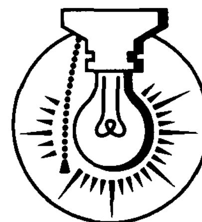
regulating misconduct by the insurers than with Quackenbush's need to raise $4 million for a "media buy" that touted his supposed efforts for consumers (see MAJOR PROJECTS). At this writing, it is unclear whether these settlements are valid; further, the Commissioner's emergency regulations were disapproved by OAL and were never pursued by DOI after Quackenbush's resignation (see MAJOR PROJECTS). The Attorney General's lawsuit is stayed while the state Controller's Office continues to audit the books of 114 title and 477 escrow companies in California (see agency report on DEPARTMENT OF CORPORATIONS for related discussion).

People v. Old Republic Title Co., No. 993507 (San Francisco Superior Court), is similar litigation filed in May 1998 by the San Francisco City Attorney and the San Francisco District Attorney. The suit charges Old Republic with unfair business practices and invokes the False Claims Act, a 1986 law intended to identify and punish companies who defraud the government. The city claims that Old Republic defrauded consumers of $30 million by failing to return unclaimed escrow accounts to homeowners or to the state; instead, the city alleges that Old Republic treated these funds as profit and placed them in its own accounts. The suit also alleges that the company falsified documents and charged illegal fees for services it did not provide. After a preliminary scuffle over the city's standing to bring a False Claims Act case (which ended in June 2000 when San Francisco Superior Court Judge Stuart Pollak ruled in the city's favor), Judge Pollak issued a "tentative decision" on April 16, 2001 finding that the escrow firm's practice of retaining interest earned on investments made with escrow funds is illegal. According to Judge Pollak, Insurance Code section 12413.5 "does not permit escrow companies to retain the net interest on instruments required to be purchased with the proceeds of below-market rate loans extended in exchange for depositing escrow funds in demand accounts at the bank making the loan." The judge noted that although state regulations do not specifically prohibit the escrow company's practice, neither do they affirmatively permit it. At this writing, Judge Pollak has yet to finalize his ruling; assess damages, civil penalties, and potentially punitive damages; and decide whether Old Republic also kept money from unclaimed escrow accounts that should have escheated to the state.

Public Utilities Commission



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The California Public Utilities Commission (PUC) was created in 1911 to regulate privately-owned utilities and ensure reasonable rates and service for the public. Today, under the Public Utilities Act of 1951, Public Utilities Code section 201 *et seq.*, the PUC regulates more than 1,200 privately-owned and operated gas, electric, telephone, water, sewer, steam, and pipeline utilities, as well as 3,300 truck, bus, railroad, light rail, ferry, and other transportation companies in California. The Commission grants operating authority, regulates service standards, and monitors utility operations for safety.

The agency is directed by a commission consisting of five full-time members appointed by the Governor and subject to Senate confirmation. The Commission is authorized directly by the California Constitution, which provides it with a mandate to balance the public interest—that is, the need for reliable, safe utility services at reasonable rates—with the constitutional right of a utility to compensation for its "prudent costs" and a fair rate of return on its "used and useful" investment.

The Commission has quasi-legislative authority to adopt regulations, some of which are codified in Chapter 1, Title 20 of the California Code of Regulations (CCR). The Commission also has quasi-judicial authority to take testimony, subpoena witnesses and records, and issue decisions and orders. The PUC's Administrative Law Judge (ALJ) Division supports the Commission's decisionmaking process and holds both quasi-legislative and quasi-judicial hearings where evidence-taking and findings of fact are needed. In general, PUC ALJs preside over hearings and forward "proposed decisions" to the Commission, which makes all final decisions. At one time, PUC decisions were reviewable solely by the California Supreme Court on a discretionary basis; now, Public Utilities Code section 1756 permits courts of appeal to entertain challenges to most PUC decisions. Judicial review is still discretionary and most petitions for review are not entertained; thus, the PUC's decisions are effectively final in most cases.

The PUC allows ratepayers, utilities, and consumer and industry organizations to participate in its proceedings. Non-utility entities may be given "party" status and, where they contribute to a beneficial outcome for the general public beyond their own economic stake, may receive "intervenor compensation." Such compensation has facilitated participation in many Commission proceedings over the past twenty years by numerous consumer and minority-representation groups, including San Francisco-based TURN (The Utility Reform Network), San Diego-based UCAN (Utility Consumers' Action Network), and the Greenlining Institute, an amalgam of civil rights and community organizations in San Francisco.

PUC staff—which include economists, engineers, ALJs, accountants, attorneys, administrative and clerical support staff, and safety and transportation specialists—are organized into twelve major divisions and offices, including industry-specific divisions addressing energy, telecommunications, rail safety and carriers, and water. The Commission's Consumer Affairs Branch attempts to resolve consumer complaints regarding utility service, safety, and billing problems; its various branches provide consumers with information, analysis, conflict resolution, and advocacy services to help them make intelligent decisions about utility purchases. The Strategic Planning Division analyzes emerging policy issues and changes in the regulatory environment caused by economic, financial, institutional, and technological trends, and helps the Commission plan future policy.

