California State Senate

COMMITTEE ON
ENERGY, UTILITIES AND COMMUNICATIONS

STEVEN BRADFORD
CHAIRMAN

STAFF
CHIEF CONSULTANT
NIDIA BAUTISTA
CONSULTANT
SARAH E. SMITH
COMMITTEE ASSISTANT
MELANIE CAIN
1021 O STREET, SUITE 3350
SACRAMENTO, CA 95814
TEL (916) 651-4107
FAX (916) 642-8979

OVERSIGHT HEARING

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

Keeping the Focus on Utility Bill Affordability

1020 O Street, Room 1200
Tuesday, February 13, 2024
9:30 a.m.

BACKGROUND

"Electricity is no longer a luxury. It is a definite necessity. It lights our homes, our places of work and our streets. It turns the wheels of most of our transportation and our factories. In our homes it serves not only for light, but it can become the willing servant of the family in countless ways."
– Franklin Delano Roosevelt

Today's hearing is the annual update to the legislature by the California Public Utilities Commission (CPUC) and Public Advocates Office (PAO) and a follow up to last year's annual update which was similarly focused on utility bill affordability. At that hearing, the Chair and members of the committee raised concerns about the increasing costs of utility bills, particularly electricity and natural gas utility bills. Last winter, Californians experienced utility bill shock largely due to a surge in the price of wholesale natural gas which were disparately high in the West Coast as compared to the rest of the country. Members of the committee expressed concerns that Californians are feeling economic hardships with the surprisingly high natural gas utility bills, combined with electricity bills that are trending higher, as well as, overall price increases on many household items.

This year's hearing is intended as both follow up and continued vigilance on the affordability of utility bills given the financial challenges faced by many Californians and the necessity of essential utility service for health, quality of life, and comfort. Affordable electric utility service is also paramount to the state's climate goals which partly hinge on the willingness of residents and businesses to shift away from fossil fuel uses and towards cleaner alternatives, including electrificity for transportation. As such, an unaffordable electric utility bill may also hamper the state's efforts to achieve its climate goals.

As the members of the committee receive the annual update from the CPUC and PAO, including their respective annual reports, they may wish to also consider and request information about the status and findings of some notable activities since last year's hearing, including:

- Status and findings of the CPUC's and Federal Energy Regulatory Commission's (FERC's) investigation(s) on the causes of winter 2022-2023 wholesale natural gas price spikes.
- August 2023 State Auditor's Report regarding electricity and natural gas rates.
- Recently approved rate increases, particularly for Pacific Gas & Electric (PG&E).
- Status and understanding of the CPUC's efforts to adopt an electricity rate-design that incorporates a fixed-charge to address equity and reduce volumetric rates, as authorized by statute.
- FERC decisions related to transmission-related incentive adders and any other cost considerations adopted or pending at FERC.
- The status of securing, accounting, and tracking federal funds from the Inflation Reduction Act (IRA) and the Infrastructure Investment and Jobs Act (IIJA) to offset costs that might otherwise be shouldered by utility ratepayers.

Winter 2022-23 Wholesale Natural Gas Price Spike Investigations

As noted at last year's hearing, the Chair and several members of the legislature sent letters to the CPUC expressing concerns about the surge in wholesale natural gas prices that were resulting in customers experiencing bill shock from high natural gas utility bills. Members, generally, supported an acceleration of the annual Climate Credit in order to provide immediate relief to customers and reduce the amount of the bill. Additionally, Chair Bradford, other members, PAO, and other stakeholders called on investigations to identify the causes in order to prevent similar future events. Members of the committee also expressed a desire for improved and earlier notifications to help customers better manage their usage when utility bills are expected to increase.

Prior to last year's hearing, the CPUC directed energy utilities to accelerate the timeframe in which residential energy customers receive a Climate Credit on their utility bills ($90-120 combined for gas and electricity) so as to arrive sooner than originally scheduled in April and therefore closer to the timing of the utility bill increases caused by the wholesale natural gas price spikes.

