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OVERSIGHT HEARING

The California Public Utilities Commission and the Public Advocates Office Annual Update to the Legislature:

Addressing Affordability by Revisiting the Economic Regulation of Investor-Owned Electric Utilities

1021 O Street, Room 1200
Tuesday, March 3, 2026
9:00a.m.

BACKGROUND

The common purpose of all regulation is performance. – Scott Hempling, Regulating Public Utility Performance

Today's hearing is the annual update to the Legislature by the California Public Utilities Commission (CPUC) and the Public Advocates Office (PAO). As in recent years, this hearing continues with the specific focus on affordability of electricity utility bills given the continued concerns about their rising costs for Californians. The hearing includes an added lens on the economic regulation of investor-owned electric utilities (IOUs). Admittedly, this is a broad topic that encompasses many aspects of the state's and CPUC's role to regulate IOUs' customer rates and cost recovery, including the over hundred years of practice and law. In this regard, the hearing is intended to surface consideration and discuss the tradeoffs of proposed changes to the existing economic regulatory construct. It is the hope of the committee that members will have the opportunity to learn about the existing processes for cost-of-service regulation, suggestions and considerations for modifications, and importantly provide the opportunity for members to ask their own questions about potential changes. Today's hearing is part of a continuum of efforts that have preceded this legislative session to address electricity utility bill affordability, including legislative and administrative reforms adopted last year.

To help set the stage for this year's discussion, Professor Severin Borenstein, faculty director at Energy Institute at Haas Business School at UC Berkeley, will present on the overall economic regulation of IOUs, the cost-of-service model. Following Professor Borenstein, CPUC President John Reynolds will

present the CPUC’s annual update to the committee and provide perspectives about possible modifications to the regulatory construct. Then, Director Linda Serizawa of the Public Advocates Office (PAO) will present the PAO’s annual update and provide their recommendations for suggested changes to the current regulatory oversight of IOUs. Following members’ questions of the PAO, the committee will hear from a panel of stakeholders about additional changes to the economic regulation of the electric IOUs.

Members may wish to explore:

- *What additional changes may be needed to improve economic regulation of electric IOUs?*
- *The IOU model rests on the ability to attract private investment. How does the determination of the IOUs’ profit, return on equity (ROE), affect affordability?*
- *The ability to recover costs outside the IOU’s general rate case has become a growing contributor to increased costs on IOU electricity bills. Does the CPUC, as the main regulator, have the necessary authority or resources to address changes to minimize their use?*
- *What near-term and long-term opportunities may be needed to support electricity utility bill affordability? How might this affect different utility classes?*
- *What additional information would be helpful to advance the discussions during the legislative session?*

Most Recent Legislative Efforts to Address Electricity Utility Bill Affordability

As electricity rates, and consequently utility bills, have risen and trend above inflation, there is a continued desire for opportunities to reduce utility bills. Last year, in response to an executive order by the Governor¹, the CPUC and California Energy Commission, presented their recommendations for opportunities to reduce costs on electricity utility bills at this committee’s hearing also focused on affordability.² Additionally, both at the hearing and during the legislative session there were many proposals considered, including those that culminated into a negotiated agreement in the waning days of the legislative session by the Governor, Assembly leadership and Senate leadership which are reflected in the passage of SB 254 (Becker, Chapter 119, Statutes of 2025). Among the myriads of policies in the bill are several to address utility wildfire mitigation costs by requiring a cost-efficiency framework to more judiciously consider costs shouldered by utility customers, limitations on the ability of electric IOUs to earn a profit on an additional \$6 billion of wildfire mitigation (adding to the \$5 billion of expenses included in AB 1054 (Holden, Chapter 79, Statutes of 2019) that were also prohibited from a return on equity), as well as, opportunities for public financing of transmission projects. Additionally, the bill removed a requirement that IOUs utilize mechanisms (memorandum accounts) to recover wildfire mitigation costs. Instead, the bill, defers to the CPUC to determine their necessity thereby allowing these costs to be folded into the broader budgeting document of the IOU (known as the general rate case (GRC) – see below). The bill also includes policies addressing wildfire liabilities for utility equipment-ignited wildfires, including authorizing an extension of the Wildfire Fund (should it be depleted) and authorizing financing of liabilities for fires post January 1, 2025 (likely the Eaton Fire). As

