

**Senate Budget and Fiscal Review—Senator Mark Leno, Chair
SUBCOMMITTEE NO. 2**

Agenda

**Senator Jim Beall, Chair
Senator Jim Nielsen
Senator Hannah-Beth Jackson**



**Thursday, April 25, 2013
9:30 a.m. or Upon Adjournment of Session
Hearing Room 2040**

Consultant: Catherine Freeman

Items Proposed for Vote-Only

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Items Proposed for Discussion

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Resources—Environmental Protection—Energy—Transportation

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DEPARTMENTS PROPOSED FOR VOTE ONLY

0555 Secretary for Cal-EPA

- 1. Transfer of the Office of Education and the Environment to the Department of Resources Recycling and Recovery (CalRecycle).** Pursuant to Chapter 39, Statutes of 2012 (SB 1018, Leno), this proposal transfers the Office of Education and the Environment from the Secretary's office at Cal-EPA to CalRecycle. The proposal shifts 10 positions and associated funding for the program.

Recommendation: APPROVE Item 1.

Vote:

3720 California Coastal Commission

The California Coastal Commission, following its initial creation in 1972 by a voter initiative, was permanently established by the State Coastal Act of 1976. In general, the act seeks to protect the state's natural and scenic resources along California's coast. It also delineates a "coastal zone" running the length of California's coast, extending seaward to the state's territorial limit of three miles, and extending inland a varying width from 1,000 yards to several miles. The commission's primary responsibility is to implement the act's provisions, including regulation of development in the coastal zone. Additionally the Commission serves as the state's planning and management agency for the coastal zone. The commission's jurisdiction does not include the San Francisco Bay Area, where development is regulated by the San Francisco Bay Conservation and Development Commission.

Governor's Budget. The Governor's Budget includes \$17.8 million for the operation of the Coastal Commission. This is a reduction of \$300,000, mostly reflected in the completion of a significant data project at the Commission.

Items Proposed for Vote-Only

- 1. Coastal and Marine Education Whale Tail License Plate Program.** The Governor's Budget requests \$357,000 from the Coastal Beach and Coastal Enhancement Account (funds derived from the sale of Whale Tail license plates) for grants to nonprofits and government agencies consistent with its strategic program.

Recommendation: APPROVE Item 1.

Vote:

*Items Proposed for Discussion***1. Adapting to Climate Change—Commission Responsibilities**

Background—Land Use Planning in the Coastal Zone. Land use planning in the coastal zone, as in the rest of the state, is the primary responsibility of local governments. However, the Coastal Act imposes a number of requirements on land use in the coastal zone. Most significantly, the act requires local governments to adopt Local Coastal Programs (LCPs) to govern development of land in their jurisdictions that lie within the coastal zone.

In preparing to develop LCPs, many local governments have chosen to divide their coastal zone territory into several segments. This is done when a local government's coastal jurisdiction encompasses several distinct regions with different land use issues. A separate LCP is developed for each coastal segment. There are currently 128 coastal segments within the 76 coastal cities and counties.

An LCP must contain (1) a land use plan and (2) zoning ordinances to implement the land use plan. In general, LCPs must be designed to ensure maximum public access to the coast, provide recreational facilities, protect the marine environment, and otherwise promote the goals and objectives of the Coastal Act.

The Coastal Commission reviews and certifies LCPs for conformity with the act. As originally passed, the act required all local governments in the coastal zone to have submitted LCPs to the commission by January 1, 1980. However, this deadline has been extended several times, and today some jurisdictions still have not submitted LCPs to the commission.

The Commission's status of LCP review includes:

- 92 LCP segments are certified.
- 79 of 92 certified LCP segments (86 percent) were certified more than 20 years ago.
- 24 of 92 certified LCP have been comprehensively updated.

Sea Level Rise Adds Complexity. As has been seen throughout the country with Hurricane Sandy, as well as the recent "king tides" (very high tides) in Southern California, much of the developed California coast is susceptible to the impacts of sea level rise. In recent events, high tides inundated parts of the Pacific Coast Highway, Huntington Beach and other low-lying areas of Southern California. Parts of the San Francisco Bay Area also experienced flooding, including portions of Highway One in Marin County. These very high tides are considered a good indicator of the possible impacts of sea level rise and create challenges for local planners and developers in low lying areas.

Many of the areas without certified LCPs are at sea level, with significant development. These include most of the City of Los Angeles, including the airport, as well as parts of San Pedro and Venice. Also among the non-certified LCPs are the Santa Ana River, San Diego's Mission Bay and the City of Santa Monica.

Staff Comments. The Coastal Commission has maintained a steady budget over the past several years but has struggled to make progress in updating LCPs. There are many reasons for this including (1) funding has not been available to assist local jurisdictions in updating their coastal plans; (2) some locals are reluctant to take back coastal permitting and prefer to have the state provide this service; and, (3) recent local funding issues have, as with other areas of government, reduced their ability to do forward thinking planning.

Sea level rise has added urgency to the issue of outdated, incomplete and uncertified LCPs. Local planning and preparation are critical if the State is to maintain its coastal development zones and prepare for possible inundations. Creating a local plan is part of every coastal jurisdiction's responsibility to determine how to preserve life and property along the California coast.

Questions for the Commission. The Commission should address the following questions in their opening statement.

- The commission cannot continue to be the coastal permitting agency for 36 jurisdictions along the California coast, particularly in light of sea level rise. How would the commission proposed to close this gap and help the remaining local entities to update their LCPs?
- What concerns does the commission have about sea level rise, particularly in areas where LCPs have not been certified?
- What would it take to make significant progress in updating and approving these LCPs and how do we ensure that those without certified LCPs move to certify?

Recommendation: Informational Item.

Vote:

8660 California Public Utilities Commission

The California Public Utilities Commission (CPUC) is responsible for the regulation of privately owned "public utilities," such as gas, electric, telephone, and railroad corporations, as well as certain video providers and passenger and household goods carriers. The PUC's primary objective is to ensure adequate facilities and services for the public at equitable and reasonable rates. The PUC also promotes energy conservation through its various regulatory decisions.

Governor's Budget. The Governor's Budget proposes \$1.4 billion and 1,053 positions to support the CPUC in the budget year.

Items Proposed for Discussion

1. Update on Safety Oversight

Last year, the California Public Utilities Commission (CPUC) came to the Legislature with its "Global Safety" budget change proposal, claiming the San Bruno explosion was a "game changer" with regard to how the CPUC viewed its safety responsibility. The Legislature approved 22 positions to strengthen safety oversight and enforcement over gas, electric, communications and rail public utilities.

Background. On September 9, 2010, a natural gas transmission pipeline, owned and operated by Pacific Gas and Electric (PG&E), ruptured in a residential area in the city of San Bruno, California. The accident killed eight people, injured many more, and caused significant property damage. The released natural gas ignited sometime after the rupture and the resulting fire destroyed 37 homes and damaged 18 others.

Prior to the San Bruno explosion, the CPUC's safety staffing levels reflected its expectation that utilities inherently recognize public safety as their top priority. Thus, the CPUC focused on fulfilling its own state and federal mandates, primarily through audits, inspections, and after-the-fact investigations, conducted within industry-specific programs, in a reactive mode. The CPUC stated that San Bruno "was a game-changer in terms of how the commission intends to conduct critical safety oversight going forward. Recommendations from gas safety experts, the Independent Review Panel (IRP or Panel) and the National Transportation Safety Board (NTSB), as well as our own lessons learned, apply across all industries under our jurisdiction."

California's energy and transportation systems are antiquated, overloaded, prone to accidents, and need closer scrutiny. The majority of the electrical system was installed in the 1950s and 1960s, which means such facilities are nearing the end of their useful lives. Generators, poles, wires, pipelines, and tracks constructed in lightly populated areas in the 1950s, are now surrounded by homes, parks and schools. For example, PG&E installed the San Bruno gas transmission line in 1956, well before housing development in the area.

Safety Culture Investigation. Last year, the CPUC admitted that policy objectives took priority over safety, prior to the San Bruno explosion. CPUC's reactive safety strategy, premised on the assumption that utilities recognized public safety as their top priority, was inherently misguided. Both the NTSB recommendations and the IRP report validated the need for a comprehensive relook at natural gas pipeline safety and additional activities and resources at both the State and Federal level to ensure safe operation and support comprehensive safety program reform.

In the Fall of 2012, the CPUC engaged an independent consulting firm, for an undisclosed amount, to facilitate its "Safety Culture Change" project. This project began with an initial discovery phase, which consisted of a document review, interviews and focus groups. The purpose of this phase was to uncover the existing culture, identify culture changes needed, and to develop a draft problem statement that would allow the CPUC to plan its culture change strategy.

A report of this discovery phase was released to the CPUC on January 25, 2013. It identifies significant cultural problems at the CPUC and a fundamental failure of leadership. The report strongly suggests that safety concerns continue to be a secondary priority at the CPUC and this message is transmitted from leadership to staff and the utilities it regulates. Through months of focus groups and interviews with employees, the report identifies a few of the prevailing perceptions of the employees at the CPUC:

- "For the past ten years we have been mostly focused on climate change policies. Everything else takes a back seat. We have not been focused on creating the safety infrastructure."
- "There has been a lot of lip service to safety. I have not seen enough action yet to back up the talk."
- "When Commissioners vote, they don't support safety, so there's no incentive for the utilities to be safer. If they knew they were 100 percent liable for safety problems, they'd take it more seriously. If the commission lets them put the burden on ratepayers, rather than shareholders, there is no incentive for the utilities to change."

The core mission of the CPUC is to ensure "safe, reliable utility service and infrastructure at reasonable rates." In the past several years, the CPUC has focused on other non-statutorily directed activities, including the Electric Program Investment Charge (EPIC), the Climate Change Institute, grants of ratepayer funds to Lawrence Livermore Laboratory, and implementing the 33 percent Renewables Portfolio Standard (RPS) several years prior to Legislative direction. Results of the San Bruno explosion investigation revealed that the CPUC was unaware of PG&E's under-spending on gas safety measures. In so directing resources to unauthorized activities, the CPUC has neglected its statutorily and constitutionally-mandated core functions to ensure compliance with safety requirements.

Staff Comments. This issue provides a basis for discussion of several items in the agenda that following. While there may be a response to the issue of prioritizing safety, it seems clear that the CPUC has spent considerable time on some policy objectives while deprioritizing critical functions such as safety, budgeting, and basic ratemaking. In meetings with staff of the CPUC, generally the discussion focuses on requests for more positions at all levels because, for example, when proceedings come up, there are not enough administrative law judges to hear cases, or not enough individuals to budget. These requests make it seem as though the CPUC is short-staffed, and unable to complete its basic core functions. As will be discussed under other items, staff suggests the CPUC is fully staffed and rather would better serve the public and its mission by eliminating unnecessary and extracurricular policy projects and focus its staff from top to bottom on its core mission—safety oversight and ratemaking.

Recommendation: Informational Item.

2. Public Utilities Commission Performance Audit

Background. On January 10, 2013, the Department of Finance (DOF) Office of State Audits and Evaluations (OSAE) released its performance audit of the CPUC budget process. The audit identified significant weaknesses with CPUC’s budget operations that negatively affect the commission’s ability to prepare and present reliable and accurate budget information. Specifically, the audit found that:

- The organizational structure of CPUC does not facilitate cohesive budgeting practices.
- The CPUC’s budget forecasting methodologies produced results that differed significantly from actual results, with most of these differences unexplainable.
- Cases of fiscal mismanagement in which accounting records for certain funds were misrepresented and incorrect. For example, OSAE identified records that did not include certain fund transactions that ranged from roughly \$40,000 to \$275 million.
- The CPUC’s reconciliations of certain funds—where there were differences between DOF and State Controller’s Office records—were inaccurate. (In order to reconcile current year, as well as past variances, the Administration made total budget adjustments in the hundreds of millions of dollars.)
- According to the audit, CPUC must implement and strengthen the fiscal controls over its budgeting practices and procedures in order to produce reliable and accurate budgetary information for the Governor, the Legislature, DOF, and other stakeholders.

Governor’s Proposal. The Governor requests \$210,000 and 3 positions to provide budget support to the CPUC, including internal budgeting allocations and expenditure monitoring reporting.

LAO Concerns. The LAO reviewed the audit and found that in addition to the questionable internal budgeting functions, external auditing functions were also deficient. Specifically:

“We find that the above OSAE audit raises several issues that merit legislative oversight, in order to ensure that CPUC’s budget process becomes more transparent and accurate. We also note that the audit’s findings regarding problems with the commission’s internal budgeting and accounting practices raise questions about CPUC’s ability to effectively audit the records and accounts of the utilities that it regulates. Under current law, CPUC is required to audit at least once every three years utility “balancing accounts.” (Balancing accounts are authorized by the CPUC for specific projects, programs, or other requirements that the utility must implement in accordance with CPUC decisions.) These accounts are established by the utilities and used to track revenues and expenditures for such activities as electricity procurement, energy efficiency programs, and the EPIC program.

Balancing accounts help to ensure that ratepayers only pay CPUC-authorized amounts and that the utilities will be able to recover the amounts needed to support their revenue requirements or costs. If a utility receives more revenue than is needed from ratepayers, then ratepayers receive a credit. Alternatively, if the utility has not received enough revenue, then ratepayers will be required to pay more to make up the difference.”

Initial Legislative Response. The chairs of the Senate Budget Subcommittee #2, Assembly Budget Subcommittee #3 and the chairs of both the Assembly and Senate energy and utilities committees wrote a letter to the Joint Legislative Audit Committee recommending further audits of the CPUC’s external auditing functions. Specifically, the question of balancing accounts and monitoring of the Investor Owned Utility funds was questioned.

Staff also performed a statutory review of the pertinent sections of code. Of relevance, Public Utilities Code (PUC), Section 314.5 states:

“The commission shall inspect and audit the books and records for regulatory and tax purposes (a) at least once in every three years in the case of every electrical, gas, heat, telegraph, telephone, and water corporation serving over 1,000 customers, and (b) at least once in every five years in the case of every electrical, gas, heat, telegraph, telephone, and water corporation serving 1,000 or fewer customers. An audit conducted in connection with a rate proceeding shall be deemed to fulfill the requirements of this section. Reports of such inspections and audits and other pertinent information shall be furnished to the State Board of Equalization for use in the assessment of public utilities.”

Staff Comments. The OSAE follows years of questions brought to the CPUC on: (1) its ability to manage funds; (2) the use of staff for policy purposes while budget monitoring seemed to be missing; and, (3) questions about fund balances on the many off-budget accounts managed by the CPUC.

In meetings with budget staff, CPUC executives attempted to divert responsibility for its external auditing functions to the Division of Ratepayer Advocates (DRA). (DRA will come before this committee under a separate item). However, as the LAO points out, the CPUC must audit utility balancing accounts (external accounts) every three years. The CPUC executives attempted to state that the DRA is required to conduct these audits with positions that have been approved by the Legislature over the years. After a review of statute, it is clear that statute authorizes the DRA to conduct audits in order to objectively review the CPUC’s ratemaking cases. It is also clear that should DRA conduct an audit, the CPUC may use this in its evaluation of the utilities. However, nowhere in statute does it say that the DRA is responsible for conducting the every-three-year audits required by Section 314.5.

There remain several questions for the CPUC. Among them is the clear question of why budgeting is given such a low priority at the executive level of the Commission. The CPUC maintains that one person manages budgets for the over 1,000 person department, including managing funds for all of the relevant accounts maintained. This seems both highly unlikely and highly suspect.

The basic checks and balances seem to be missing, more so than in any other agency brought before this subcommittee. In most cases, the CPUC says that those responsible for budgeting were given “other policy duties” that subsumed their jobs. Culpability seems to remain at the highest levels of the agency, rather than line staff. The development of policy, rather than the execution of the core mission of the CPUC, will be discussed in the next agenda item.

Staff are reluctant to recommend approving additional positions for the CPUC. This issue, combined with others on this agenda, does not paint a picture of a capable state agency, particularly one whose responsibilities go far beyond simple rate-setting but rather to the core of safety in utilities, transit and rail. However, it seems clear that the CPUC does not have any budget staff with the exception of the recent hire of a budget administrator (whose recent promotion leaves no dedicated budget staff at the CPUC). Normally, in circumstances such as these where a need is clear but questions remain about the functions of the department, staff recommends limited-term positions. In this case, that recommendation might result in the hiring of lesser-caliber individuals who may not be able to manage the significant problems presented by the CPUC budget. Staff will reserve its recommendations for executive staff until a later agenda item.

It is apparent that the CPUC personnel, who were supposed to be maintaining budgets for the agency, were likely added more than 10 years ago and converted to other purposes over the years. Therefore, it seems clear that a reduction in staffing corresponding to the increase in budget staff is necessary. Staff recommends three positions in CPUC be made limited-term for one year and that these positions be made eligible for conversion to permanent only after a full review the CPUC’s budgeting functions in the forthcoming year. These positions should be at the program administration level.

Questions for the Agency. The CPUC should address these questions in their opening statement:

- The CPUC has consistently maintained that it has never received budget staff; however, in the current Salaries and Wages there are a number of positions that could be budget-related. Many of these were approved many years ago as the divisions were established. What impact has the conversion of budget-related positions to policy had on the CPUC and could these audit findings have been prevented with some simple budgeting and accounting directed by executive staff?
- Describe the corrective actions that the CPUC will take to correct this problem in the forthcoming years. Does the commission believe that a lack of internal controls and fiscal management compounded other problems that the Commission is currently facing?

Recommendation:

- (1) **APPROVE** budget proposal as budgeted.
- (2) **CONVERT** three program administration level positions to one-year limited-term until such time as the CPUC can demonstrate the disposition of its original budget positions.

Vote:

3. Trusts and Entities Created by the PUC

Background. The CPUC is entrusted with rate-making at investor-owned utilities. Within this capacity, the CPUC reviews current policy and attempts to set rates in a manner that is forward thinking and in compliance with the terms of state law. In recent years, the Commission has extended its reach a number of times beyond its rate-making capabilities, spending considerable time and effort to create entities that use ratepayer funds but are outside the state budget process. It is common for Commissioners or their designees to serve on these nonprofits as board members, officers, or advisors. In many of these cases, the Legislature has stepped in to stop these practices. This issue was highlighted in the adoption of a report annually to the legislature (PUC Section 326.5) in 2008, wherein the Legislature required the Commission to report on expenditures from specific non-budget entities established by the CPUC.

Lawrence Livermore National Laboratory (\$150 Million Project). In July 2011, the CPUC sought authority to increase customer rates to recover more than \$150 million for research conducted by Lawrence Livermore National Laboratory (LLNL) for a five-year cooperative research and development agreement entitled “California Energy Systems for the 21st Century Project,” (CES-21 Project). The CPUC issued a decision in late 2012 authorizing the utilities to enter into the agreement, and to provide the CPUC with a list of proposed projects annually. The utilities would be exempt from anti-trust laws. There was no competitive solicitation for this project or consideration of other currently pending proposals at both the Legislature and the CPUC, such as the Public Goods Charge and the Electric Program Investment Charge.

Commissioners Directing Programs Outside Ratemaking Process. It is clear from the public record of the CPUC proceedings that this proposal was not only directed by the CPUC, but that for more than a year prior to the application’s submission, the president of the CPUC worked with the utilities and LLNL to develop the proposal. The president, as revealed in now-public email records, oversaw the shaping of the proposal and calling it the “overall grand project with all three energy utilities.” The entirety of this project would be undertaken outside the State’s budget process, with utilities required to send their contributions directly to LLNL, with no state review.

Upon developing the proposal, the president of the CPUC assigned the approval of this project to himself. He then approved the proposal in its entirety.

Circumvention of Legislative and Budget Process. The CPUC has crossed the line between budget and policy, both of which are the purview of the Legislature. The CPUC in its quasi-legislative capacity, has attempted to usurp the Legislative branch’s prerogative to determine what future projects and policies make sense. The major five-year proposal described above should be vetted in the Legislature, either in a policy bill or in the budget process. The manner in which this project was approved would circumvent both of these processes and effectively challenge the notion of checks and balances.

Staff Comments. As will be discussed in a later agenda item, this is not the first or the only proposal the Commission has approved recently that circumvents Legislative authority. At the same time, the CPUC annually requests multiple positions to continue its work. It would seem that the establishment of these programs and policies that circumvent legislative authority, including all research, proceedings and Administrative Law Judge time should be considered an extracurricular activity of the CPUC and as such, subject to budget reduction. Not only should the use of CPUC staff and time be subject to legislative review, they also should be subject to Legislative approval through the policy process.

Questions for the Agency. The CPUC should address these questions in their opening statement:

- What other projects is the CPUC currently considering that would either direct utilities to establish programs outside of Legislative purview or would establish a nonprofit without the approval of the Department of Finance ?
- What was the role of the other commissioners in establishing this proposal?

Recommendations:

(1) **APPROVE** a request to the Fair Political Practices Commission to review the CPUC practice of directing, adjudicating and approving the establishment of nonprofits for possible conflict of interest or bequest violations.

(2) **APPROVE** trailer bill language halting the establishment of California Energy Systems for the 21st Century Project (Lawrence Livermore) and to refund all ratepayer funds that have been directed to this project.

3) **APPROVE** trailer bill language that prohibits the CPUC from creating non-state entities through decisions, settlements, rules, orders, or mergers.

5) **APPROVE** trailer bill language that prohibits the CPUC from awarding contracts to nonprofits in which a sitting commissioner serves as an employee, officer, or director.

6) **APPROVE** trailer bill language that prohibits CPUC commissioners from serving on commission-established non-state entities.

Vote:

4. Energy Program Investment Charge (EPIC)

Background. In December 2011, funding for the state's Public Goods Charge (PGC) on electricity ratepayers expired. The PGC funded energy efficiency research and development and renewable energy programs. Efforts to continue the surcharge, which requires a 2/3 vote of the Legislature failed. The charge, considered a tax for voting purposes, supported about a quarter of the total energy efficiency programs funded by the state and energy utilities.

In September 2011, the Governor sent a letter to the CPUC requesting that they take action under its quasi-legislative authority to ensure that programs, like those funded under the PGC, would be continued, but with the modifications legislators discussed during the PGC renewal deliberations. In December 2011, the CPUC initiated a rulemaking (essentially started a pathway to a new policy) to continue the programs similar to PGC, with a sole focus on the investor-owned utilities (IOUs). The commission planned a two-phased deliberation. The first phase addressed the appropriate funding levels for renewables and research and development. The second phase, currently under way, creates a detailed program.

2012 Budget Action. In the 2012 Budget, the Legislature approved \$1 million from the EPIC and 4.5 positions specifically to complete an investment plan for the future appropriations from this charge, established for the CPUC (and also described above) in the 2012 budget. Considerable thought was given to this appropriation given as was established administratively. Specifically the budget trailer bill requires the CPUC to administer the fund, and funds are required to be collected by the CPUC and forwarded to the CEC for administration. The budget trailer bill language specifically did not authorize the levy of this charge at the CPUC or increase the amount collected for an existing charge.

Governor's Overall 2013-14 EPIC Proposal. The Governor requests baseline authority for 55.5 position, \$575,000 in technical assistance funds and \$159.3 million in project funds for the implementation and execution of the EPIC program (the majority of which will be discussed under a separate agenda item within the California Energy Commission). The proposal includes an additional \$25 million in EPIC Funds the CPUC may approve for the New Solar Homes Partnership program. Proposed expenditures would roughly be broken out with \$76 million for applied research, \$62 million for demonstration and deployment, and \$20 million for market facilitation. All funding for the programs would be derived from utility ratepayers. The program would increase to \$185 million in 2014-15.

The proposal continues to assume that the EPIC Program will be developed fully by the CPUC, who would then direct the CEC programs related to EPIC. The Legislature would essentially be approving programs already developed by the CPUC. In addition, the CPUC could develop programs and activities by the investor-owned utilities that would not be subject to legislative budgetary review.

Circumvention of the Legislature. As will be discussed under the California Energy Commission items, the state currently spends over \$1 billion per year on energy efficiency programs, most of this derived directly from utility ratepayers. In developing the EPIC Program at the CPUC, the Administration purposefully bypassed the Legislature after the failed reauthorization of the Energy Public Goods Charge. The Legislature should consider whether or not the CPUC is the appropriate

place to allow new policies to be developed, including those that increase costs to energy customers in the state. Is it appropriate for one state agency to develop programs for another state agency without statutory approval by the Legislature? If so, what would stop the CPUC from developing any number of off-budget activities without statutory approval?

The EPIC program continues funding for activities that were authorized by two-thirds vote of the state Legislature. These original funds were approved as a tax for basic activities such as research and development. This new program did not have such authorization. The CPUC should describe the nexus between the program activities and fee payers, based on fee versus tax-related case law. The Administration also has not submitted a plan for proposed expenditures under the EPIC program as required by the 2012 budget. Therefore, there is little review for the budget change proposal.

Governor's Proposal (CPUC). The budget requests \$88,000 and one position to oversee the EPIC program development at the CPUC.

Staff Comments. As with the previous item, this proposal undoes the balance of authority between the three branches of government by bypassing the Legislature. As such the policy has not been vetted in a legislative hearing, rather through the ratemaking processes of the CPUC. The position requested seems quite unnecessary since it is clear the CPUC redirected multiple internal staff to develop the program, review comments from stakeholders, develop the regulatory policy and framework, and to adjudicate the ratemaking case.

Questions for the Agency. The department should address these questions in their opening statement:

- What is the status of any lawsuits on this item and what is the nature of the complaints?
- Statute requires the utilities to direct funds to the CPUC for transfer to the CEC. In meetings with legislative staff, this did not seem to be the case. Describe the discrepancy.

Recommendation:

- (1) **DENY** the proposal.
- (2) **REQUIRE** the CPUC to account for all personnel hours used to develop and adjudicate this program, including at the commissioner level.

Vote:

5. Expanding Policy Programs at CPUC—Demand-Side Program Facilitation and Expansion

Governor’s Proposal. The Governor requests one position and \$88,000 from the PUC Utilities Reimbursement Account to enable the growth and integration of demand response into wholesale markets.

Staff Comments. Based on the overabundance of staff and time to develop policies outside of the legislative process, staff recommends the commission absorb the costs of this proposal.

Recommendation: DENY proposal.

Vote:

6. Administrative Law Judge Support for Recent Legislation

Governor’s Proposal. The Governor requests two administrative law judge (ALJ) positions and \$231,000 from the PUC Utilities Reimbursement Account to implement the requirements of recently passed legislation.

Staff Comments. Based on the overabundance of staff and time to develop policies outside of the legislative process, staff recommends the commission absorb the costs of this proposal and redirect current ALJ positions to appropriately focus on statutory requirements.

Recommendation: DENY proposal.

Vote:

7. High-Speed Rail Oversight

Governor's Proposal. The Governor requests 3.0 positions and \$330,000 from the Public Transportation Account, State Transportation Fund, to oversee the design and construction of California's new High-Speed Rail system. The CPUC is required to oversee rail safety systems in California including the High-Speed Rail system. The CPUC requests staff to review design, construction and operation of equipment, and associated electrical facilities.

LAO Recommendation. Reject proposed funding for CPUC.

“Our analysis finds that the requested funding for CPUC to develop high-speed rail regulations is premature given the reality that California's high-speed train service will not be in operation before 2021 at the earliest.”

Staff Comments. Staff concurs with the LAO.

Recommendation: REJECT proposal.

Vote:

8660 Division of Ratepayer Advocates (California Public Utilities Commission)

The Division of Ratepayer Advocates (DRA) is an independent division of the California Public Utilities Commission (CPUC) that advocates solely on behalf of residential and small commercial utility ratepayers. As the only state agency charged with this responsibility, DRA plays a critical role in ensuring that the customers of California's investor-owned utilities are represented at the CPUC and in other forums that affect how much consumers will pay for utility services and the quality of those services. DRA's staff of experts performs detailed analyses in the areas of communications, energy, and water to determine the impact that they will have on ratepayers' bills, as well as the impacts on safety and service quality. Additionally, DRA evaluates the environmental impact of regulatory issues and seeks to ensure that any utility actions will comport with CPUC rules and California laws.

Governor's Budget. The Governor's Budget includes \$24.4 million for the operation of the DRA. DRA's staff consists of 137 technical, policy, and financial analysts with professional backgrounds as engineers, auditors, and economists with expertise in regulatory issues related to electricity, natural gas, telecommunications, and water industries in California.

Introduction. The DRA usually comes before this subcommittee under the auspices of the CPUC. However, in recent years considerable tension has emerged in hearings and prehearings between staff of the DRA and the CPUC. Therefore, this subcommittee will hear the DRA as a separate and stand-alone entity to review its budget proposals.

Background. Since its establishment in 1984 by the CPUC and subsequent codification (Chapter 856, Statutes of 1996) as an independent entity within the PUC, the DRA has provided a voice for lower rates at CPUC proceedings and other forums. Various legislative efforts over the years have sought to give the DRA more independence from the CPUC while keeping it as a division of the Commission and therefore allowing it access to information provided during hearings and proceedings. At this time, the DRA is maintained as a division within the CPUC, requesting and reporting its budget through the CPUC executive management. The DRA is also referred to in statute as the Office of Ratepayer Advocates.

Concerns About DRA Budget Processes. As has been discussed in previous agenda items, the CPUC has had considerable problems in its development of the annual budget, creating difficulties for legislative oversight. In order to develop its budget, the DRA submits its budget request to the executive staff of the CPUC which then may adjust this request before final submission to the Department of Finance and Legislature. This process is appropriate for divisions reporting directly to the Executive Director; however, the DRA Director is appointed by the Governor and confirmed by the Senate. Within other state agencies, separate entities are generally either budgeted entirely outside the governing agency or are allotted a clear "line item" annually, that separates the chain of command.

Governor's Proposals. The Governor's budget includes three separate requests for DRA.

1. **DRA Energy Financial Examiners.** Request for two positions and \$151,000 from the PUC Ratepayer Advocate Account to perform audits of energy companies' financial records, in conjunction with General Rate Cases, natural gas proceedings, the Energy Resource Recovery Account, and other proceedings initiated by the CPUC or the investor-owned utilities.
2. **DRA Water Auditors.** Request for two positions and \$151,000 from the PUC Ratepayer Advocate Account to meet the increased workload associated with inspection of water utilities' accounting records. The two positions will be assigned to DRA's Water Branch which has experienced significant increases in both the frequency and complexity of utility rate requests within the past four years.
3. **DRA Gas Safety.** Increase of one position and \$89,000 from the PUC Ratepayer Advocate Account, to accommodate expanding workload related to natural gas safety. This will allow DRA to keep pace in this increasing workload area.

Staff Comments. Staff are concerned about oversight of DRA in the budget process and have concerns about the current structure and management of DRA. There is also some confusion about the name of the Division.

Recommendation:

1. **APPROVE** Items 1-3.
2. **APPROVE** trailer bill language that changes the name of the "Division of Ratepayer Advocates" to the "Office of Ratepayer Advocates."
3. **APPROVE** trailer bill language that requires DRA to submit its budget to the Department of Finance directly.
4. **APPROVE** trailer bill language that allows DRA to employ its own personnel, including attorneys, instead of having them supplied by the CPUC.

Vote:

3360 Energy Resources Conservation Development Commission (California Energy Commission)

The Energy Resources Conservation and Development Commission (commonly referred to as the California Energy Commission or CEC) is responsible for forecasting energy supply and demand; developing and implementing energy conservation measures; conducting energy-related research and development programs; and siting major power plants.

Governor's Budget. The Governor's Budget includes \$486 million (no General Fund) for support of the CEC, a decrease of approximately \$21 million, due primarily to the phasing down of the Public Interest Energy Research (PIER) Program and the Renewable Resources Trust Fund (RRTF) as a result of the failure to reauthorize the Public Goods Charge.

Items Proposed for Vote-Only

- 1. Finance Letter—Appliance Efficiency Database Modernization.** The budget requests \$2.4 million to replace the current system with an automated system to allow manufacturers to electronically complete and submit necessary applications and appliance data. This proposal is supported by a completed Feasibility Study Report.
- 2. Conversion of Two Limited-Term Positions to Permanent.** The budget requests authority to convert two limited-term positions to permanent to continue implementation of the ongoing and permanent solar electric mandates in Chapter 132, Statutes of 2006 (SB 1, Murray). These positions were originally made limited-term in 2007 and extended twice, based on ongoing workload associated with the legislation.

Recommendation: APPROVE Items 1-2.

Vote:

Items Proposed for Discussion**1. Public Goods Charge Ramp Down**

Governor's Proposal. The Governor's budget identifies the reduction of nine positions (\$980,000) and the elimination of new project funding in response to the January 1, 2012 sunset of the authority to collect the Public Goods Charge (PGC) on January 1, 2012. As a result, no additional funds were collected after January 1, 2012, and the duties and positions necessary to administer the Renewable Energy and Public Interest Energy Research Programs are required to ramp down.

Proposed Ramp-Down. Beginning in 1996, a series of legislative efforts have authorized ratepayer funding to increase the proportion of research and development, renewable energy, and energy efficiency servicing California utility customers. Following the failed renewal of the PGC, the CEC must reduce activities in the following areas:

- Renewables Facilities Programs
- Emerging Renewables Program
- Consumer Education Program
- New Solar Homes Partnership
- Public Interest Energy Research Program

Because funding for many of these programs creates an ongoing workload, the PGC ramp-down is anticipated to take several years.

Questions for the Commission. The department should address these questions in their opening statement:

- How long will the PGC ramp-down take?
- What are the direct impacts of the reduction of these funds on current programs and is there any effort to renew the PGC through statute?

Recommendation: APPROVE proposal.

Vote:

2. Implementation of the Electric Program Investment Charge (EPIC) and Energy Efficiency Programs Statewide

BACKGROUND:

During the 2012 session, the Legislature considered multiple policy and budget proposals to increase energy efficiency and its funding. These included an Administration proposal to reinstate the Public Goods Charge through a California Public Utilities Commission (CPUC) rulemaking process (discussed below under the Electricity Procurement Investment Charge header), various greenhouse gas emission reduction programs that target energy programs, and renewable energy bills.

Given what seemed to be an abundance of existing energy-efficiency programs, the 2012 budget required the LAO to review energy efficiency programs throughout state government and to provide both (1) a list of all programs and funding related to energy efficiency and alternative energy, and (2) provide a preliminary assessment of these programs in terms of priority, overlap, and redundancy. The LAO report is partially summarized in this analysis on current energy efficiency budget issues.

Summary of State Energy Efficiency and Alternative Energy Programs

Program Category	2012-13	Cumulative Funding to Date
Energy Efficiency (Investor Owned Utility, federal funding and state financing programs)	\$1 billion	\$9.5 billion
Renewable Energy (Public Interest Renewable Energy Program, Go Solar California Program, Self-Generation Incentive Program, And Clean Energy Upgrade Financing Program)	\$317 million	\$4.2 billion
Advanced Transportation and Low-Carbon Fuels	\$250 million	\$683 million
Energy Research	\$44 million	\$556 million
Totals	\$1.6 billion	\$15 billion

a) Source: Legislative Analyst's Office, 2012

In no less than 10 separate programs, and spanning five state departments, over \$1.6 billion was spent directly on energy efficiency and alternative energy programs. Cumulatively, to date, nearly \$15 million has been spent by the state. The vast majority of funding for these programs comes from utility ratepayers. Most of these programs are located in three state departments: the CPUC, the California Energy Resource Conservation and Development Commission (CEC), and the California Alternative Energy and Advanced Transportation Authority.

NEW PROGRAMS AND THE BIGGER PICTURE:

Cap and Trade Funding. In the near future, new funding will be available to support programs as a result of the state's cap-and-trade auctions, a tool to reduce greenhouse gas emissions (GHG). As part of the Global Warming Solutions Act of 2006, commonly referred to as AB 32, the goal of reducing greenhouse gas emissions to 1990 levels by 2020 was established in statute. AB 32 revenues generated from the auctions constitute a mitigation fee, and a nexus must exist between an activity for which the fee is paid and the adverse effects related to the activity on which that fee is levied. Therefore, in order for their use to be valid as mitigation fees, revenues from cap-and-trade auctions must be used only to mitigate GHG emissions or the harms caused by these emissions. A number of the existing energy efficiency and alternative energy programs currently also have a focus on GHG emission reductions. It is conceivable that the new auction revenues could either supplant or be used in addition to funding for these existing programs. The Governor has not released his expenditure plan for auction credits and therefore it is unknown what the budget proposals may entail.

Proposition 39, passed in November 2012, eliminates the ability of multi-state businesses to choose the way in which their taxable income is determined. As a result, some corporations will pay higher taxes, resulting in projected revenues of \$1 billion per year. Under the measure, half the annual revenues—up to \$550 million—will be deposited into a new Clean Energy Job Creation Fund to support projects intended to improve energy efficiency and expand the use of alternative energy for a five-year period (2013-14 through 2017-18). The Legislature will determine spending from the fund and is required to use the monies for cost-effective projects run by agencies with expertise in managing energy projects. These projects must also be coordinated with the CEC, CPUC, and with a newly-established nine-member oversight board to annually review spending from the program. Proposition 39 requires funds to be used to support:

- Energy efficiency retrofits and alternative energy projects in public schools, colleges, universities, and other public facilities;
- Finance and technical assistance for energy retrofits; and,
- Job training and workforce development related to energy efficiency and alternative energy.

Why State Program Funding is Not the Whole Picture. One cannot review energy efficiency in the state solely on the basis of state-funded programs. In addition to programs where funding is managed through state agencies, other actions and agencies impact our state's overall energy efficiency and may have had even more profound effects. For example, both the state and federal government have building standards that reduce energy usage in all new construction. Appliances have minimum energy standards and a federal "energy star" program that allows consumers to compare and choose energy efficient products. Commercial buildings, outdoor lighting and many other areas of energy are regulated by both state and local agencies. In many cases, locals may go further than the state. Local water and energy utilities (those local entities that provide water and energy directly to customers), also have programs designed to reduce energy usage—including many programs independently not managed by the state.

GOVERNOR'S PROPOSAL:

Proposition 39. The Governor's budget includes all of the revenue derived from proposition 39 in the calculation of the education Proposition 98 minimum guarantee. The budget proposes to use that funding for energy efficiency projects at schools and community colleges. This was discussed at length in the Senate Budget Joint Hearing of Subcommittees #1 and #2 on April 4, 2013.

Electricity Procurement Investment Charge (EPIC). The Governor's proposal for EPIC is discussed on page 15 of the agenda.

ISSUES TO CONSIDER:

LAO Analysis and Recommendations. The LAO reviewed the various energy efficiency and alternative energy programs for overlap and coordination issues. They recommend a comprehensive strategy be developed that: (1) avoids program duplication, particularly where departments have overlapping jurisdiction; (2) align programs with legislative priorities, including those the CPUC administers for investor-owned utilities; (3) measures program effectiveness across the state agencies.

The LAO has made a strong case for development of unified energy efficiency and alternative energy policies. The lack of coordination makes it difficult to determine where scarce resources should be directed, and how much a given ratepayer should pay. This also sets up an unbalanced ratepayer system wherein those in investor-owned utilities ratepayer areas pay into a statewide program while those in other areas, such as those in publicly-owned utilities ratepayer areas, do not. The Legislature should consider policy before budget, and should determine which activities should be funded by clarifying statute before budget actions take place.

EPIC Program—Legislative Involvement Needed? The state currently spends over \$1 billion per year on energy efficiency programs, most of this derived directly from utility ratepayers. In developing the EPIC Program at the CPUC, the Administration purposefully bypassed the Legislature after the failed reauthorization of the Energy Public Goods Charge. As discussed under the CPUC, the Legislature should consider whether or not the CPUC is the appropriate place to allow new policies to be developed, including those that increase costs to energy customers in the state. Is it appropriate for one state agency to develop programs for another state agency without statutory approval by the Legislature? If so, what would stop the CPUC from developing any number of off-budget activities without statutory approval?

The EPIC program continues funding for activities that were previously authorized by two-thirds vote of the state Legislature. However, this new program did not have such an authorization. The CPUC and CEC should describe the nexus between the program activities and fee payers based on fee versus tax-related case law. The Administration also has not submitted a plan for proposed expenditures under the EPIC program as required by the 2012 budget. Therefore, there is little review for the budget change proposal.

Staff Comments. The CEC has spent considerable time and effort to develop the EPIC Investment Plan. This plan largely mirrors previous efforts to renew the Public Goods Charge. Given lingering questions about the nature of the charge and its status as a fee or a tax, it would be premature to authorize any spending for this program without clear statutory authorization. However with statutory authorization, the plan for expenditure of funds including the ramp-down of previous PGC programs and possible shifts to new and emerging research and development programs may be a worthwhile policy discussion.

Questions for the Agency. The Commission should address these questions in their opening statement:

- This program clearly needs to be authorized by the Legislature in statute that includes program parameters, focus and goals. The CPUC does not set renewable or energy efficiency policy for this state. Can the Administration produce draft legislation authorizing this program for review by budget and policy committees?
- What is the impact of holding off funding for this program until statute authorizes the expenditure of funds.

Recommendation:

(1) **APPROVE** positions and funding provisionally such that no positions may be added, nor funds expended, until a statute expressly authorizes the EPIC program including program provisions.

Vote: