Act, the respective Commissions' lack of will to find a "common ground", and institu-

tional pride and prejudice on the part of both staffs, have impeded implementation.

Among the reasons why the Biennial Report has not functioned as the basis for a systematic approach to electric utility regulation are some factors intrinsic to the Report itself. First, it suffers technically, and politically, from a lack of active participation by the PUC in its preparation and in its recommendations. Although the PUC does participate to some extent, their participation is limited by budgetary and personnel constraints. The PUC's enthusiasm for participation is further dampened by a presumption that the Energy Commissioners and Energy Commission staff are not particularly concerned, nor particularly knowledgeable, in the area of rate-making. As one former Public Utilities' commissioner told our consultant, "no one at the Energy Commission understands the utility business."

Additionally, there is a sort of obverse concern for efficiency. As one top staff person at the PUC pointed out, there is little justification for the PUC to expend its staff resources on improving Energy Commission planning and analysis, "when we know we're going to do the analysis again, ourselves, in the rate-making process anyway."

Yet another rationale for infrequent adoption of Energy Commission recommendations is that the recommendations themselves are occasionally obscure. As former Energy Commissioner Gene Varanini told us in his May 6 testimony, the Energy Commission tends to be scrupulously specific when making recommendations to themselves in areas where they have clear regulatory authority. On the other hand, recommendations made to others -- specifically to the PUC,

because of the nature of the relationship between those two commissions -- tend to be "softer", so as not to irritate tender institutional sensitivities. Quoting Varanini, "if you can literally figure out what each one of those recommendations (to the PUC) means, more power to you, because they've been massaged to a point that they, ...hopefully, offend no one."

Indeed some of the recommendations made to the PUC in recent Biennial Reports are so pedestrian that they would almost certainly have been undertaken by the PUC in the ordinary course of its work, and hardly rise to the level of a recommendation that requires close evaluation and analysis. Among this type are the following: (1) a recommendation to implement the provisions of the Public Utilities Regulatory Policy Act (federal legislation stimulating small power producers and requiring utilities to purchase electricity from private developers) to encourage development of alternative resources; and (2) a recommendation to continue to implement policies that facilitate electricity generation by small power producers. Not only are those recommendations so similar as to be reiterations of the same idea, but they are hardly on the cutting edge of policy development. The lack of specificity in the drafting of such recommendations does not facilitate the development of programs at the PUC to achieve them. Additionally, if the recommendations are vague, it is difficult, if not impossible to measure the progress toward their accomplishment.

Another rationale for the lack of weight which the Biennial Report is given is its lack of political potency and inherent authority. As an independent Commission composed of individuals who represent the public at large, the Energy Commission often

suffers the fate of a political orphan outside the hierarchy of government and therefore outside the circle of those who share the authority of the Governor. It appears that even the Governor's approval, conveyed in his endorsement of the Biennial Report, as required by the Nestande amendment, has not effectively earned the Biennial Report and Electricity Report the imprimatur of "State policy."

The "Nestande Amendment" to the Warren-Alquist Act (Public Resources Code Sec. 25309.2) requires the Governor to "report... to the legislature his agreement or disagreement with the policy recommendations contained therein... In the event the Governor disagrees with... the Biennial Report, he shall indicate the reasons... and specify the alternate policy he deemed to be his official statement of energy policy." This amendment was an attempt to make plain the Governor's adoption or rejection of the Energy Commission's Biennial Report, in whole or in part, with whatever conditions or comments he might choose to make.

By refusing to sign the report, the Governor presumably would deny the recommendations of the Biennial Report the executive endorsement necessary for its adoption as "administration policy." Unfortunately, it appears that the converse is not necessarily true. That is, despite the wording of the amendment, the Governor's endorsement has not earned for the Biennial Report the status of official "state policy". The amendment has not forged the link between the Energy Commission and the Chief Executive that would give the Biennial Report the added leverage, weight, and implicit political support that policy statements of executive branch depart-

ments have. Rather, it may in fact have produced a double negative for the Energy Commission.

First, to the extent that the Governor now has a kind of veto authority over Energy Commission analyses, conclusions, and recommendations, the credibility the Energy Commission can claim as an independent policy body is diminished. Secondly, the perfunctory attention which the Report receives in the Governor's office (indeed, the Governor's staff have no independent energy expertise with which to give it more than perfunctory review), and the lack of political advantage which the Governor's signature seems to give the Energy Commission's crown jewel, underscores the uncertain political status of both the Report and the Commission.

The Energy Commission Lacks Sufficient Mechanisms to Implement State Electrical Energy Policy; The PUC Lacks Sufficient Compulsion to Adopt and Set Timetables for Implementation of State Energy Policy

As discussed above, State energy policy as outlined in the Biennial Report and Electricity Report lacks a statutory mandate for implementation at the PUC. Beyond this, the Energy Commission is unable to effectively implement its policies through its own regulatory mechanisms. (Except for citing utility-proposed power plants, an increasingly infrequent event, the Energy Commission has few opportunities for implementation of its energy plan and policy vis-a-vis the utilities). Consequently, there is no effective means of implementing a comprehensive electrical energy strategy through the regulatory process.

This circumstance of having highly regarded analytical work performed, and recommendations prepared, with no statutory or administrative structure in place for implementation, is one of the central issues of this study.

Producing a product for which there is no market, either natural or artifically created, is bad business whether you're in the profit sector or the public sector. Clearly, there is a market for many of the work-products the Energy Commission produces. For example, private industry makes extensive use of the Energy Commission's projections of fuel prices and assessments of electricity demand and supply. Utilities in the Northwest and Southwest have used the Electricity Report and key supporting documents to help them understand the California energy market. Developers of alternative technologies use the ER to assess the market potential of their products. But the assertion that the BR and ER are used by utilities and government agencies as an overview of State electricity policy is questionable, considering the testimony of the utilities before our Commission. That testimony, in brief, indicated that the State energy policy as outlined in the BR has relatively little impact on them. The only exceptions are those policy statements which are reflected in PUC rate decisions. However, it was the intent of the Warren-Alquist Act to promote the development of a State energy policy, not simply a series of useful data analyses, for which an independent Commission would not be necessary. If the policy positions taken by the Commission are to be adopted and implemented, they must be given greater weight.

Because the Warren-Alquist Act did not include integral provisions for implementing the recommendations of the Energy Commission, the Act created a political and logistical quandry for the Legislature and the Governor. Although there are provisions in the Act that mandate some of the Energy Commission's recommendations on the PUC (load management and energy conservation, for example), the preponderance of the recommendations called for in the Warren-Alquist Act are to be made to the Governor and the Legislature.

Presumably, it was believed that the executive and the legislative branches would take up the voluminous and manifest analyses and recommendations taht the Commission produces, and on a regular basis and in a systematic way continually prescribe appropriate governmental activities in response. This has not occurred. However, in addition to the Energy Commission's "recommendations to the Governor and the Legislature for administrative and legislative actions based on results of commission's studies and evaluations...", the Warren-Alquist Act refers to the Biennial Report as "a comprehensive report designed to identify... energy supply, demand, and conservation and public health and safety factors, to specify the level of Statewide and service area electrical energy demand... <u>and to provide the basis for State policy and actions in relations thereto</u>..." Further, the Act provides that the Report "shall serve as the basis for recommendations by the (Energy) Commission to the Governor, the Legislature, and <u>the other appropriate public and private agencies...</u>" (Emphasis added).

Therefore, although the Legislature did not give away any of its appropriate responsibilities for considering various means of adopting and implementing Energy Commission policy recommendations, it fully acknowledged a direct recommendatory role for the Energy Commission in terms of the actions of other State agencies with energy regulatory responsibilities -- most notably the Public Utilities Commission. The legislative intent with respect to the findings and recommendations of the Energy Commission must be made explicit.

Deficiencies in Electrical Energy Planning and Implementation May Have Resulted in Uncertain and Inconsistent Regulatory Decisions, Higher Long-Term Electricity Costs, and Operating Inefficiencies

Existing deficiencies in the electrical energy planning and regulatory system have resulted in inconsistent and uncertain near-term energy planning objectives for utilities which rely upon these objectives as cornerstones of their resource planning activities. Regulatory decisions (as an expression of policy) are unnecessarily unpredictable; many issues are debated and finally decided in the adversarial process that might be resolved more efficiently and more objectively by reference to adaptable standards contained in State policy. Moreover, consumer costs for electricty over the long term may be higher than necessary because the lack of commitment to a long-term strategy encourages "penny wise and pound foolish" decisions. Finally, misallocation of PUC personnel resources and confusion of operational priorities increase the overall cost of electricity. Given that the PUC has finite resources to apply to each issue brought before it, the absence of cogent, flexible standards requires time and effort to be spent in each

successive case, assessing the policy ramifications of each material issue; time and effort which could otherwise be re-directed to the auditing and accountancy components of rate-application review. Such reassignment of personnel could substantially mitigate the circumstances leading to approval by the PUC of unsupportable additions to a utility's rate base, as cited by the Auditor General in his June 1983 report entitled "The California Public Utilities Commission Needs to Improve Its Rate Review Systems".

CHAPTER IV

OPPORTUNITIES FOR IMPROVING EFFICIENCIES

FINDINGS:

Overlap and Duplication Between Energy Commission and PUC Activities

Despite the stated intent of the Warren-Alquist Act to Consolidate the state's authority over energy policy in general and electricity policy in particular, important pieces of the state's policy making for electricity were left fragmented between the two commissions.

The utility participants in our study have indicated that there are areas of program duplication between the Energy Commission and the PUC which require redundant and costly responses to data requests, and create the potentiality (indeed likelihood) of conflicting findings and requirements. These program overlaps have been the subject of proposed remedial legislation. The most notable bill was SB 1380 (Montoya), which failed passage in the closing hours of the 1982 legislative session.

Load management and research and development are program areas "shared" by the two commissions which have been mutually recognized as problem areas. Progress toward an agreement on approaches to research and development priorities has begun. A joint research and development committee has been convened. Although the committee is lacking official sanction, a dialogue has been established to build upon recent PUC decisions which acknowledge the importance of utility resource plans in the development of research and development priorities. Efforts to develop a more efficient approach to utility load management programs dis cussed below, have been initiated in recent months.

Although the San Diego Gas and Electric Company was unable to quantify the exact cost to them resulting from dual jurisdiction, Pacific Gas and Electric was helpful in that area. PG&E estimates total staff hours expended for required participation in Energy Commission planning and policy-making activities to be about 16,550, at a total cost of about $897,000 for staff, computer time, and consultant expenses. With respect to the PUC's policy-making activities (specifically excluding the general rate cases), PG&E officials testified that 15,000 staff hours are expended annually, at an additional cost of $216,000.

San Diego Gas and Electric discussed the nature of duplication. "It is SDG&E's experience that the CPUC energy planning and policy direction is performed independently of the (Energy Commission's) energy planning and policy set forth in the Biennial Report. The CPUC reviews utility plans and sets policy primarily in accordance with determinations from the General Order 131B filings, ratemaking proceedings and certificate proceedings. On occasion, the CPUC considers the (Energy Commission's) position on energy matters, but, for the most part, establishes its own priorities and emphasis."

"In addition, the CPUC staff prepares its own energy forecast for consideration, despite the availability of the CEC's Biennial Report containing the common forecasting methodology demand forecast which contains a very detailed short and long-term end-use forecast. In other words, despite the fact that the utities and CEC staff have collaborated and expended significant effort in the preparation of a demand forecast, the CPUC prepares its own energy forecast for consideration in ratemaking proceedings."

Ideally, the information contained in the Biennial Report should yield conclusions regarding utility resource plans and electricity demand. Clearly, the Warren-Alquist Act delegates to the Energy Commission the responsibility for preparing the State's demand forecast. Nonetheless, the CPUC does not appear to rely upon the forecast developed by the Energy Commission.

Forecasting

As has been mentioned above, the Energy Commission's 5, 12 and 20 year forecasts are central not only to the Biennial Report and its component analyses of what California's energy future looks like, but also for the Energy Commission's power plant siting responsibilities, its responsibility to develop and promote alternative energy resources, and its responsibility to establish conservation standards for buildings and efficiency standards for appliances. Indeed, the entire process of forecasting, nominally the responsibility of the Assessments Division of the Energy Commission, is so fundamental to the function and purpose of the Energy Commission that it calls upon each of the Energy Commission's divisions for input and, conversely, should be considered critical to the direction, pace, and priority of the work of each of the Energy Commission's divisions.

The Public Utilities Commission also maintains an energy forecast function although it is much more limited in its scope and application. As part of every general rate case, the PUC conducts a short-term forecast of sales for the period of the pending rate application. This forecast takes a near-term look at the effects of inflation and weather on sales during the

period under consideration to help ensure that the rate of return granted the applicant utility is equitable. If the forecast of sales by the applicant utility is too high, the rate of return established will, when applied to the actual sales, produce insufficient revenues for the utility during the period for which rates are being established. This will require a subsequent off-set proceeding. If the forecast of sales for the period are too low, the rate of return determined to provide equitable return on an investment will generate windfall profits to the utility.

This issue of apparent duplication has been considered by both commissions. Careful comparisons of each commission's respective processes indicate that the Energy Commission's common forecasting methodology, the scope and time horizons employed by the Energy Commission in their "umbrella" forecast, are not well suited to the purpose served by the PUC's narrow and discrete one-year sales forecasts. This however does not exhaust the issues of integration, cost savings, and consistency which relate to the forecasting activities conducted by the two commissions.

For example, the PUC has recently completed an extended settlement conference process intended to produce standard offers for long-term contracts for the sale of energy by independent energy producers to California utilities. Government analysts, utility managers and energy economists all agree that independently produced energy will largely supplant new utility-built generating capacity for the foreseeable future. The PUC must ensure California ratepayers that the contracts between independent energy producers and the utilities make electricity available at rates that will

be "just and reasonable." The price of energy provided for by these contracts depends in large measure upon forecasted fuel prices, forecasted load growth, forecasted availability of energy purchased by the utilities from sources, and other factors. These issues have been an integral part of the CFM process conducted by the Energy Commission, in which process the viewpoints of most of the parties to the PUC settlement conference were represented. Yet, the production-cost values which were finally adopted for inclusion in the standard offers were not those generated by the Energy Commission's process, but were taken, in some cases, directly from the utilities. Therefore, in a circumstance which seems tailor-made to utilize the comprehensive and analytically based projections of the Energy Commission, the Public Utilities Commission has chosen to adopt energy-rate values submitted by the utilities. There can be scant public policy rationale for such action.

To reject, or fail to consider, the Energy Commission's forecasts is demeaning to the process conducted by the Energy Commission (contributed to by the utilities), wasteful of public funds spent in both the Energy Commission and the Public Utilities Commission process, and directly counter-productive to the effort to develop a consistent approach to the evaluation and comparison of various resource mixes in the rate-making process, in the facility siting process, in forecasting energy requirements, and in establishing conservation goals.

Load Management

Another area of overlap between the two commissions' activities is load management, a term used to describe various means of reducing peak demand for electricity. Because the energy demanded by consumers during this "peaking period" far exceeds the average maximum demand during the rest of the day, expensive generating facilities must be built to satisfy this limited demand, unless the various activities are undertaken to lower the demand by reducing the total demand throughout the day or by spreading the consumer's use of energy more evenly through the day.

There are various incentives and mechanical devices that are used to reduce consumer demand during peak periods and shift that demand for service to off-peak hours. Among these methods are time-of-use rates, which provide incentives to customers to shift their usage patterns by charging lower rates for off-peak use and higher rates for on-peak use, and mechanical devices such as air conditioning cyclers and electric water heater cyclers. Other quasi-contractual approaches are also in place, in which the energy customer agrees to accept curtailment during periods of peak demand in exchange for a reduced energy rate.

The Energy Commission is responsible for the development of load management (and other conservation) programs. The general authority to establish cost-effective load management standard is provided in Public Resources Code, Section 25403.5, which states that, "The commission shall... adopt standards by regulation for a program of electrical load management for each utility service area..."

Under this broad mandate, the Energy Commission could adopt standards requiring and defining a wide range of demand reduction programs to be carried out by electric utilities. However, a number of such utility programs already existed, and the Energy Commission chose to adopt standards only for cycling of residential air conditioners and water heaters, swimming pool pumps, and commercial building audits.

Each investor-owned utility may thus have a large number of load management programs, some of which are required and regulated according to standards adopted by the Energy Commission, and others which were undertaken by the utility with the initial approval of the Public Utilities Commission. This difference in the origin and source of regulatory approval for various programs has led to conflicting methods and criteria by the two commissions in their reviews of utility load management programs under their respective authorities. Such conflicts have occurred in rate cases where utilities sought PUC approval of funding for load management programs required by the CEC.