In addition, the PUC includes two special offices important to public access and representation. The San Francisco-based Public Advisor's Office and the Commission's outreach offices in Los Angeles and San Diego provide procedural information and advice to individuals and groups who want to participate in formal PUC proceedings. Most importantly, under Public Utilities Code section 309.5, an Office of Ratepayer Advocates (ORA) independently represents the interests of all public utility customers and subscribers in Commission proceedings in order to obtain "the lowest possible rate for service consistent with reliable and safe service levels." On March 21, 2001, after a long delay during which the directorship of the Office remained vacant, Governor Davis appointed Regina Ann Birdsell to direct ORA.

The five PUC commissioners each hold office for staggered six-year terms. The precise Commission line-up at any given point in time has been much complicated by Governor Davis' delay in filling these appointed positions. As of November 1999, the Commission consisted of three Wilson appointees (PUC President Richard Bilas and Commissioners Henry Duque and Josiah Neeper) and Davis appointees Carl Wood and Joel Hyatt, both of whom had been appointed on June 9, 1999 after Governor Davis left their slots empty for six months (and filled them with temporary appointees Tal Finney and Loretta Lynch from June 4–9, 1999). *[17:1 CRLR 170]* Hyatt's term was to end on December 31, 2000, but he resigned in January 2000. At that time, Governor Davis permanently appointed Loretta Lynch to the vacancy and designated her as the President of the Commission; her term expires at the end of 2004. Lynch is a Yale Law graduate and former partner in the firm of Keker & Van Nest. Previously, she was director of Governor Davis' Office of Planning and Research.

Meanwhile, Wilson appointee Josiah Neeper continued to hold the fifth seat, even after his term expired at the end of 1999. Because of Governor Davis' failure to replace him, Neeper remained as a holdover (and was the deciding third vote on many key issues) during all of 2000, at which time the position became vacant by operation of law. On January 1, 2001, Governor Davis appointed his chief of staff, John Stevens, as a temporary member to fill the vacant swing slot. Stevens served for 18 days; the Governor then replaced him with Geoffrey Brown as a permanent appointee. Brown graduated from the University of San Francisco Law School in 1970 and became a public defender in 1971. In 1978, he took over as the head of the San Francisco Public Defender's Office and served there until his appointment to the PUC on January 18, 2001. His term expires at the end of 2006.

Thus, at this writing, the Commission consists of Davis appointees Lynch (President), Wood, and Brown, and Wilson appointees Bilas and Duque (whose tenure is in jeopardy; see LITIGATION).

MAJOR PROJECTS

The Crash of California's Electricity Industry Restructuring Experiment

Starting in the summer of 2000, California's vaunted experiment with electricity deregulation resulted in unprecedented and disastrous market failure—including volatile and excessive prices, insufficient supply of electricity forcing blackouts across the state, and PUC impotence to do anything about either. Most California ratepayers have suffered 50% rate increases; San Diego residents saw their bills double for several months during 2000. The state's three investor-owned utilities—which spent millions lobbying the legislature for its 1996 approval of the experiment, raked in billions due to the required sale of their power-generating facilities and artificially high rates during the first two years of the program, and then diverted much of that revenue to their parent companies—purport to stand at the brink of financial ruin, while out-of-state power generators have posted obscene profits. The poor credit rating of all three utilities has forced the state to purchase electricity for its citizens to the tune of $5.1 billion at this writing—most of which will be borne by current and future ratepayers, none of whom voted for deregulation.

Starting in the summer of 2000, California's vaunted experiment with electricity deregulation resulted in unprecedented and disastrous market failure—including volatile and excessive prices, insufficient supply of electricity forcing blackouts across the state, and PUC impotence to do anything about either.

◆ ***Deregulation Overview.*** California's deregulation effort formally began with the Commission's December 1995 decision to "unbundle" and deregulate the state's $23 billion electricity industry. Under the new regime, the PUC maintains regulation of the power distribution grid (*i.e.*, the rights of way and wiring which bring power into homes and businesses), but generation is subjected to competition. Utilities that previously generated and transmitted electricity were required to divest themselves of their power generation facilities, and must now purchase power from generators in a competitive environment and transmit it to their customers.

The Commission's decision required approval by the state legislature and the Federal Energy Regulatory Commission (FERC). In 1996, the California legislature confirmed most of the PUC's initiative by enacting AB 1890 (Brulte) (Chapter 854, Statutes of 1996). Effective March 1, 1998, AB 1890 created three new entities to administer the deregulation scheme:

• The Independent System Operator (ISO), a private nonprofit organization, assumed control of the power grid that transmits electricity statewide between the respective utilities controlling local delivery. The stated purpose of the ISO is to ensure efficient use and reliable operation of the state's electricity transmission system. As enacted in AB 1890, the ISO was controlled by a 26-member governing board appointed by the Electricity Oversight Board (see below). Under Public Utilities Code section 337 (as added by AB 1890), the ISO's governing board "shall be composed of California residents and shall include, but not be limited to, representatives of investor-owned utility transmission owners, publicly owned utility transmission owners, nonutility electricity sellers, public buyers and sellers, private buyers and sellers, industrial end-users, commercial end-users, residential end-users, agricultural end-users, public interest groups, and nonmarket participant representatives. A simple majority of the board shall consist of persons who are themselves unaffiliated with electric generation, transmission or distribution corporations."

• The Power Exchange (PX), also a private nonprofit organization, was established to function like a stock exchange, enabling sellers and buyers to bargain for the best price for electricity. As enacted in AB 1890, the stated purpose of the PX is to provide an open, efficient, competitive public auction to meet customers' electricity loads. Under Public Utilities Code section 338, the PX's governing board "shall be composed of California residents and shall include, but not be limited to, representatives of investor-owned electric distribution companies, publicly owned electric distribution companies, nonutility generators, public buyers and sellers, private buyers and sellers, industrial end-users, commercial end-users, residential end-users, agricultural end-users, public interest groups, and nonmarket participant representatives."

• The Electricity Oversight Board (EOB), a five-member board, was established to oversee the ISO and the PX and to "appoint governing boards [for both entities] that are broadly representative of California electricity users and providers" and to "serve as an appeal board for majority decisions of the [ISO] governing board." As enacted in AB 1890, EOB's five members included three voting members (all of whom must be California residents and electricity ratepayers) appointed by the Governor, and one non-voting member each appointed by the Senate Rules Committee and the Assembly Speaker.

As noted above, FERC also had to approve the deregulation scheme. Inasmuch as the ISO and the PX are non-public entities engaged in the interstate transmission and wholesale power markets, their operations are subject to FERC jurisdiction under the Federal Power Act. When it approved the ISO and the PX tariffs, FERC rejected those portions of the ISO and PX bylaws requiring California residency and EOB appointment of governing board members. In doing this, FERC exercised jurisdiction over not only the interstate operations of the ISO and the PX, but also over the framework of the institutions themselves. FERC found that the EOB's role (and thus the state's role) in regulating the ISO and the PX conflicted with FERC's own jurisdiction and undermined the independence of the ISO and the PX governing boards. FERC further found the residency requirement established in AB 1890 to be inconsistent with FERC's policy to provide "broad-based, non-discriminatory, open-access transmission service" and that it "discourages participation in the ISO by out-of-state entities by denying them meaningful representation." In FERC's view, the ISO should not be controlled by the State of California, but rather should be a regional organization in which other states may participate—a concept that California has resisted. FERC did recognize a limited oversight function for the EOB on strictly California matters. As such, the authority of the EOB over the governing boards of the ISO and PX was limited in SB 96 (Peace) (Chapter 510, Statutes of 1999). *[17:1 CRLR 179–80]*

AB 1890 authorized "direct access"—direct transactions can occur between power generators and end use customers without effective interference from the utility carrying the electricity. AB 1890 also outlined a general plan to accomplish the "unbundling," or separation, of the three distinct functions of electricity service: (1) generation, (2) transmission, and (3) distribution (including the unbundling of the maintenance of electricity lines, metering, and billing). Thus, under the new scheme, the traditional local utility—now called a "utility distribution company" (UDC)—continues to transmit electricity to end users, but power generation and some aspects of distribution (such as metering and billing) have been removed from direct private utility control and placed under a competitive format managed by the ISO or the PUC.

AB 1890 also permitted utilities to charge ratepayers a "competition transition cost" (CTC) to compensate them for "stranded costs" or "sunk investments" in imprudent power generation facilities; the CTC appears as a special itemized cost on energy bills. Further, the utilities were allowed to freeze the price of electricity for residential and small business users at high 1996 levels (about 50% above the national average) until 2002 or whenever the utilities sell their power generation assets. The new law also required the utilities to give consumers a 10% reduction in electricity rates from those in effect on June 10, 1996. This rate reduction was effective January 1, 1998 and continues until the earlier of March 31, 2002, or such earlier time as each utility fully recovers its transition costs (the "transition period"). However, the rate reduction was accompanied by the issuance of "rate reduction bonds" by the utilities to finance the reduction, and consumers are required to pay the borrowed money back in an-

other specially designated charge on the monthly bill called "trust transfer amount" (TTA). The latter charge was greater than the rate cut (due to interest accumulation). In other words, the rate reduction bonds were secured by a surcharge on ratepayers that substantially offsets the facial reduction. Finally, the bill promised ratepayers an "anticipated result" of "no less than a 20% reduction" in post-transition electricity rates. As events have unfolded, these mandated savings will not occur.

As described in prior issues, the PUC's implementation of the new scheme has been fraught with problems. *[17:1 CRLR 170–75; 16:2 CRLR 140–44; 16:1 CRLR 158–62]* Prior to the summer of 2000, consumer advocates complained about the PUC's creation of a new and complicated set of terms of art and multi-step proceedings, the separation of rate regulation into "transition period" and "post-transition period" phases, and complex decisionmaking in separate and fragmented hearings not amenable to comprehensive coverage by underfinanced consumer groups. But these complaints have been vastly overshadowed by the emergence of four fundamental flaws in the system: (1) the underlying nature of power and the extraordinary cost of market failure; (2) possible natural or manipulated scarcity as an unaddressed defect; (3) the involvement of the self-interested parties in public "oversight"; and (4) the use of a "market clearing price" at the end of a bidding period that hikes up all previous bids to that level and gives all bidders an incentive to "game" that number.

The system of buying and selling power through the PX/ISO is extraordinarily complex and consists of numerous "markets" for the purchase and sale of electricity.

◆ ***The Mechanics of Power Purchases Through the PX/ISO***. The system of buying and selling power through the PX/ISO is extraordinarily complex and consists of numerous "markets" for the purchase and sale of electricity. In the so-called "day-ahead market," a day in advance, market buyers request the amount of electricity they anticipate needing for each hour of the following day; sellers of power state the amount of energy they can produce and the prices they require for each hour. On the basis of hourly supply and demand bids and orders, the PX sets the "market clearing price"—the price to be paid by all buyers to all sellers for energy purchased during each hour—at the highest amount bid for that hour (even if some sellers are willing to sell for less). In another market called the "forward market," some market participants can utilize longer-term contracts to lock in prices. The ISO directs the flow of electricity throughout the state and tracks real-time supply and demand. When supply purchased through the PX is less than the anticipated demand, the ISO purchases additional electricity to balance the load and meet specified "reserve" levels (the buffer capacity needed at all times to keep the electric system stable and operating). These "real-time" purchases are not subject to the "day-ahead" prices; ISO must pay what the market demands (subject to possible price caps set by FERC).

When the ISO anticipates that the state's purchased electricity and its reserves will not meet forecasted demand, the ISO begins to issue a series of alerts, warnings, and then staged emergencies. If reserves fall below 7%, the ISO declares a "Stage 1 Alert" and asks all customers to reduce energy consumption. If reserves fall below 5%, the ISO declares a "Stage 2 Alert" and power is cut off to commercial and industrial users who are on interruptible contracts (who receive discounted rates in exchange for shutting down in times of high demand). If reserves fall below 1.5%, the ISO declares a "Stage 3 Alert" and orders rolling blackouts for one to two hours in the affected area(s) to keep the entire system from crashing.

◆ ***A Chronology of California's Energy Crisis***. As noted above, the "transition" period ends when a utility disposes of all of its power generation assets. San Diego Gas & Electric Company (SDG&E) became the first major utility to do so in July 1999. With the PUC's decision in D. 99-05-051, the rate freeze ended, and SDG&E's rates immediately spiked 10%. *[17:1 CRLR 173]*

By May 2000, regional wholesale prices had started a general and steep climb, particularly in San Diego, with SDG&E passing through higher energy costs to shocked ratepayers who saw their bills doubling or tripling by the end of June 2000 (despite the fact that overall area power use was down). Residential and small business ratepayers revolted, holding rallies to burn their utility bills in downtown San Diego.

By May 2000, regional wholesale prices had started a general and steep climb, particularly in San Diego, with SDG&E passing through higher energy costs to shocked ratepayers who saw their bills doubling or tripling by the end of June 2000.

On June 8, 2000, the PUC issued a controversial decision (D. 00-06-034) which ultimately proved critical in the unfolding energy crisis. Capping a yearlong evidentiary hearing involving all the UDCs, consumer groups, power producers, and other parties, the Commission released a 3–2 decision requiring all three UDCs to continue to buy electricity only through the PX or other "qualified exchange" subject to PUC approval; only in the post-transition period (when a UDC has sold off its generation assets and its rate freeze has ended) may a UDC purchase more broadly, including through long-term contracts. The Commission also rejected PG&E's proposal to cap rates to insulate customers from high prices during times of high demand. The PUC stated: "We are confident that the market will evolve to develop various services and options that will further enhance competition, while dampening price volatility" (see "Post-Transition Period Ratemaking Applications" below for detailed discussion of this decision).

On June 14, 2000, a heat wave in northern California spiked energy consumption, which led to blackouts affecting

100,000 Bay Area ratepayers. The lack of supply during peak hours pushed real-time power rates to the maximum permitted—$750 per megawatt-hour (mwh). However, Pacific Gas & Electric Company (PG&E) was not able to pass on these prices to ratepayers, as its rates were still frozen.

On June 29, 2000, the ISO's governing board (with FERC authorization) reduced the wholesale power price cap from $750/mwh to $500/mwh; the board deadlocked 12–12 on whether to further reduce the cap to $250/mwh. The power generators warned that lower caps would backfire on consumers because they would discourage power companies from investing in new facilities; further, generators would simply sell power to other western-state customers with higher caps—thus leading to low supply and blackouts in California. On July 6, the ISO board again refused to lower the cap.

On July 6, 2000, the Utility Consumers' Action Network (UCAN), a San Diego-based ratepayer advocacy organization, filed a petition asking the PUC to freeze SDG&E's rates at 1999 levels.

In late July 2000, FERC announced that it would conduct an inquiry into national pricing and energy market issues.

On August 1, 2000, as prices hit the $500 cap for ten consecutive hours, the ISO finally lowered the cap to $250/mwh. However, the cap was only applied during energy emergencies and its level—even as reduced—remained almost four times the historical and normal competitive price. As such, the cap did not ameliorate excessive bidding or costs.

Also on August 1, 2000, as the ISO governing board was debating the cap, the ISO declared a statewide Stage 2 Alert because of sizzling temperatures and soaring demand; ISO officials noted that the state narrowly missed Stage 3 only because interruptible customers shut down for the third day in a row and because of unprecedented conservation efforts by ratepayers in the San Diego area.

On August 2, 2000, the Commission released its first major report to the Governor concerning the state's skyrocketing electricity costs. The report, coauthored by PUC President Loretta Lynch and EOB Chair Michael Kahn, found that "wholesale prices for electrical power in California have increased on average 270% over the same period in 1999, resulting in over $1 billion in excess payments for electricity. During the week of June 14, purchasers of California power spent $1.2 billion on electricity, 300% more than they paid during the same period in 1999....Had the 1999 price cap of $250/mwh been in place in 2000, electricity purchasers would have saved $110 million on June 14 alone."

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The report made the following points: (a) the state's deregulation scheme has eliminated the PUC's authority to cap rates; only FERC is authorized to established maximum prices; (b) the ISO and PX "have no duty to protect the public or consider the retail customer," are not accountable to California consumers, and are controlled by boards "whose members can have serious conflicts of interest"; (c) because the construction of new powerplants requires considerable lead time and should not be relied upon to increase supply in the short term, base energy demand must be reduced through conservation; (d) renewable energy sources and transmission upgrades should be stimulated; and (e) FERC must impose a wholesale price cap to blunt price volatility. The report did not endorse the pass-through of high energy prices to Commission-regulated utilities, noting in a pungent line: "Short term price relief...cannot resolve market gaming or fundamental wholesale pricing problems controlled by federal regulators."

The report repeatedly noted that "the data we need to assess wholesale market pricing and supply scheduling behavior is in the hands of two private, autonomous entities: the California Independent System Operator and the Power Exchange. Despite the Electricity Oversight Board's legislative mandate to oversee these institutions, we have been unable to obtain this data....We recommend that the California Attorney General immediately subpoena relevant records and data to determine the pricing and offering behavior of market participants; the actions of the ISO and its board members; and the actions of generators in supplying California's energy needs." The report specifically said that "California should not wait for national findings [stemming from FERC's inquiry] before it investigates California market practices."

The report also recommended the creation of a California Energy Council, modeled after the National Security Council, to "unify State action to resolve energy problems and to perform integrated energy planning." Other recommendations included vigorous advocacy to FERC of wholesale power price caps; energy conservation; investment in renewable energy sources that could be ready for the summer of 2001; improved monitoring of powerplant maintenance schedules and withdrawal of capacity (which creates artificial shortages for radical price increases); and the elimination of conflicts of interest in the ISO and PX governing boards. Other more immediate recommendations included the imposition of transitional price caps in San Diego; allowing "hedging" and "bilateral contracts" by utilities (the use of long-term contracts and one-on-one contracts between a UDC and an electricity producer to lock in prices); revising building standards to reduce energy use; streamlining state powerplant siting procedures; investment in targeted transmission upgrades for new supply; and reforming the PX's pricing protocols to reduce excess profit.

On August 3, 2000, the PUC denied UCAN's request for a rate freeze in San Diego (D. 00-08-021), opining that a freeze might conflict with federal law. Although the Commission

took other actions it said would assist San Diegans (including a requirement that SDG&E accelerate rebates owed to ratepayers for previous overpayments), local leaders vowed to take their case to the legislature. On the same day, President Clinton ordered federal facilities in California to lower electricity use and vowed to make federal energy available to California; Governor Davis called for state and federal investigations into price manipulation by wholesale power producers.

Statewide Stage 2 Alerts were declared for four straight days from August 15 through 18, 2000. In late August, the Joint Legislative Audit Committee ordered the Bureau of State Audits to commence an investigation into the structure and market surveillance activities of the ISO and the PX, to determine whether the operation of and relationship between the two entities have contributed to rising electricity costs.

On September 27, 2000, PG&E and SCE asked the Commission to authorize retroactive pass-through rate increases to pay for $4 billion in power purchases over the summer of 2000. Consumer groups howled, noting that the utilities knew there would be risks when they advocated deregulation in 1996 and should not now be allowed to hold consumers accountable for the volatility of the market.

On August 21, 2000, eighteen days after it refused to freeze SDG&E's rates, the PUC adopted a "bill stabilization plan" for SDG&E ratepayers due to the rising furor in San Diego and repeated requests by Governor Davis (see "SDG&E Bill Stabilization Decision and Investigation" below for details on this decision). That plan was quickly superseded by the August 30, 2000 passage and September 6, 2000 approval of AB 265 (Davis), urgency legislation that caps SDG&E's rates at 6.5 cents per kilowatt-hour (kwh); it also appears to allow the utility to subsequently collect from ratepayers the growing deficit between that charge and the amount it pays to generators for electricity (see 2000 LEGISLATION). Called a "sham" and "window-dressing" by San Diego officials, the bill did nothing to address the underlying causes of the energy crisis, and in fact may require future SDG&E ratepayers to pay the exorbitant rates charged by the producers.