¹ <https://seuc.senate.ca.gov/system/files/2025-02/2-19-25-governor-newsom-energy-eo-10-30-24.pdf>

² See Senate Energy, Utilities, and Communications Committee hearing on February 19, 2025.

https://seuc.senate.ca.gov/system/files/2025-05/cpuc-response-to-eo-n-5-24_0.pdf and

<https://seuc.senate.ca.gov/system/files/2025-05/cec-response-to-eo-n-5-24-ada.pdf>.

part of the broader negotiation, there was a related bill on the Cap-and-Invest program, AB 1207 (Irwin, Chapter 117, Statutes of 2025) that included provisions to direct 5% of the electric IOUs' allowance revenue over five years for transmission financing and makes adjustments to the Climate Credit provided to utility customers, including directing their distribution to the high-bill months of the year. These policies are in various stages of being implemented by the responsible agencies. SB 254 also requires a study by the California Earthquake Authority, by April 1, to address liabilities and risks of catastrophic events, including IOU equipment-ignited wildfires.

Little Hoover Commission Makes Recommendations

This past year, the Little Hoover Commission conducted four public workshops soliciting suggestions about addressing electricity utility affordability. These workshops and study culminated into a final report released in October 2025, "The High Cost of Electricity in California."³ The report includes ten recommendations listed below:

1. Increase the income-graduated fixed charge to reduce rates and spread costs more equitably.
2. Require a feasibility study and criteria-based framework for shifting some costs to non-ratepayer funding sources.
3. Mandate timely completion of GRCs before the test year begins.
4. Task the State Treasurer's Office with providing independent analysis for Cost of Capital proceedings.
5. Integrate cost-related proceedings (e.g., wildfire, cost of capital) into the GRC and streamline filings.
6. Direct the State Auditor to evaluate CPUC staffing levels and expertise.
7. Balance fairness for home solar investors with the need to reduce the Net Energy Metering cost shift by capping program duration and benefits.
8. Redirect California Climate Credits to California Alternate Rates for Energy (CARE)/Family Electric Rate Assistance (FERA) and hot climate zone customers during summer months.
9. Expand support for low-middle income households above the CARE threshold.
10. Simplify and accelerate clean energy grant processes.

Electricity Utility Rates Outpace Growth of Inflation

Electricity is an essential necessity for modern life, as it is used for lighting, heating, cooling, refrigeration, operating appliances, telecommunications, computing, and public transportation. Californians generally enjoyed lower energy bills when compared to the rest of the country, largely due to milder weather and investments in energy efficiency, even as electric rates have been higher than many other states. However, in more recent years, these trends have been changing as California's higher energy rates are also resulting in higher electricity utility bills. As such, there are growing

³ Milton Marks "Little Hoover" Commission on California State Government Organization and Economy, "The High Cost of Electricity in California," Report #290: October 2025. <https://lhc.ca.gov/wp-content/uploads/LHC-Report-290-The-High-Cost-of-Electricity-in-California-FINAL-1.pdf>

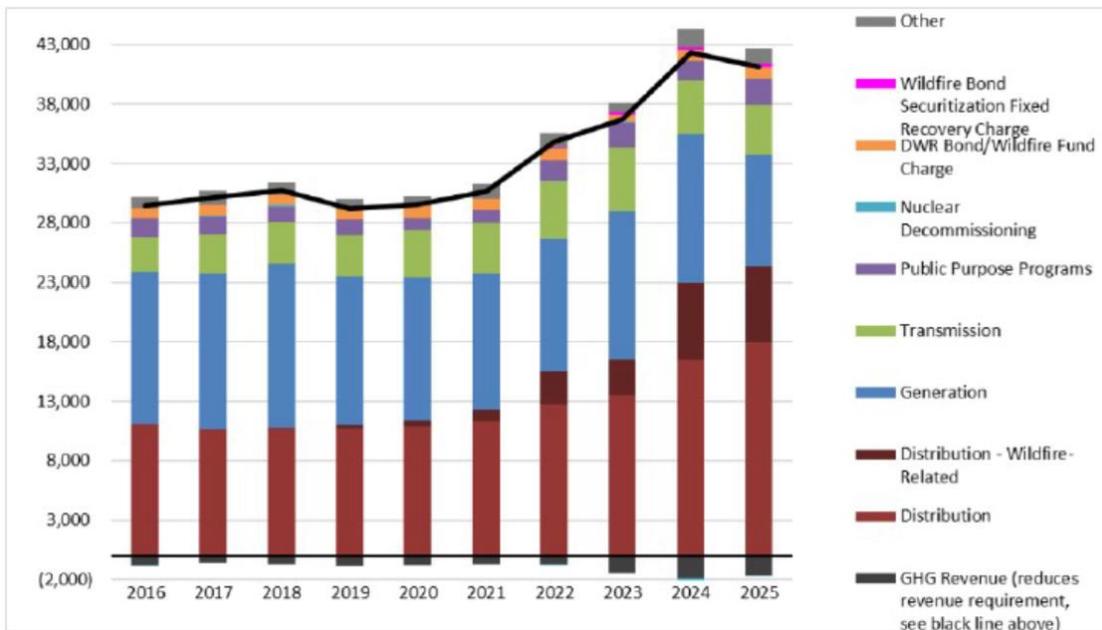
concerns about the affordability of utility bills on household budgets and commercial and industrial entities' balance sheets.

The state is served by several dozen electric utilities, with most customers (75%) served by private companies, known as investor-owned utilities (IOUs). California's ratio of IOUs to publicly owned utilities (POUs) is the like the aggregate percentage for the country, though individual states vary in terms of the proportion of IOUs and POUs. There are six electric IOUs in the state, with three serving the majority of the state's customers – Pacific Gas & Electric (PG&E), San Diego Gas & Electric (SDG&E), and Southern California Edison (SCE).

What's Embedded in Electricity IOU Rates?

Several drivers are increasing costs within IOU electricity bills. According to the CPUC's 2025 Annual SB 695 Report (published September 2025), since 2016, bundled residential average rates have increased at an annual average rate greater than the rate of inflation: about ten percent for PG&E, 8 percent for SCE, and 6 percent for SDG&E.⁴ The primary drivers include wildfire mitigation investments, and transmission and distribution costs. The following chart is from the SB 695 Report showing the combined authorized electric revenue requirement for the three large IOUs – PG&E, SCE, and SDG&E. According to the report, the distribution costs – both for wildfire and others – are significant driver of increased utility bills. This includes expenses related to replacement of poles and powerlines, transformers and other equipment, as well as vegetation management, wildfire insurance, and infrastructure hardening.

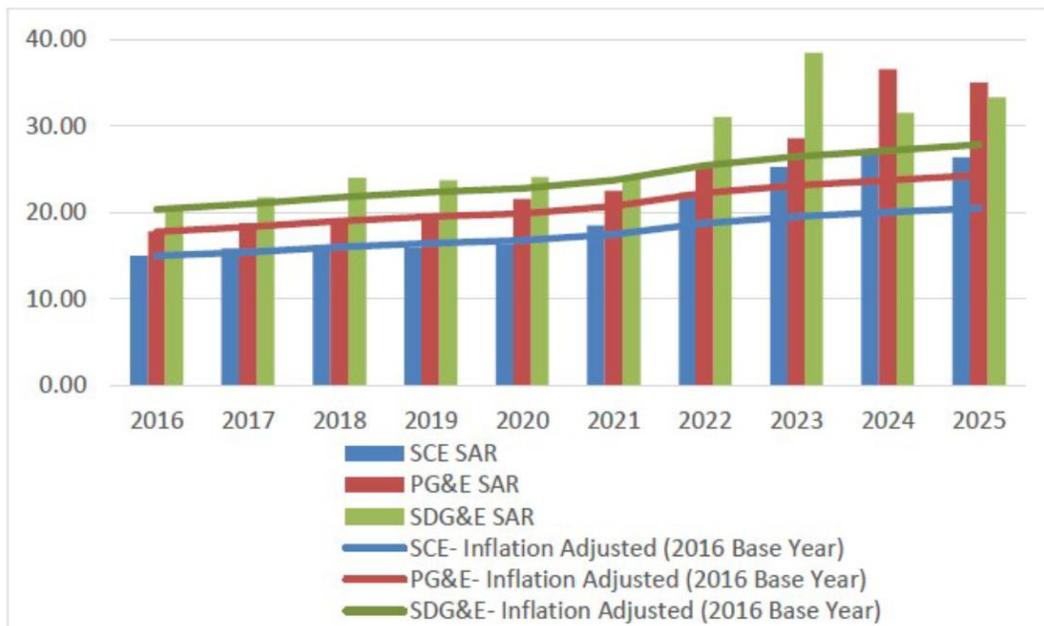
PG&E, SCE, and SDG&E Combined Authorized Electric Revenue Requirement, by Rate Component Category (January 1, \$Millions)⁵



⁴ CPUC “2025 Senate Bill 695 Report,” September 2025. https://www.cpuc.ca.gov/-/media/cpuc-website/divisions/office-of-governmental-affairs-division/reports/2025/2025-sb-695-report_093025.pdf

⁵ Ibid., p. 16

PG&E, SCE, and SDG&E January 1 Bundled System Average Rate, Nominal and Inflation-Adjusted Comparison⁶



Source: California Public Utilities Commission. Energy Division analysis. *SB 695 Report* (published September 2025)

Note: The chart displays total system average rates which reflect total authorized revenue requirement and total forecasted sales for bundled customers.

IOU Model and the Regulatory Compact

California is the birthplace of the first sale of electricity in the country when in 1879 the California Electric Light Company in San Francisco produced and sold just enough electricity to power 21 electric lights.⁷ In its early days, only a small fraction of the country (roughly eight percent in 1907⁸) received electricity service. At the time, numerous companies with different electric systems in the same city provided service to those who could afford it, as electricity was largely a luxury service. Most residents and businesses relied on other less expensive energy forms (such as steam, natural gas, and oil) to power lamps, motors, and manufacturing facilities. As technology advanced, multiple electricity providers entered the market and competed for customers. Competition was fierce among providers with urban areas witnessing numerous electrical lines crisscrossing city streets to serve individual customers. Municipalities issued franchises, though they generally did little to limit market entry or to set rates.⁹

In the late 19th century, Thomas Edison’s former secretary, Samuel Insull, a leading industry leader and controller of Chicago Edison of Illinois, began advocating for the idea of electricity service as a natural

⁶ Ibid., p. 19

⁷ Energy Information Agency (EIA) website “Use of electricity” <https://www.eia.gov/energyexplained/electricity/use-of-electricity.php> Accessed 23 Feb. 2026.

⁸ Arthur G. “The Residential Adoption of Electricity in Early Twentieth-Century America.” *The Energy Journal*, vol. 8, no. 2, 1987, pp. 19–30. *JSTOR*, <http://www.jstor.org/stable/41322257>. Accessed 23 Feb. 2026.

⁹ Knittel, Christopher. “The Origins of State Electricity Regulation: Revisiting an Unsettled Topic.” Program on Workable Energy Regulation (POWER): University of California Energy Institute: Berkeley: November 1999, pg. 2. <https://www.haas.berkeley.edu/wp-content/uploads/pwp048.pdf>

monopoly that would benefit from government economic regulation in exchange for a monopoly franchise that limits competition. A natural monopoly provides that the per-unit-price of a product or service declines over the market's demand. The representatives of the electricity industry in general did not initially support Insull's perspective. At the same time, the Progressive Era movement sought to provide government regulation of many industries, beginning with the railroads, to address price and access. Given the electricity industry's view that local municipalities often had a tendency for unreasonable charges and corruption at the local level,¹⁰ the industry may have preferred state regulation over local or federal regulation, recognizing regulation was inevitable.¹¹

The natural monopoly model afforded vertically integrated utilities, both public and private, to prosper and expand (along with federal actions to expand hydroelectricity and rural electrification). In its early years, the IOU model generally supported universal access, economies of scale, and steady financing. Over the past hundred years, the model has shifted with some aspects of competition. In the 1990s, through CPUC orders and legislation, the state directed the electric IOUs to divest much of their generating resources with the goal of supporting competition to spur lower prices for customers. However, these and other changes from the CPUC orders and legislation (including caps on retail rates), combined with market manipulation from nefarious actors, resulted in an energy crisis where IOUs experienced limited supply to meet demand. The crisis triggered rotating power outages and high prices that pushed one IOU to enter bankruptcy and others on the verge of entering. Since the energy crisis the role of the CPUC has evolved, but its main role continues to be as it was in 1911 when it was first established in the state constitution – the economic regulator of the IOUs in the state.¹²

CPUC Role in Setting IOU Rates

Investor-owned utilities (IOUs). Privately-owned utilities, commonly referred to as IOUs are afforded an exclusive license to provide service in a specific geographic area (known as a utility service territory) in exchange, the IOUs' rates are regulated by the regulatory agency – the CPUC. In California, the CPUC reviews and approves rates for IOUs to ensure they are “just and reasonable.” Most Californians, about 75% of the population, receive electricity services from electric IOUs; POUs, including a few rural cooperatives, whose rates are set by local governing boards, provide service to the remaining 25%. IOUs, as private companies, can earn a rate of return (authorized profit from rate base) on utility-owned and capitalized assets and equipment. The regulatory construct is intended to limit the ability of the monopoly entity to charge unfettered rates by serving as a proxy for competition. In general, utilities operate on access to long-term financing with the interest rates determined by their credit ratings.

Bundled and unbundled customers. Electric IOU customers may be both bundled (meaning they receive distribution, transmission, and generation service from the utility) and unbundled (meaning they only receive distribution and transmission services from the utility and receive generation services from another provider). In the case of electric IOUs, customers may receive generation service from a community choice aggregator (CCA) or electric service provider (ESP). CCAs and ESPs set their own rates for electricity, though many CCAs, which are overseen by local government entities, seem to index their rates to those of the incumbent electric IOU. When a local government (or multiple governments together) launches a CCA within their geographic jurisdiction, they file an implementation plan and

¹⁰ Ibid., pp. 14-16.

¹¹ Ibid., p. 15

¹² Article XII of the California Constitution

schedule with the CPUC that details the schedule for automatically enrolling IOU bundled customers to the CCA (usually in phases), unless customers proactively opt out. ESPs are third party entities who like CCA's use IOUs' distribution and transmission services but procure their own generation resources. ESPs are limited by statute to serve a capped amount of the overall load (roughly 13-15%) due to the experience during the energy crisis where some ESPs abruptly went out of business and returned customers to the incumbent IOU which further exacerbated the crisis for the IOUs and their customers.

Cost-of-Service – Cost Recovery Proceedings and Processes

Cost-of-Service Rate Regulation. Under cost-of-service regulation, the CPUC, as the economic regulator determines the total amount of revenue that must be collected in rates (revenue requirement) for the utility to recover its costs and earn a reasonable return. The cost-of-service regulatory model is a standard model that is utilized across the country, including by the federal government. At its core, the IOU submits an application to the regulator to recover costs from their customers, plus an opportunity for a reasonable return (profit), which if approved are then recovered in rates. The regulator can disallow costs.

The General Rate Case (GRC). The CPUC reviews and approves IOU costs and revenues through various applications submitted by the IOUs – most notably the GRC. GRCs are forward-looking, as IOUs forecast and estimate their anticipated costs to operate their respective utility and conducted on four-year cycles (previously three-year cycles). The GRC proceedings at the CPUC can last 18 months to two years, or more, whereby all aspects of the IOUs' costs of operating and maintaining the utility system are reviewed. More recently, per statutory requirements adopted following the 2010 San Bruno pipeline explosion, IOUs must also ensure their forecasted expenses associated with investments on their systems are informed by safety and other risks to the system. The GRC has two main components: Phase I determines the total amount the IOU is authorized to collect, known as the “revenue requirement” (the size of the pie), and Phase II determines the share of the costs attributed to each customer class (e.g. residential, small commercial, industrial, etc.) and the corresponding rate schedules (the slicing of the pie). Importantly, the CPUC provides economic regulation of distribution services, whereas the federal government serves as the economic regulator for interstate transmission (see below). Stakeholders often complain about delayed CPUC decisions, including IOU GRCs. This regulatory lag is considered by some an important feature of the regulatory model to best reward IOU efficiency and performance by placing the risk on the IOU. However, the regulatory lag can also limit the ability of the IOU to deliver the many demanded services and contribute to utility bill shocks when the new GRC is approved.

Cost of Capital proceeding. Separate from the GRC, but informing the GRC, is the cost of capital proceeding at the CPUC. An IOUs rate of return, or cost of capital, is the weighted average cost of debt, preferred equity, and common stock the IOU has issued to finance its capital investments. Cost of debt is determined by weighted average interest rates on long-term debt issuances. The cost of common stock, expressed as the return on equity (ROE), represents the financial return to shareholders that invest in common stock and is expressed as a percentage. The CPUC says it “attempts to set the authorized ROE at a level that is adequate to enable the IOU to attract investors to finance the replacement and expansion of its facilities so it can fulfill its public utility service obligation.” The CPUC determines the ROE through the cost of capital proceeding which they undergo every three years to examine various financial models and estimate market returns on investments for other companies with similar levels of risk.

Other cost recovery processes at the CPUC. In addition to GRCs, IOUs submit other applications (or advice letters) for cost recovery. In the case of electric IOUs, Energy Resource Recovery Account proceedings are used to reconcile estimated versus actual fuel and purchased power costs. The CPUC annually reviews these costs, and to the extent they are deemed reasonable, approves passing through those costs to customers without any mark-up or profit to the utility. The costs are forecasted for the year ahead. If the actual costs are lower or higher than forecasted, then the electric IOU credits or charges customers for the difference. Beyond these proceedings, if authorized, IOUs also utilizes other mechanisms which may allow for recovery of costs outside the GRC. These mechanisms include memorandum and balancing accounts. These cost recovery mechanisms can be for costs that are unexpected and difficult to forecast or costs that may change due to exogenous factors. Some of these applications can be for substantial amounts of cost recovery, such as electric vehicle charging infrastructure investments or wildfire-related expenses, which when approved by the CPUC get rolled into customer rates. This is an area of growing concern by many stakeholders, including a recommendation in the Little Hoover Commission and by consumer organizations to roll these expenses further within the GRC.

Transmission-related costs. Lastly, in addition to CPUC cost recovery processes, IOUs also undergo similar reviews at the Federal Energy Regulatory Commission for costs associated with operating transmission systems (generally high voltage electric lines many that traverse the state and across to other states). The CPUC represents California ratepayers' interests in these proceedings. These costs have also been contributing to increasing costs on electricity utility bills.