Section 25403.5 of the Public Resources Code further requires that "...the standards shall be cost-effective when compared with the costs for new electrical capacity, and that the Energy Commission shall find them to be technologically feasible. Any expense or any capital investment required of a utility by the standards shall be an allowable expense or an allowable item in the utility rate base and shall be treated by the Public Utilities Commission as such in a rate proceeding". The PUC's role, then, is to approve in its general rate cases those investments by the utilities required to conform to the standards established by the Energy Commission.

The statutory requirement cited above is customarily ignored. Citing from Gary Cotton's testimony on behalf of SDG&E at our May 6 hearing, "In compliance with California Energy Commission mandated load management standards, SDG&E has expended $4.86 million over the past three years. Expending this money found the development of specific plans to meet the standards and approval of the California Energy Commission. In order to recover through rates the expense of the load management program, SDG&E sought rate relief from the PUC. Despite the fact that the resulting load management programs require CPUC funding approval, the CPUC and the California Energy Commission used different criteria to evaluate the program's effect. As a result, SDG&E encountered resistance and difficulty in receiving adequate and timely rate relief to cover the load management expenditures."

Similar testimony was provided by PG&E. "In their response to the California Energy Commission's load management program, the company requested $5 million in 1980 for implementation of the California Energy Commission load management standards. Because of differences of opinion regarding which program should be included within the company's conservation expenditures, the PUC granted only about $4 million. Again in our 1982 general rate case a similar conflict occurred. Under Public Resources Code, Section 25403.5, the company is subject to the CEC load management standards and can receive an exemption from them only on very narrow grounds. However, the company was faced with a situation in which the PUC's staff recommended disallowing the needed funds to carryout the Energy Commission's approved plan."

Information taken from consultant's interviews with the Public Utilities Commission's top staff persons indicates that the rationale for the PUC's subsequent independent review of load management programs is their interpretation of the requirement to adopt and approve only those expenditures which are least cost options for the ratepayer. In the view of PUC's staff persons, the cost benefit analyses performed at the Energy Commission to support the load management programs were inadequate, in that they did not account for the benefits to the proper classes of ratepayers.

There are indications that the PUC's reevaluation of the Energy Commission's load management work is not simply redundant, but is multiply redundant. In testimony offered by PUC staff to the Energy Commission in the matter of residential load management programs by Pacific Gas & Electric, the PUC staff witness testified not only that the Energy Conservation Branch of the Utilities Division would be making load management recommendations to the Public Utilities Commission which were different than those being made by the Energy Commission, but, in addition, <u>other</u> units in the PUC might be recommending yet other standards to the commissioners.

It appears, therefore, that despite the wording of 25403.5, load management standards adopted by the Energy Commission continue to be the object of various potentially conflicting recommendations coming from various divisions within the PUC.

Such anomalies are costly and confusing, and should be remedied in ways that acknowledge the legislative intent of Public Resources Code Section 25403.5. Subsequent re-analyses

of the Energy Commission's standards generate costs that are borne by ratepayers, invalidate forecasts of "realistic" conservation potential, and further irritate relations between the Commissions.

Although there has been no formal action by either of the Commissions and that might point toward a resolution of this problem, there has been some effort in the last year to coordinate staff analyses in future rate proceedings. In February of this year the staffs of the two commissions jointly produced a "Standard Practice for Cost Benefit Analysis of Conservation and Load Management Programs." This standard practice report establishes consistent procedures to be used in calculating cost effectiveness, but leaves open the substantial problem of determining the value to be used in the equations. For example, the report does not address the values that will be inserted for energy or demand, or the discount rate used to determine the present value of cost and savings. (It is worth noting that the Energy Commission proposed using the energy cost forecasts adopted in the CFM process for the energy cost assumptions in the calculations. For reasons discussed in the above section on forecasts, the Energy Commission felt that these estimates, subject to intensive analysis and public inspection, had been validated. The PUC declined.)

In September 1983, selected members of the two commissions and their staffs met to establish a joint task force for the purpose of coordinating CEC and PUC staff analyses of utility conservation programs. Initially, the task force intends to develop

procedures that will result in an integrated analyses for the 1984 general rate case for Southern California Edison Company. In addition, the task force also hopes to establish procedures for developing integrated analyses of utility R&D programs.

Nevertheless, despite these efforts, the most recent PUC decision in the SDG&E rate case disapproved all further funding for the utility's swimming pool load management program, a program required by the Energy Commission's standards. As of this writing, the legal dilemma created for the utility by this action had not been resolved.