

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 diminishes 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 authoritative, 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 rule-making.
 - 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 redundant 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.