On September 7, 2000, the PUC issued orders implementing AB 265 (Davis), and ordered an investigation into the "prudence" of SDG&E's energy procurement decisions from June 2000 forward.

Simultaneously, PG&E—with its rates still frozen—announced it had lost $2 billion during the summer of 2000 and wanted similar assurance that it could pass on the difference between its costs and its rates to its ratepayers. PG&E estimated that its losses could reach $15 billion if prices remain at summer 2000 levels. A week later, PG&E notified the U.S. Securities and Exchange Commission of its intent to sell its remaining hydroelectric plants by the spring of 2001—at which point it would divest itself of its generation assets and its rate freeze would be lifted, exposing northern California ratepayers to the kind of rates suffered by San Diegans. Several days later, a PG&E official announced that the utility might petition for a lifting of the freeze even before it sells its hydroelectric facilities.

On September 21, 2000, the PUC authorized SDG&E to enter into long-term contracts to purchase electric energy. The amount of the long-term contracts into which SDG&E may enter is limited; the utility is permitted to purchase about one-half of its peak load via long-term contracts. The contracts can be up to five years in length and must expire by December 31, 2005. SDG&E was not compelled to disclose the terms of those contracts publicly.

On September 27, 2000, PG&E and Southern California Edison (SCE) asked the Commission to authorize retroactive pass-through rate increases to pay for $4 billion in power purchases over the summer of 2000. Consumer groups howled, noting that the utilities knew there would be risks when they advocated deregulation in 1996 and should not now be allowed to hold consumers accountable for the volatility of the market. Nevertheless, on October 4, 2000, PG&E filed for a rate increase of two cents/kwh, or $20/mwh, while the average price of wholesale power had escalated to $102/mwh. On October 17, the PUC temporarily denied the utilities' requests for an urgency ruling, but announced its intent to begin a fact-finding proceeding concerning the utilities' financial status. In announcing the Commission's decision, PUC President Loretta Lynch stated that "in my view, the basic assumptions underlying AB 1890 are ripe for reconsideration. This legislation, enacted by the previous administration, was based on assumptions about how the California energy markets would work in a restructured environment. Those assumptions have not proven accurate. We should evaluate the reality of California's energy markets and act to coordinate energy policy based on today's facts, not theories, to serve the overall public interest of California's businesses, families, and the California economy."

On October 19, 2000, The Utility Reform Network (TURN), a San Francisco-based ratepayer organization, released a report in which it contended that PG&E and SCE received $4.5 billion in windfall profits from the sale of their powerplants, and argued that those sums—rather than a rate increase—should be made available to offset the claimed $4 billion in losses due to high energy prices during the summer of 2000.

On November 1, FERC issued a ruling on its investigation into potential market manipulation by power generators. Although it found that electricity prices charged to California during the summer of 2000 were "unjust and unreasonable," the Commission found no evidence of market manipulation and said it lacks legal authority to order refunds of federally-sanctioned wholesale rates in the absence of such evidence. FERC instead suggested that California build new power generating facilities, relax its air pollution guidelines to allow facilities to generate more power during peak hours,

and permit its utilities to enter into long-term power contracts for price stability.

On November 29, 2000, consumer attorney Mike Aguirre filed suit in San Diego County Superior Court on behalf of a single ratepayer against 16 power generators (*Hendricks v. Dynegy Power Marketing Inc.*, No. GIC758565). During the same week, similar suits were filed by three San Diego County water districts. These suits allege violation of federal antitrust law prohibiting unreasonable restraints of trade (section 1 of the Sherman Act). State legislators subsequently joined these suits. Initial removal to federal court and motions to dismiss based on federal preemption were denied.

During November and December 2000, Governor Davis and other California officials urged FERC to impose wholesale price caps. In mid-November, the ISO declared Stage 2 Alerts on three successive days, blaming low supply and soaring prices on powerplant shutdowns for maintenance—both scheduled and unscheduled.

On December 7, 2000, the ISO declared California's first ever Stage 3 Alert, but was able to avert statewide rolling blackouts because the Stage 3 declaration permitted it to call back some power that was being exported out of state. Once again, powerplants that could have generated about one-third of California's needed electricity sat idle because they were undergoing maintenance, shut down because of operational problems, or had reached their air pollution limits for the year.

Also in December 2000, the ISO executive director inexplicably petitioned FERC to lift its high $250/mwh ceiling on energy prices, contending that anticipated scarcity demands high incentives to develop production. More inexplicably, FERC in fact lifted the ceiling on December 8. By December 11, the wholesale price of electricity had jumped to between $600–$800/mwh in northern California; on December 12, the PX price of electricity was $1,182/mwh during hours of peak demand, as the ISO declared the state's 30th Stage 2 Alert in 2000. On December 14, Clinton administration Energy Secretary Bill Richardson helped the state avoid imminent rolling blackouts by ordering twelve generating plants to sell power to PG&E and SCE (some were refusing on grounds that previous bills remained unpaid).

By December 11, the wholesale price of electricity had jumped to between $600–$800/mwh in northern California; on December 12, the PX price of electricity was $1,182/mwh during hours of peak demand, as the ISO declared the state's 30th Stage 2 Alert in 2000.

On December 15, 2000, FERC issued a new order again denying California's requests for mandatory wholesale price caps and refunds to ratepayers. Instead, the Commission imposed a temporary wholesale "soft" price cap of $150/mwh (meaning that wholesale bids above that figure must be specially justified); authorized UDCs to enter into long-term contracts with generators for electricity; authorized UDCs to use power they generate or control through contracts to serve their customers (rather than requiring them to direct it to the PX); and called for a restructuring of the ISO governing board to ensure its independence from generators. California officials and consumer groups were outraged. Governor Davis accused FERC of ensuring "unconscionable profits for the pirate generators and power brokers who are gouging California consumers and businesses." He ordered the legislature into special session commencing January 3 to pass legislation restructuring the ISO board, authorizing the state to inspect private powerplants to assure the coordination of maintenance and operating schedules, and providing low-interest financing for new power generation facilities.

On December 18, 2000, two class action lawsuits were filed in Los Angeles alleging that Southern California Gas and SDG&E conspired to manipulate natural gas prices in southern California. The suits allege a conspiracy with El Paso Natural Gas Corporation of Houston, which owns the only major natural gas pipeline into southern California. Natural gas prices at the California end of the pipeline were three to six times the price in Texas, reaching $55 per million BTU in early December 2000; by contrast, natural gas cost $3 per million BTU in December 1999.

By December 21, 2000, the average price of wholesale electric power in California reached an extraordinary $377/mwh. Historical prices and energy costs vary from $60–$90/mwh. By December 31, 2000, PG&E announced that its debt to generators totaled $4.8 billion and again demanded pass-through rate increases; both PG&E and SCE threatened to file for bankruptcy if rate increases were not granted.

On December 27, 2000, the PUC announced its hiring of KPMG to audit SCE and the Barrington-Wellesley Group to audit PG&E, to determine the validity of the utilities' claims of "extreme financial distress" cited to justify their requested rate increases.

In late 2000, SCE and PG&E filed federal court actions seeking to compel the PUC to grant them rate increases to pay for the higher energy costs imposed upon them. PG&E's lawsuit, filed in the Northern District of California, was transferred to the Central District of California where U.S. District Judge Ron Lew is presiding over SCE's case. The January 2001 average price of energy stood at $314/mwh.

On January 4, 2001, the PUC reversed previous ground and announced approval of an emergency rate hike for SCE and PG&E customers; rates increased 9% for residential customers and about 15% for large commercial and industrial users. PG&E complained that the rate increase was not nearly enough, having applied for an immediate increase of 20% and a 40% increase by the end of 2001. Combined, PG&E and SCE claimed that they had run up $11 billion in losses since June 2000, complained that the rate increase was insufficient, and vowed to pursue their federal court lawsuits.

On January 12, 2001, FERC approved PG&E's petition to restructure its relationship with its holding company and subsidiaries to shield the latter from any indebtedness incurred

by the utility. Consumer advocates decried the move, contending that substantial revenues were transferred from the utility to the holding company—revenues that should be available to cover PG&E's indebtedness.

On January 11, 16, and 17, 2001, the ISO declared Stage 3 Alerts. The January 17 alert resulted in rolling blackouts across California and a declaration of a state of emergency by Governor Davis. In a January 17 press conference, the Governor announced that four power generators—Duke Energy, Southern Company, Reliant Energy, and Dynegy—were "prepared to pull down the utilities into bankruptcy tomorrow at 12:01 p.m. They have agreed, if legislation passes tomorrow, they will not do that, [and] they will provide us the power necessary to keep the lights on." Because the utilities continued to claim that they were on the verge of bankruptcy, Davis ordered the Department of Water Resources (DWR) to use funds already budgeted to it to purchase electricity for the state, and further ordered the legislature to appropriate general fund monies to pay for power.

On January 11, 16, and 17, 2001, the ISO declared Stage 3 Alerts. The January 17 alert resulted in rolling blackouts across California and a declaration of a state of emergency by Governor Davis.

On January 18, 2001, as the ISO declared another Stage 3 Alert, the legislature passed and the Governor signed two bills consistent with FERC's December 15 decision. ABX1 5 (Keeley) converts ISO's 26-member "stakeholder" governing board to a five-member board of directors appointed by the Governor; prohibits any member of the independent governing board from being affiliated with any actual or potential participant in any market administered by the ISO; prohibits the ISO from entering into a multistate entity or a regional organization unless that entry is approved by the board; and requires the ISO to publish on the Internet a list of California powerplants that are out of service due to either a planned or unplanned outage on a daily basis. ABX1 6 (Dutra) prohibits the sale of any public utility-owned powerplant until January 1, 2006, requires the PUC to ensure that generation assets remain dedicated to service for the benefit of California ratepayers, and clarifies that public utility-owned generation assets remain regulated by the PUC until the Commission authorizes their disposal under Section 851 of the Public Utilities Code (see 2001 SPECIAL SESSION LEGISLATION).

On January 19, 2001, as power outages affected 675,000 ratepayers in northern California during the state's fourth consecutive day on Stage 3 Alert, the legislature passed and the Governor signed SBX1 7 (Burton), which appropriated $400 million from the general fund to DWR to purchase energy for the use of utility customers for twelve days.

Also on January 18, 2001, the City of San Francisco filed suit against 13 major power producers, contending that they unlawfully colluded to manipulate the wholesale market. City Attorney Louise Renne filed the action (*People v. Dynegy Power Marketing Inc.*, No. SCV318189), which is similar to the class actions filed in San Diego County in November 2000.

On January 19, 2001, as power outages affected 675,000 ratepayers in northern California during the state's fourth consecutive day on Stage 3 Alert, the legislature passed and the Governor signed SBX1 7 (Burton), which appropriated $400 million from the general fund to DWR to purchase energy for the use of utility customers for twelve days. The legislation directed the PUC to implement emergency regulations to facilitate utility collection and remittance of customer payments to DWR for its purchases (see 2001 SPECIAL SESSION LEGISLATION). The Commission's decision implementing SBX1 7 was issued on January 31, 2001. It allocated revenues collected by utilities to DWR in proportion to the energy delivered by DWR.

Starting on January 19, 2001, the State of California began buying power with this initial $400 million—which covered only twelve days of purchases. Governor Davis began negotiations with executives of the top four power generators—Duke, Southern, Reliant, and Dynegy—for long-term contracts. The Governor announced that the contracts would be let via an auction, in which he expected up to 50 sealed bids in the 5–5.5 cents/kwh range. By January 24, the state had received 39 bids with a "weighted average" price of 6.9 cents/kwh.

On January 24, 2001, Governor Davis named five new members to the ISO board, which had been reconstituted by ABX1 5 (Keeley) (see above). All board members must be "independent from any market participant."

Also on January 24, 2001, SDG&E petitioned the PUC for an additional 17% rate increase. Under AB 265 (Davis) (see above), the utility is under a rate freeze until December 31, 2002, but is entitled to any overage from power purchases accrued to that point, which it warned could reach $1.45 billion by then. SDG&E complained that its debt is hampering its ability to buy power and borrow money.

On January 26, 2001, Governor Davis outlined a "nine-point plan" under which the state would establish its own power authority and purchase "stock ownership" in the utilities, thus infusing the utilities with cash that would enable them to pay off their soaring debts. The Governor proposed to finance the purchase by selling bonds, and expressed "hope and expectation" that current electricity rates would not have to be increased beyond the 9–15% increases authorized by the PUC on January 4 (see above). The Governor's proposal mirrored ABX1 18 (Hertzberg), introduced on January 25, which would allow the state to sell $12 billion in bonds to help PG&E and SCE cover their summer 2000 debt. Consumer advocates blasted the plan as a bailout of the utilities which sought deregulation.

By January 30, 2001, the $400 million authorized in SBX1 7 (Burton) had run out. Governor Davis ordered DWR to continue purchasing electricity from its own budget.

On January 30, 2001, the PUC ordered PG&E to file a plan for cost-based rates for remaining utility-generated power (not yet sold to generators), authorized $314 million in energy efficiency funding, and scheduled hearings starting in March 2001 on PG&E's requested rate increase.

On January 31, 2001, the results of the PUC-ordered audits of SCE and PG&E were released. KPMG's audit of SCE concluded that the utility overstated its debt in purchasing electricity by at least $1.5 billion, and that it had transferred $4.8 billion to its parent company since 1996 deregulation. SCE earned $2 billion from the generating facilities it had not yet sold. The PUC-ordered audit of PG&E by the Barrington-Wellesley Group revealed that during nine months of 2000, the utility turned over nearly one-third of its cash flow to its parent, PG&E Corporation, including $632 million in dividends. In total, the two utilities received more than $10 billion above their costs during the first two years of deregulation. These funds were transferred to parent companies and then to stockholders, bondholders, or other subsidiaries. The holding companies have sought and obtained restructuring permission from FERC to immunize these funds from liability should they be ordered to pay power generators. The audits did confirm that the utilities, as presently financed, do not have sufficient reserves to pay current and imminent bills from power generators at the rates extant.

On February 1, 2001, the legislature passed and the Governor signed ABX1 1 (Keeley), which significantly expands DWR's role in purchasing power for the state. ABX1 1 authorizes DWR to enter into long-term contracts to purchase power and sell it at cost to retail customers of PG&E, SCE, and SDG&E and to municipal utilities; appropriates $500 million to DWR with which to buy power; requires revenues collected from end-use customers to be deposited into a new "Electric Power Fund" in the State Treasury; and authorizes DWR to sell bonds to finance its power purchases. ABX1 1 also somewhat limits PUC authority by providing that residential customer rates may not be increased for usage up to 130% of baseline quantities.

On February 2, 2001, the *Sacramento Bee* published a detailed accounting of the extensive lobbying and campaign contribution activity of the state's major utilities, mostly through their parent companies. While claiming financial ruin, SCE and PG&E and its affiliates expended over $2 million on lobbying and campaign contributions to the state legislature during the last half of 2000. Federally, five major power generators—Mirant, Reliant, Dynegy, