Date of Hearing: April 24, 2024

ASSEMBLY COMMITTEE ON UTILITIES AND ENERGY
Cottie Petrie-Norris, Chair
AB 3256 (Irwin) – As Amended March 21, 2024

SUBJECT: Memorandum and balancing accounts: reports to the Legislature

SUMMARY: Requires the California Public Utilities Commission (CPUC) to annually determine if accounts of public utilities have achieved their intended purpose; and if not, to deny ratepayer recovery of the costs recorded therein and to limit the public utility in using such accounts. Additionally requires the CPUC to include the status of utilities' accounts as part of an existing report.

EXISTING LAW:

1) Mandates the CPUC to require utilities to maintain balancing accounts reflecting the balance between the related costs and revenues whenever the CPUC authorizes a change in rates. Additionally requires the CPUC to take action on any balance remaining during a subsequent rate adjustment. (Public Utilities Code § 792.5 (a))

2) Mandates the CPUC develop a risk-based approach for auditing utility balancing accounts, and to maintain an inventory of the balancing accounts. Permits the CPUC from auditing any balancing account an independent audit has reviewed in the preceding five years. (Public Utilities Code § 792.5 (b)-(f))

3) Requires the CPUC to annually report on the status of its balancing account audit activities, and to share the report publicly, as specified. (Public Utilities Code § 910.7)

4) Mandates the CPUC apply a risk-based approach for auditing records of electrical, gas, telephone, water, and sewer corporations. Requires the CPUC to conduct the review or audit of every electrical or gas corporation at least once every 5 years; and of every high-risk telephone, water, or sewer corporation at least once every 10 years. Allows an audit or review of balancing accounts to fulfil this requirement. (Public Utilities Code § 314.5)

5) Authorizes the CPUC to conduct financial and performance audits of any entity or program created by any order, decision, motion, settlement, or other action of the CPUC and authorizes the CPUC to conduct additional follow-up work that is related to any findings and recommendations related to the audit. Requires that the audit be completed in a timely manner consistent with applicable auditing standards. (Public Utilities Code § 314.6)

6) Authorizes the CPUC to conduct audits or reviews of specified telecommunications funds whenever the CPUC deems necessary, applying a risk-based methodology to reviewing the program-related costs and activities. Authorizes the CPUC to contract with the California State Auditor's Office, the Department of Finance, or another qualified audit firm for any necessary auditing or review services. (Public Utilities Code § 274)

7) Defines "public utility" as every common carrier, toll bridge corporation, pipeline corporation, gas corporation, electrical corporation, telephone corporation, telegraph corporation, water corporation, sewer system corporation, and heat corporation, where the service is performed or commodity is delivered to the public. (Public Utilities Code § 216)

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

BACKGROUND:

Cost Recovery Processes: GRCs, Balancing Accounts, and Memorandum Accounts – Utilities employ a number of accounts to track expenses, both anticipated and unanticipated. Anticipated costs are determined through the General Rate Case (GRC) proceedings at the CPUC. The GRCs evaluate both past expenses and utility forecasts of likely future costs. They cover four years of a utility's anticipated costs. The GRC establishes how much money the utilities are allowed to collect, and a fixed escalation rate is applied to expenses for the subsequent three years captured in the GRC cycle. Once the CPUC authorizes the costs, the costs are allocated to different classes of customers and built into future billing.

Balancing accounts are typically used for costs that are expected and occur on a regular basis, but cannot be estimated accurately. For instance, the Energy Resource Recovery Account (ERRA) is a balancing account that tracks, and utilities are pre-approved to collect, costs of fuel and power purchases. These accounts are subject to audit and adjustment, but do not automatically undergo a reasonableness review. Rather the CPUC authorizes a scope of the recorded activity, and maximum level of acceptable expense, before the utility undertakes the activity.[1] But forecasts are imperfect. If the CPUC authorizes a forecasted amount and also a balancing account for that activity, then when actual costs are higher or lower than the authorized forecast, rates are adjusted up or down to compensate for the forecasting error. For example in data provided to this committee, Edison reported overcollections for their 2019, 2020, and 2023 ERRA; these overcollections were returned to customers.[2] However, 2022 ended with a $1.5

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[1] Functionally, a balancing account tracks the difference between actual expenditures associated with the account, revenue authorized for recovery by the CPUC (authorized revenue requirement), and the actual revenues collected within customer rates to cover those specific expenditures. Applicable rules for a given balancing account are presented in the utility's Preliminary Statement, which also includes a description of the purpose of the account, the types of costs and/or revenues that are to be tracked in the account, and specific accounting procedures that the utility must follow to record transactions in the balancing account. Additionally, unless approved otherwise, a balancing account is required to accumulate monthly interest at a rate equal to one-twelfth of the previous month's interest rate on three-month Commercial Paper published by the Federal Reserve. Actual revenues collected by a utility in rates can be more or less than what CPUC had authorized to collect because rates are always forward-looking and based on forecasted sales. Thus, the balance in a balancing account can either be over-or under-collected. If a balancing account is over- or undercollected, the net balance is typically recovered from or refunded to ratepayers on an annual basis through an adjustment in rates.

[2] Southern California Edison,"ERRA Analysis 2019-2023," March 28, 2024.

billion undercollection, primarily driven by the severe spike in natural gas prices that occurred that winter; customers paid for that undercollection.[3]

Memorandum accounts are used for activities that are likely to be a reasonable use of ratepayer funds. The CPUC does not decide on the reasonableness of the costs recorded in the memorandum accounts; rather they authorize the tracking of costs that *may* be reasonable. Costs recorded in memorandum accounts are subject to a later reasonableness review, with the potential inclusion in rates, but such recovery is not guaranteed. Memorandum accounts are meant to address expenditures that are much less certain than balancing accounts. For example, per statute,[4] utilities record costs incurred in responding to emergencies in Catastrophic Event Memorandum Accounts.

The differences in the account types lie in the timing and certainty of cost recovery. Memorandum accounts require a review of reasonableness before cost recovery is approved. Balancing accounts pre-approve the scope of activities and their associated costs because they are believed to be both certain and reasonable. This allows IOUs to incorporate the costs incurred in balancing accounts into rates as soon as it is practicable for them to do so.

Before the regular use of memorandum and balancing accounts, utilities were at risk of absorbing the cost of unforeseen activities until the next GRC is authorized, a process years in the making. The CPUC has noted to this committee that prior to the use of these accounts, utilities were hesitant to engage in activities unforeseen during the GRC, leading to unnecessary delays. In the current era of decarbonizing our electric and gas sector, and mitigating and responding to climate events, such delays might carry dire consequences.

Balanced Accounting –The CPUC has a responsibility to authorize the rates that regulated utilities may charge their customers. The CPUC does not audit every large balancing account or utility record every year. Statute requires the CPUC to review or audit balancing accounts *periodically* using a risk-based approach, but allows it to forgo the review or audit if an independent auditor has performed a review in the preceding five years. In a 2014 State Auditor report regarding the CPUC's monitoring of balancing accounts, the auditor recommended that the CPUC adopt a risk-based approach to select a sufficient number of accounts to review.[5] This was recommended after the CPUC was found to have not reviewed many balancing accounts over the years reviewed by the auditor, despite a statutory mandate requiring audits at least once every three years.[6] In 2022, the Legislature made the auditor's recommendation of risk-based auditing a requirement.[7]

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[3] *Ibid.*
[4] PUC § 454.9
[5] State Auditor, *California Public Utilities Commission: Improved Monitoring of Balancing Accounts Would Better Ensure that Utility Rates Are Fair and Reasonable.* Report 2013-109, March 2014.
[6] Formerly in PUC § 274, changed under AB 209 (Committee on Budget, Chapter 251, Statutes of 2022)
[7] PUC § 792.5

As directed by statute, the Utility Audits Branch (UAB) utilizes a risk-based approach for reviewing or auditing balancing accounts to ensure that the transactions recording in the balancing accounts are for allowable purposes and are supported by appropriate documentation. According to the CPUC's 2022 Annual Report, as of December 31, 2021, the total population of balancing accounts consisted of 8 energy and 12 water utility companies, encompassing a total of 486 balancing accounts (367 electric and gas, and 119 water).[8] UAB's completed audits seek to ensure that balancing accounts operate within the context of what has been authorized.[9] The CPUC reported UAB completed 45 utility audits in 2023.[10]

In addition to the CPUC's UAB, the California Public Advocates Office (PAO) likewise reviews utility balancing accounts. PAO typically reviews a selection of balancing accounts, usually based on whether the utility requests rate changes related to an account, not based on the size of the account.[11] According to a recent State Auditor report, PAO audited between 35-42 electricity balancing accounts over 3 years, or about 6-33% of each electric utility's balancing accounts.[12]

COMMENTS:

1) *Author's statement.* According to the author, "Since 2015, utilities have sought additional budget authorizations outside of the general rate cases, citing wildfire and energization costs. These requests, once emergency exceptions to utility budgets, have become the norm, and resulted in rate increases of 127% for PG&E ratepayers, 91% for Southern California Edison ratepayers, and 72% for SDG&E ratepayers over the past 10 years. Investor-owned utilities have used balancing and memo accounts to recoup wildfire mitigation costs while simultaneously boasting record profits. Ratepayers can no longer shoulder these exorbitant utility costs and as such, there must be greater oversight of these regulatory accounts."

2) *Financial Icebergs.* PAO, in their role of reviewing utility finances, has noted a growing trend of more utility expenses being recorded outside the GRC in memorandum and balancing accounts. They note over $14 billion in wildfire-related expenses alone have been requested through these accounts since 2020.[13] As noted in a recent State Auditor report, PAO only reviews a fraction of utility accounts.[14] Many utility accounts carry high balances, and do not receive scrutiny until a utility requests recovery for costs in the account.[15] In other words, that $14 billion PAO tracked may be the tip of the financial

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[8] Pg. 69, CPUC 2022 Annual Report, https://www.cpuc.ca.gov/-/media/cpuc-website/divisions/news-and-outreach/reports/annual-reports/ar2022_web_013123.pdf
[9] Pg. 68, *Ibid.*
[10] Pg. 37, CPUC 2023 Annual Report.
[11] Pgs. 53-54, State Auditor, *Electricity and Natural Gas Rates*, August 2023; Report 2022-115
[12] Pg. 53, State Auditor, August 2023, *Ibid.*
[13] Slide 7, presentation of Linda Serizawa, "Affordability Concerns in the Electric Sector," March 6, 2024; Assembly Utilities and Energy Committee hearing, State Capitol Room 437; https://autl.assembly.ca.gov/system/files/2024-03/2-linda-serizawa-pao-assembly-utilities-energy-hearing-final.pdf
[14] Pg. 53, State Auditor, August 2023, *Ibid.*
[15] Pg. 54, State Auditor, August 2023, *Ibid.*

iceberg. The State Auditor report highlights this possibility, noting “reviewing those accounts with significant undercollected balances is prudent and helps to ensure that reported costs are not overstated and do not lead to improper rate increases.”[16] This bill requires the CPUC to annually review every utility account, and determine if the account has achieved its intended purpose. In so doing, the author hopes to provide increased oversight and accountability for these accounts, reversing a growing trend noted by both the PAO and State Auditor.

3) *Broad Strokes.* This bill, in seeking to capture the universe of potential financial accounts overseen by the CPUC, has cast a wide net. It requires the CPUC to annually evaluate every utility memorandum and balancing account. As noted above, the CPUC’s UAB is the primary office to audit utility accounts. However, the UAB is small and reviews accounts in a risk-based approach, as recently mandated by statute.[17] In 2022, this risk-based approach led UAB conduct 34 audits; a fraction of the review needed to cover the 486 balancing accounts operational that year, not to mention the additional memorandum accounts called for under this measure.

   This bill is also inclusive of reviewing the accounts of all “public utilities,” a term which captures every conceivable aspect of public utility service: from toll bridge corporations to pipeline owners, telephone corporations, or sewer system providers.[18] For the CPUC to undertake this effort in the entirety proposed by this bill – *all* accounts of *all* public utilities – would likely take years to complete.[19] To do so annually, as required under this measure, would likely take an unprecedented increase to staff positions at the CPUC; positions which would be paid for by ratepayers.[20]

   Finally, this bill includes review of both balancing and memorandum accounts, and upon a CPUC finding that the intended purpose of the account has not been achieved then the recorded costs will be ineligible for rate recovery. As noted above, memorandum and balancing accounts differ in the timing and certainty of cost recovery. Memorandum accounts require a review of reasonableness before cost recovery is approved. Balancing accounts receive pre-approval of the scope of activities and their associated costs. This bill contemplates an after-the-fact reasonableness review for both account types. Writing in joint opposition, the investor-owned utilities[21] highlight this point, commenting that the bill “misconstrues” utility financing. Because the bill is inclusive of all current and future accounts – including balancing accounts that have already received pre-approval from the CPUC – requiring a reasonableness review for those costs increases risk to these

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[16] *Ibid.*
[17] PUC § 792.5
[18] PUC § 216
[19] Recognizing, of course, that these other utilities likely do not carry the volume, if any at all, of memorandum or balancing accounts as the electric, gas, and water utilities.
[20] PUC § 431-435; establishes the Public Utilities Commission Utilities Reimbursement Account (PUCURA)
[21] Southern California Edison, Pacific Gas and Electric, and San Diego Gas and Electric

utilities' creditworthiness[22] or even presents potential constitutional challenges. Given the author's stated intent for this measure to help alleviate ratepayer costs as well as specific concerns raised regarding the accounting practices of electric utility wildfire expenses, the author may wish to limit this measure to a review of the wildfire balancing accounts of electrical corporations, and in so limiting, remove the after-the-fact reasonableness review currently called for under this measure.

4) *Intents and Purposes.* This bill requires the CPUC to determine whether an account of a public utility has achieved its "intended purpose." However, it is unclear what is meant to be captured in this evaluation. On its face, an account that was established to record utility costs is fulfilling its intended purpose by doing just that: recording costs. Presumably, the desire is for the costs recorded within the accounts to be evaluated to determine whether they were spent in a manner as previously authorized, not double-collected, and still required to serve the need originally requested; in essence, a reasonableness review and a prospective determination of the continued need for the account. The author may wish to clarify the intended purpose for the account review called for under this measure, to best guide the CPUC in its efforts.

5) *Amendments Needed.* This bill seeks to address a growing concern around the growth of IOU balancing and memorandum accounts to record costs outside the GRC. Such activity, while permitted and legal, may lead to unforeseen and volatile increases in rates. There is also a growing concern that utilities may be recording costs in a manner that is hard to track, and difficult to determine whether those costs have already been authorized or collected. As noted in the 2023 State Auditor report, "there is risk that a utility may attempt to include activities in a cost recovery application that are the same as those it already included in a GRC application, thus passing on the same costs to customers twice."[23] The auditor raises utility vegetation management work as a prime example of this possibility, where IOUs have recently been directed to conduct enhance vegetation management, exceeding the previous vegetation management requirements that were authorized in the GRC. The audit notes, "because these activities are similar, clearly distinguishing between the costs that a utility included in its previous GRC application and those costs that it incurred to meet enhanced requirements is not straightforward."[24]

   A March 2022 State Auditor report specifically focused on IOU wildfire spending found evidence for this.[25] The audit notes a CPUC-contract auditor's findings of nearly $2.5 billion in wildfire costs that could either duplicate already authorized costs or require additional documentation from the IOUs to properly evaluate. Following this audit, the CPUC instituted internal procedures to safeguard against duplicative cost recovery. The

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[22] As they may now be carrying millions to billions of costs that are more at risk of not being recoverable.
[23] Pg. 41, State Auditor, August 2023 *Ibid.*
[24] Pg. 42, State Auditor, August 2023, *Ibid.*
[25] State Auditor, *Electrical System Safety: California's Oversight of the Efforts by IOUs to Mitigate the Risk of Wildfire Needs Improvement*, Report 2021-117, March 2022.

2023 State Auditor report noted the CPUC applied these principles to an audit of Southern California Edison's (SCE) 2021 wildfire mitigation and vegetation management costs. The CPUC found that SCE had overstated its expenses and sought to recover unsubstantiated funds, leading the auditor to note "such findings can underscore the importance of scrutinizing cost recovery applications closely." [26]

This bill seeks such close scrutinizing of utility cost recovery applications. However, as noted above, it tries to capture too much at once. Since the author has indicated the chief motivation for this measure is better tracking of utility wildfire expenses, *the committee recommends amendments to narrow the bill to only electrical corporation wildfire and emergency related memorandum and balancing accounts. Rather than an annual determination, the committee recommends amendments to require the CPUC conduct a comprehensive audit of each of these accounts by July 1, 2025; on a one-time, not recurring, basis.*[27] *The committee recommends amendments to clarify denial of cost recovery shall only be for expenses that have already been authorized and collected from customers, thus preventing double recovery. Finally, the committee recommends amendments to allow the CPUC to prioritize high-impact accounts and set up a review schedule should it be unable to meet the July 1, 2025 timeline. The CPUC may contract with outside firms to conduct the audits mandated by these amendments.*

Moreover, this bill makes reference to a nonexistent section of Public Utilities Code. This appears to be a drafting error. *The committee recommends correcting this, by having the annual CPUC account review be consistent with Public Utilities Code Section 739.17, not 739.14.*

6) *Related Legislation.*

   AB 2054 (Bauer-Kahan), among other provisions, requires the CPUC to conduct a reasonableness review prior to a utility receiving rate recovery for any costs recorded in memorandum or balancing accounts above those authorized in a forecast. Mandates that any costs above the authorized forecast, regardless of reasonableness, shall be allocated between ratepayers and shareholders, with the ratepayers responsible for no more than 50% of the costs. Status: *pending hearing* in the Assembly Committee on Appropriations, after passage in this committee on April 3rd on a 12-2-2 vote.

7) *Prior Legislation.*

   AB 209 (Committee on Budget), among its many provisions, adopted a risk-based approach for CPUC auditing of balancing accounts. Status: Chapter 251, Statutes of 2022.

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[26] Pg. 43, State Auditor, August 2023, *Ibid.*
[27] As the committee is only aware of the audit of SCE's 2021 wildfire expenses performed under this enhanced scrutiny to date

AB 1072 (Jim Patterson), modifies statute regarding the CPUC's obligation to audit or review the books of the electric, gas, heat, telegraph, telephone and water corporations it regulates. Status: Chapter 448, Statutes of 2019.

REGISTERED SUPPORT / OPPOSITION:

Support

Sonoma Clean Power

Oppose

California State Association of Electrical Workers
California Water Association
Coalition of California Utility Employees
Pacific Gas and Electric Company
San Diego Gas & Electric
Southern California Edison

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