Date of Hearing: April 24, 2024

ASSEMBLY COMMITTEE ON UTILITIES AND ENERGY
Cottie Petrie-Norris, Chair
AB 2666 (Boerner) – As Amended March 21, 2024

SUBJECT: Public utilities: rate of return

SUMMARY: Requires the California Public Utilities Commission (CPUC) to require electric or gas investor-owned utilities (IOUs) to refund revenues in excess of its approved rate of return from the prior year to its ratepayers.

EXISTING LAW:

1) Requires that all charges demanded or received by any public utility for any product, commodity or service be just and reasonable, and that every unjust or unreasonable charge is unlawful. (Public Utilities Code § 451)

2) Requires the CPUC to establish rates using cost allocation principles that fairly and reasonably assign to different customer classes the costs of providing service to those customers, consistent with the policies of affordability and conservation. (Public Utilities Code § 739.6)

3) Requires the CPUC to ensure that any errors in estimates of demand elasticity or sales do not result in over or undercollections by the IOUs. (Public Utilities Code § 739.10)

4) Mandates the CPUC develop a definition of energy affordability, and use the definition to assess the impact of proposed rate increases on different types of residential customers, among other requirements. (Public Utilities Code § 739.13)

5) Declares the legislative intent that the CPUC reduce rates for electricity and natural gas to the lowest amount possible. (Public Utilities Code § 747)

FISCAL EFFECT: Unknown. This bill is keyed fiscal and will be referred to the Committee on Appropriations for its review.

BACKGROUND:

General Rate Cases (GRCs) – The CPUC reviews and approves electric IOU costs and revenues through a variety of public processes. The most notable are the GRC proceedings, which are used to address the costs of operating and maintaining the electric system and the allocation of those costs among customer classes. The CPUC evaluates detailed cost data from both past expenses and utility forecasts of likely future costs, and establishes how much money the utilities are allowed to collect for the first year – called a test year. The GRC decision then prescribes how to adjust the test year budget for inflation and other factors that may affect costs, such as additional capital projects, for the following 3 years, summing to a total of 4 years that each GRC cycle encompasses.

Rising utility bills – Since 2013, rates have increased across all three IOUs and exceeded the assumed rate of inflation.[1] Californians currently pay some of the highest utility rates in the country. In March 2023, California had the seventh highest average electricity rates and the tenth highest average residential natural gas prices of any of the states.[2] According to an analysis by the Public Advocate's Office (PAO), the primary drivers for these electric rate increases, which are visualized in Figure 1, arise from wildfire mitigation work, transmission and distribution investments, and rooftop solar incentives.[3] In an analysis by the CPUC, increases in natural gas rates in recent years, as seen in Figure 2, were primarily driven by increased commodity prices, which felt upward pressure from gas market conditions, colder winter weather, and gas pipeline infrastructure and storage issues.[4] Due to a mild 2023 winter, natural gas rates have come back down.[2]

Figure 1. California IOU electric rates over the recent years[2]

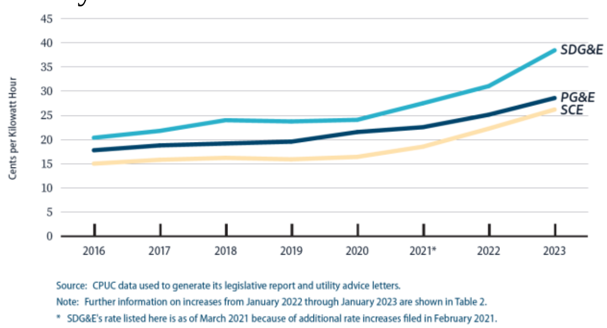
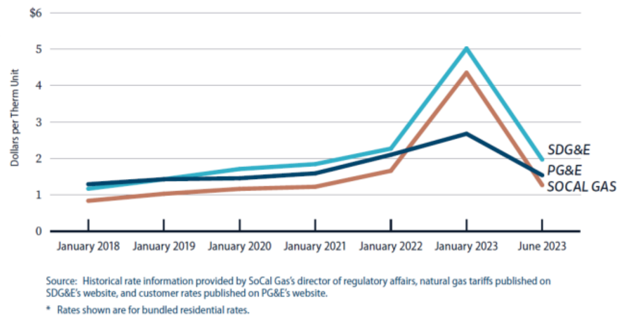


Figure 2. California IOU natural gas rates over the recent years[2]



While the current high electric bills experienced by California customers raise concern, the projection of future rate impacts is even more troubling. Spurred by the climate goals the state has set, the rapid growth in consumer demand of electricity and the transition to clean energy resources necessitates updating and expanding our distribution and transmission systems. According to a May 2023 study by Kevala, Inc. released by the CPUC, "up to $50 billion…in investments are needed by 2035" for distribution grid upgrades.[5] In their 20-Year Outlook, the California Independent System Operator (CAISO) – which operates and plans the majority of high-voltage transmission in the state – estimated total costs arising from needed upgrades and new build of the high-voltage bulk transmission system would be roughly $30 billion dollars by 2045.[6] These costs will be borne by ratepayers. By 2030, bundled residential rates are forecasted by the CPUC to be much higher than they would have been if 2020 rates had grown at the rate of inflation.[7] These forecasts largely attribute this increase to capital expenditures (infrastructure build) and wildfire mitigation. However, these forecasts rely on fairly conservative assumptions

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[1] CPUC; "Utility Costs and Affordability of the Grid of the Future: An Evaluation of Electric Costs, Rates, and Equity Issues Pursuant to P.U. Code Section 913.1"; May 2021.

[2] State Auditor; "Electricity and Natural Gas Rates: The California Public Utilities Commission and Cal Advocates Can Better Ensure That Rate Increases are Necessary"; August 2023.

[3] PAO; "Q4 2023 Electric Rates Report"; https://www.publicadvocates.cpuc.ca.gov/-/media/cal-advocates-website/files/press-room/reports-and-analyses/240119-caladvocates-q4-2023-quarterly-rate-report.pdf; January 2024.

[4] CPUC; "2022 California Electric and Gas Utility Costs Report: AB 67 Annual Report to the Governor and Legislature"; April 2023.

[5] Kevala; "Electrication Impacts Study Part 1: Bottom-Up Load Forecasting and System-Level Electrification Impacts Cost Estimates"; May 2023.

[6] Approximating $11 billion for upgrades; $8 billion for offshore wind integration; and $11 billion for out-of-state wind integration. CAISO, *20-Year Transmission Outlook*; January 2022.

[7] Approximately 12% higher for PG&E, 10% for SCE, and 20% for SDG&E. CPUC; "Utility Costs and Affordability of the Grid of the Future: An Evaluation of Electric Costs, Rates, and Equity Issues Pursuant to P.U. Code Section 913.1"; May 2021.

about utility expenditures that could underestimate the actual rate increases expected in the future.

State audit of the CPUC – A recent report by the State Auditor had similar findings to PAO on the causes for increasing electricity rates.[2] Wildfire costs, including insurance, was noted as a key factor in increased utility expenses. Decreasing electricity sales due to solar system adoption was noted to have led to IOUs raising rates to recover fixed costs. Further, the audit found increases in IOU operating costs, which may be inclusive of these other categories, as contributing to increased rates; specifically distribution costs for Pacific Gas and Electric (PG&E), administrative costs for Southern California Edison (SCE), and higher property and non-income taxes for San Diego Gas and Electric (SDG&E). The report also had similar findings to the CPUC on the causes for increasing natural gas rates.

The State Auditor concluded that, while some of the elements contributing to electricity and natural gas rate increases are outside of the control of the CPUC, the commission can better protect customers by implementing improvements to its oversight. The Auditor provided some of the following recommendations, among others, to the CPUC:

1) To promote transparency, institute a process that requires utilities to periodically publish actual rate-of-return calculations, using a methodology acceptable to the CPUC and to PAO;
2) When the actual rate of return significantly exceeds the authorized rate of return, require IOUs to identify the major costs categories where projected costs exceeded actual costs, and publish and analyze this information;
3) Develop an audit procedure that requires, on a sample basis, verification that work was completed as claimed in the IOU's cost recovery application; and
4) Provide to the public a summary of energy rate increases that identifies the previous rate, the new rate, the expected impact on the average customer's bill, and the CPUC-approved drivers of the rate increases.

COMMENTS:

1) *Author's statement.* According to the author, "It's unconscionable that while utility companies are making profit over the permissible rate set by the California Public Utilities Commission (CPUC), Californians continuously see higher gas and electric bills. With the cost of living consistently going up, every dollar counts and Californians should not bear utility costs while utility companies are making record high profits. AB 2666 would require electrical and gas corporations to refund any excess revenues for a prior year to its ratepayers if the CPUC determines that the utility companies made revenues in excess of their authorized rate of return for a prior year."

2) *Soaring profits*. The CPUC prospectively authorizes in the GRC the return on investment, or profit, that an IOU can earn in a given year, called a rate of return. In any given year, a utility's actual rate of return may be higher or lower than the rate the CPUC authorized, depending in part on how the utility manages its operations and costs. According to the State Auditor, beginning in 2013, in nine of the last ten years, SDG&E's actual rate of return was higher than its authorized rate of return, raising questions about the accuracy of their forecasted costs.[2] Although PG&E's actual rate of return has only been higher than its authorized rate of return in one of the last ten years, they recently announced record profits for 2023, earning more than $2.2 billion, a nearly 25% increase from

2022.[8] This announcement came after customers saw their monthly electric bills rise by almost 20% at the beginning of 2024,[9] following the CPUC's approval of rate increases in PG&E's 2023-2026 GRC.[10]

This bill seeks to lower electric and gas bills by requiring any profits a utility earns above its authorized rate of return to be refunded to customers. Opponents of this bill argue that the ability to earn a profit above what is authorized in the GRC incentivizes IOUs to find efficiencies in their processes. However, soaring profits are untenable when nearly a third of households in the U.S. have reported struggling to pay their energy bills; about one in five households have reported consequently forgoing other necessities such as food and medicine; and more than 10% of households reported keeping their homes at unhealthy or unsafe temperatures.[11] As pointed out in the State Auditor's report, SDG&E's ability to earn higher-than authorized rates of return for multiple years and through different general rate case cycles suggests that it may have overstated its forecasted costs during the GRC proceeding, and leads to concerns over whether the CPUC's process for setting revenue requirements is sensitive enough to realize these efficiencies as standard practice moving forward and to self-correct in the following GRC proceeding.

3) *Legal questions. Pacific Telephone and Telegraph Company (PacTel) v. CPUC* (1965) was a Supreme Court case that evaluated the legality of refunding to customers money already authorized by the CPUC for the utilities to collect. In that case, the CPUC had conducted an extensive investigation of the rates charged by PacTel and found them to be unreasonably high. As a consequence, the CPUC fixed new lower rates. In addition, the commission also ordered PacTel to refund its customers all charges collected in excess of the new rate level since the beginning of the investigation. This latter order would have resulted in the new general rate structure taking effect retroactively, which the Supreme Court struck down in favor of PacTel. The Supreme Court has routinely ruled that retroactive ratemaking is beyond the statutory power of the CPUC.[12,13] Such court precedent raises legal concerns around the mechanism proposed by this measure to refund monies authorized by the CPUC and already collected by the IOU.

4) *What else could we do?* As was affirmed in *PacTel v. CPUC*, the CPUC has the authority to fix new lower general rates prospectively when it finds rates unreasonably high, even outside of the normal GRC timelines. However, the lack of any mid-term adjustments to Southern California Gas Company's (SoCalGas) rate of return between 2006 and 2020 when they earned a profit every year in that time period – at a median of 1.64% – and to SDG&E's rate of return between 2013 and 2023 points to a presumable lack of ever using this mechanism in recent decades.[2] With these postulations on the lack of sufficient safeguards for ratepayers at the CPUC brought to light by the State Auditor, it is unclear to this committee how much the "test year" of a GRC cycle stands up to its name as a test. Since the CPUC's decision in each GRC is based heavily on its extensive review of the test year forecasts, *the committee recommends amending this bill to require the*

[8] Mercury News; "PG&E profits hop higher as revenue surges from electricity and gas"; February 2024.
[9] San Francisco Chronicle; "Why are PG&E bills so high? Answers to questions about the rate hike"; February 2024.
[10] D. 23-11-069, CPUC
[11] U.S. Energy Information Administration; "2015 Residential Energy Consumption Survey"; https://www.eia.gov/consumption/residential/data/2015/index.php?view=characteristics.
[12] *Bluefield vs. Public Service Commission* (262 U.S. 679, 692-92 (1923))
[13] *Federal Power Commission vs. Hope Natural Gas* (320 U.S. 591, 602 (1944))

CPUC to review actual utility costs after its test year, including consideration of how much the utility earned compared to the authorized rate of return. The committee recommends an amendment directing the commission to adjust future authorized revenue requirements, as appropriate, based on the actual past costs recorded. Further, in line with recommendations from the State Auditor, the committee recommends amendments requiring the commission establish guidelines and annual reporting obligations on the utilities regarding calculating their actual rate of return.

5) *Related legislation.*

AB 2054 (Bauer-Kahan) would require the CPUC to conduct a reasonableness review prior to a utility receiving rate recovery for any costs recorded in balancing accounts above those authorized in a forecast, and would authorize any costs above the authorized forecast to be allocated between ratepayers and shareholders. Would also require all proposed IOU spending for wildfire expenses that is eligible for rate recovery to include a cost-benefit analysis of the proposed expenses and at least one credible alternative, as specified. Status: *pending hearing* in the Assembly Committee on Appropriations. This bill passed this committee on April 3rd, 2024 with a 12-2-2 vote.

AB 2847 (Addis) would require electric and gas IOUs to provide in their request for capital expenditures their best estimation, alongside supporting documents, of the impact of the proposed expenditures on the utility's authorized revenue for each year of the life of the capital asset, as well as the asset's net present value. Status: *pending hearing* in the Assembly Committee on Appropriations. This bill passed this committee on April 3rd, 2024 with a 13-2-1 vote.

AB 3256 (Irwin) would require the CPUC to annually determine if each memorandum and balancing account has achieved its intended purpose in the previous year. Requires the CPUC to include the status of utilities' memorandum accounts as part of an existing report. Status: *set for hearing* in this committee on April 24th, 2024.

SB 938 (Min) would prohibit electric and gas IOUs from recording various expenses associated with political influence activities, as defined, or with advertising, as defined, to accounts that contain expenses that the IOUs recover from ratepayers. Status: *failed passage* in the Senate Committee on Energy, Utilities and Communications on April 16th, 2024 on an 8-4-6 vote. Granted reconsideration.

6) *Prior legislation.*

AB 1710 (Ta) would have prohibited an electric IOU from proposing a rate increase above the rate of inflation, as a system-wide average, for any given GRC cycle. Status: Died in Assembly Committee on Appropriations.

REGISTERED SUPPORT / OPPOSITION:

Support

Media Alliance
SanDiego350
The Utility Reform Network (TURN)

Opposition

California State Association of Electrical Workers
California State Pipe Trades Council
Coalition of California Utility Employees
Pacific Gas and Electric Company
Southern California Edison
Southern California Gas Company

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