Since last year's committee hearing, the CPUC opened a new proceeding (I. 23-03-008), on March 16, 2023, to investigate the causes and impacts of the winter 2022-2023 natural gas price spikes and the potential for recurrence; the impact of the price spikes on natural gas and electric prices and customer bills; the potential threats to natural gas and electric reliability and price volatility in summer 2023 and beyond, and potential mitigations; and utility communications to customers to determine whether they were sufficient or require modifications. The CPUC held a public workshop in the fall, in addition to the earlier *en banc* on the issue, and solicited information from parties on the various aspects of the investigation. As of the timing of this hearing, the proceeding remains open.

On February 6, Governor Newsom sent a letter to the FERC, as the agency responsible for regulating and overseeing wholesale natural gas markets, requesting they investigate whether market manipulation, anticompetitive behavior, or other anomalous activities were driving the elevated prices in the western gas markets. FERC's November 2023 Office of Enforcement's Annual Enforcement Report noted the agency's Division on Analytics and Surveillance (DAS) engaged in "enhanced surveillance" involving coordinated efforts by both the natural gas and electric surveillance teams, into disruptive market events associated with the price spikes in the wholesale natural gas markets. The report notes the surveillance is ongoing through fiscal year 2024. Additionally, FERC's DAS referred one market participant to the Division of Investigation for investigation, although the details of that investigation have not been disclosed. Additionally, DAS staff "continues to analyze the information gathered during these natural gas and electric market inquiries to determine if other referrals are necessary."

State Auditor Issues Report on Electricity and Natural Gas Rates

In August 2023, the State Auditor released an audit report, *Electricity and Natural Gas Rates: The California Public Utilities Commission and Cal Advocates [PAO] Can Better Ensure That Rate Increases Are Necessary*. The audit focused on electricity and natural gas rate increases of four large utilities – PG&E, San Diego Gas & Electric (SDG&E), Southern California Edison (SCE), and Southern California Gas Company – and the oversight conducted by the CPUC and the PAO. The audit noted that some of the causes contributing to rate increases are outside the control of the CPUC and PAO; however, "both can better protect customers by implementing certain improvements to their oversight."

Some of the key findings of the audit report include:

- Several factors have contributed to increases in electricity and natural gas rates for the four utilities. These include:
    - Utilities' operating costs have been increasing, though the largest category of increases vary by utility: distribution costs for PG&E, administrative costs for SCE, and higher property and non-income taxes for SDG&E.
    - Wildfire costs, including insurance, has also been a key factor in increased utility expenses.
    - Decreasing electricity sales due to installation of solar power systems has required utilities to raise rates to recover fixed costs.
    - Market forces have contributed to rising natural gas rates.
- The CPUC and PAO need to strengthen their processes to better protect customers.
- PAO does not have a risk-based approach for reviewing utility balancing accounts, which utilities use to track variable costs that may be difficult to predict and could have a material impact on rates, to ensure that utilities' request for rate changes are appropriate.

The State Auditor's report also provides recommendations to improve the CPUC's and PAO's oversight of utility expenses, including:

- The CPUC should institute a process that requires utilities to periodically publish actual rate-of-return calculations using methodology acceptable to the CPUC and PAO in order to promote transparency. The agency should also require utilities to identify the major cost categories in which projected costs exceeded actual costs.

- The CPUC and PAO should strengthen their processes to verify whether a utility has completed the activities associated with the costs it claims it unexpectedly incurred and is seeking to recover through rate increases.
- The CPUC should also clearly and comprehensively communicate to customers the reasons for cost increases it authorizes at the start of each rate cycle and the reasons for rate increases that utilities seek mid-cycle.
- PAO should verify whether balancing account balances and the resulting rate changes are accurate and comply with CPUC rules in order to ensure utilities can support the rate changes they request.

Recently Approved PG&E Rate Increases

PG&E's pending general rate case (A.21-06-021) was approved by the CPUC in November. The approval of the general rate case provides for a sizeable rate increase which is roughly $34.50 more each month for average households, beginning the first year of what is intended as a four-year budget cycle, which runs through from 2023-2026. The approval includes PG&E's request to bury about 1,200 miles of power lines in high fire threat areas. Specifically, the CPUC approved a 2023 base revenue requirement of $13.759 billion for the utility, which is an increase of $1.545 billion or 12.6% over PG&E's currently authorized 2022 revenue requirement of $12.214 billion. However, the CPUC directed PG&E to remove the costs recorded in certain memorandum accounts which have not yet been reviewed for reasonableness. The CPUC also adopted increases in the following years' revenue requirements, specifically: $671 million or 4.9% over 2023 for 2024, $301 million or 2.1% over 2024 for 2025, and $121 million or 0.8% over 2025 for 2026.

CPUC Proceeding on Income-Graduated Fixed Charges

Among the many provisions in AB 205 (Committee on Budget, Chapter 61, Statutes of 2022) was the removal of the existing fixed charge caps on default electricity rates, as established under AB 327 (Perea, Chapter 611, Statutes of 2013) which limited default fixed charges to no more than 10 dollars for most residential customers, and five dollars for customers on the California Alternate Rates for Energy (CARE) low-income rate assistance program. The CPUC never adopted the ten dollar fixed charge on default residential rates, opting for a minimum bill option instead. Although, they have adopted optional electrification rates for electric vehicles and rooftop solar that require a fixed charge of between $12-15 per month, with a lower volumetric rate. With the passage of AB 205 in 2022, the CPUC initiated a proceeding to adopt the default income graduated fixed charge, with the statutory requirements for "no fewer than three income thresholds so that low-income customers in each baseline territory would realize a lower average residential monthly bill without making changes in usage."

The proceeding has been very active since the passage of AB 205. The CPUC has held workshops, solicited comments on various aspects of establishing default fixed charges (including timing, income verification, income tiers, etc.). The CPUC has solicited proposals from parties on a rate-design and structure. Parties have submitted various proposals, each with varying rate-designs, some with varied income tiers, and other structural differences, including the fixed charge amounts. Some parties have expressed concerns that high fixed charge amounts could hamper the ability to deploy customer-sited solar, as the customers' payback periods would be extended. Other parties have expressed concerns that the income tiers should reflect multiple tiers. Some parties have suggested a larger fixed charge would help reduce the volumetric rate therefore incentivize customers to electrify more uses. Some parties have raised concerns about ensuring the structure accounts for varied needs for electricity in the state especially for regions that rely on air conditioning in the summer. The CPUC generally views these proposals as information to inform the agency's development of their proposed decision, which has not been issued in the proceeding. The CPUC anticipates adopting a decision for a first-phase of income-graduated fixed charges in July of this year and has solicited comments regarding shaping a second-phase.

FERC Transmission-Related Decisions

On December 29, 2023, the FERC denied PG&E's request for an additional 0.5% return on equity (worth roughly $41 million annually) as a bonus for participating as a member of the California Independent System Operator (CAISO). FERC denied PG&E the "incentive adder" citing the passage of AB 209 (Committee on Budget, Chapter 251, Statutes of 2022), an energy and climate change budget trailer bill that among its many provisions, prohibits PG&E, and other investor-owned utilities, from leaving the CAISO without CPUC approval. The incentive adder is a construct of federal legislation from the late 1990's to encourage participation in independent system operators (ISOs) and regional transmission organizations (RTOs) across the country by providing incentives to those who voluntarily participate. Prior to the passage of AB 209, California's investor-owned utilities had successfully argued that their participation was voluntary and therefore merited the collection of the incentive amounts from their customers in transmission rates. However, FERC has now ruled that they are no longer eligible for the incentives given the language in AB 209. As cited in news reports, the

IOUs are challenging FERC's decision against the opposition from the CPUC and many other California utilities and entities.

Securing and Tracking Federal Funds

In April 2023, the CPUC adopted Resolution E-5254 to adopt procedures to require review and approval of electric and natural gas IOUs' cost recovery requests for federal funds from the Inflation Reduction Act (IRA), Infrastructure Investment and Jobs Act (IIJA), and the Creating Helpful Incentives to Produce Semiconductors and Science Act (CHIPS). The resolution provides direction on how IOUs should track project costs and taxes associated with grants awarded under the federal programs and how they should seek to recover matching funds and other costs associated with participation in the program funding opportunities. The resolution also establishes a tracking mechanism for IOUs to regularly report to the Energy Division on planning, seeking, and implementation of the IIJA, IRA, and CHIPS awards. The IOUs' ability to secure some of the billions of dollars available in federal funding from the adopted federal legislative acts could help reduce the amount that might otherwise be collected from ratepayers. As such, the CPUC's requirement to track, and also the state's ability to support the IOUs (and other utilities) successful efforts to secure awards is critical.

Additional background from last year's hearing:

Electricity utility bills continue trending higher

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 energy utility bills. As such, there are growing concerns about the affordability of utility bills on household budgets and commercial and industrial entities' balance sheets. Given the state's strategies for reducing greenhouse gas emissions depends on shifting fossil fuel uses to alternatives, including electricity, electrification of transportation and other sectors

These concerns are exacerbated by the interest to adopt policies to reduce the state's greenhouse gas emissions by shifting away from fossil fuels towards alternatives, including electrification in the transportation and building sectors. Such a transition relies on changing customer behaviors, in addition to policies.

However, Californians may be reluctant to switch fuels if utility costs are unaffordable, thereby potentially slowing progress towards the state's climate goals. Just as importantly, many Californians have also struggled to overcome economic challenges, including impacts from the COVID-19 pandemic. Low-income and fixed-income residents have fallen behind on paying their bills, including the utility debt accumulated over the time of the pandemic. The legislature and governor have helped alleviate these concerns by approving over $2 billion in funding to address energy utility bill arrearages and another $1 billion to address water utility bill arrearages. Nonetheless, the growing costs for goods and services due to inflation and supply shortages is also affecting the cost of utility bills and the ability for Californians to manage their household budgets.

CPUC role in setting utility 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 service territory) in exchange, the IOUs' rates are regulated by the regulatory agency – the CPUC. IOUs, as private companies, 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. In general, utilities operate on access to long-term financing with rates determined by their credit ratings. In California, the CPUC reviews and approves rates for IOUs to ensure they are "just and reasonable." Most Californians, about 75 percent receive electricity services from electric IOUs; publicly owned utilities (POUs), whose rates are set by local governing boards, provide service to the remaining 25 percent. On the other hand, the vast majority of Californians receive natural gas utility service from an IOU, with some exceptions (such as the City of Long Beach, which provides its own natural gas utility service).

Bundled and unbundled customers. Electric and natural gas IOU customers may be both bundled (meaning they receive distribution and procurement service from the utility) and unbundled (meaning they only receive distribution and transmission services from the utility and receive procurement services from another provider). In the case of electric IOUs, customers may receive procurement service from a community choice aggregator (CCA) or electric service provider (ESP). CCAs and ESPs set their own rates, though most CCAs, which are overseen by local government entities, seem to index their rates to those of the electric IOU. When a local government launches a CCA, they develop an implementation plan and schedule to automatically enroll customers to the CCA (usually in phases), unless the customer proactively opts-out. In the case of natural gas IOUs, core customers (mostly residential and small commercial) may receive procurement services from either the utility or opt-in to receive service from a third party provider known as a core transport agent (CTA). Non-core customers (usually large industrial customers, including natural gas power plants that generate electricity) procure their own natural gas, but often utilize the utility's transmission and distribution pipelines to deliver their gas.

Cost recovery proceedings and processes

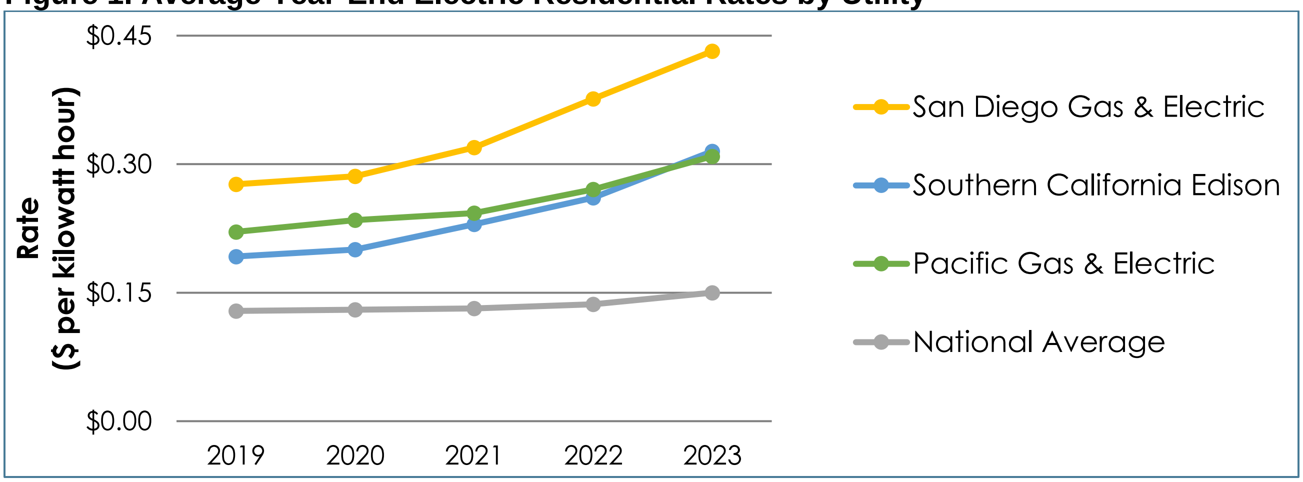
The General Rate Case. The CPUC reviews and approves IOU costs and revenues through various applications submitted by the IOUs – most notably the General Rate Case (GRC). The GRCs are generally conducted on three-year cycles, though are now shifting to four-year cycles. The proceedings can last 18 months 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 2008 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 and the corresponding rate schedules (the slicing of the pie). GRCs are forward-looking, as IOUs forecast and estimate their anticipated costs to operate their respective utility. In addition to GRCs, IOUs submit other applications (or advice letters) for cost recovery.

Other cost recovery processes at the CPUC. In the case of electric IOUs, Energy Resource Recovery Account (ERRA) 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, passes through those costs 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, respectively, for the difference. In the case of natural gas utilities, natural gas procurement costs are rolled into rates monthly and are therefore seen more immediately on utility bills. Natural gas costs are also not marked up, solely passed on to customers as pass-through costs. Beyond these proceedings, IOUs also submit applications (or advice letters) for other program allocations or cost recovery. 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.

Transmission-related costs. Lastly, in addition to CPUC cost recovery processes, IOUs also undergo similar reviews at the Federal Energy Regulatory Commission (FERC) for costs associated with operating transmission systems (generally high voltage electric lines and high volume natural gas pipelines). However, these tend to have fewer stakeholders actively involved in the proceedings. The CPUC represents California ratepayers' interests in these proceedings.

Below is a chart provided by the PAO noting average residential rates by large electric IOU in California.

Figure 1. Average Year-End Electric Residential Rates by Utility



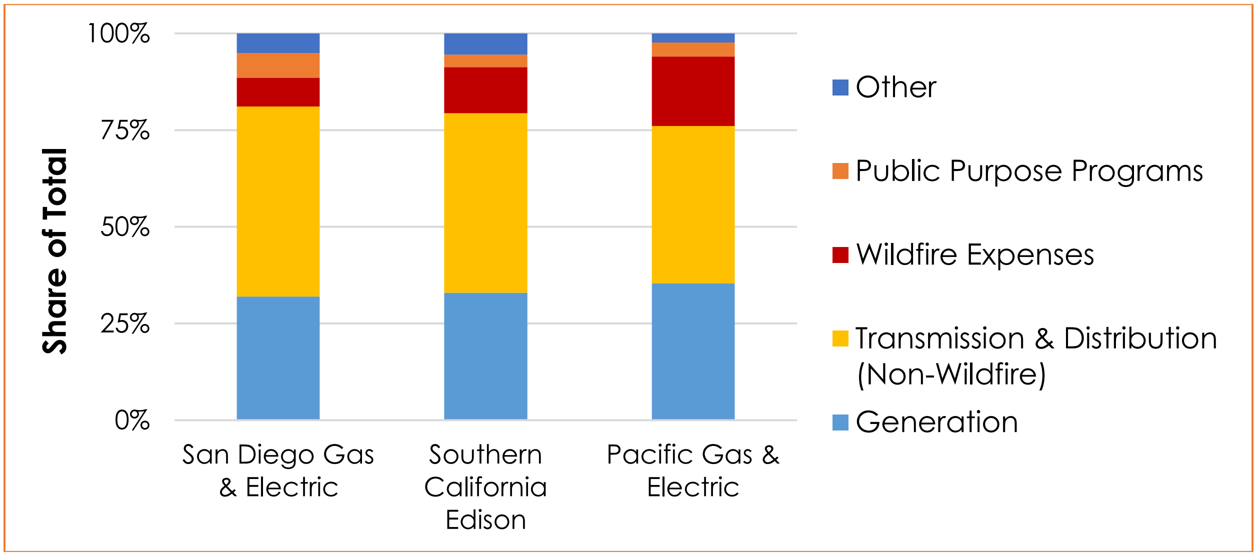
Sources: PG&E, SDG&E, SCE data (Public Advocates Office) & National (U.S. Energy Information Administration)
Note: A kilowatt-hour is a common unit of electricity, about the amount used to run a microwave for one hour.

Figure 2. 2021 Major California Investor-Owned Utility Rates by Components

Source: California Public Utilities Commission. Energy Division analysis. *2022 Senate Bill 695 Report*.
Note: The graph displays total system costs, which include the costs covered by all customer types (residential, industrial, agricultural, and commercial)

What's embedded in electric rates?

On electric side of the equation, a number of drivers are increasing costs. According to the CPUC's 2022 annual SB 695 report, since 2013, bundled residential average rates have increased at an annual average rate of about seven percent for PG&E, five percent for SCE, and 10 percent for SDG&E. The primary drivers include wildfire mitigation investments, and transmission and distribution costs. The following bar chart is provided by PAO based on CPUC and electric IOU data regarding the categories of costs in electric rates. Important to note that within each category there are a myriad of policies, programs, projects, and decisions.



Exploring additional options to address affordability

The CPUC has held two *en bancs* related to utility bill affordability, one in 2021 and another in 2022. Multiple stakeholders have proposed various strategies to reduce costs on utility bills, including utilizing the General Fund or other State funds for some utility programs. A recent example of this approach beyond the arrearages funding, includes the budget appropriations for a Strategic Reliability Reserve in 2022, which authorizes the Department of Water Resources (DWR) to utilize general fund dollars to procure energy resources for electricity. Other proposals include: finding other sources of funding for specified utility activities, including exploring state financing for expenditures such as transmission and other utility operations or securing federal funding.

Utility customer assistance

Utility bills, unlike credit card bills, can be more forgiving if not paid, but the loss of service can be a threat to life and impact health. The Legislature and the CPUC have adopted numerous rules to provide customer assistance, as well as, disconnection processes to protect customers from loss of essential services. The programs include the California Alternate Rates for Energy (CARE) program which provides a 30-35 percent discount on electric IOU bills and 20 percent on natural gas IOU bills for income qualified households. Additionally, the Family Electric Rate Assistance (FERA) program provides an 18 percent discount on electric bills for families whose household income slightly exceeds the CARE allowances. FERA is available for customers of Southern California Edison (SCE), San Diego Gas and Electric Company (SDG&E), and PG&E Company. Additional assistance programs provide greater energy allowance for customers who require energy for medical reasons. Low-cost energy efficiency and weatherization services are also available to CARE and FERA customers.

More recently, the Legislature and Governor have approved nearly $3 billion in utility debt-relief assistance for energy and water utility bills, across IOUs and POUs. The program is administered by the Department of Community Services and Development (CSD) with the bulk of the funding already provided to utilities to help customers with arrearages. In addition, CSD administers federal Low Income Home Energy Assistance (LIHEAP) program that provides one-time emergency safety net assistance to pay for utility bills for income qualified customers. Beyond these programs, the CPUC also imposes various disconnection processes and procedures in order to protect customers from being unfairly disconnected from utility service. The CPUC is also experimenting with a Percentage of Income Payment Plan (PIPP) pilot to allow some CARE customers to receive monthly household income utility bill caps, set at four percent of household incomes. The four-year pilot was only recently initiated as part of the CPUC’s utility disconnections proceeding. Findings from the pilot are still years away.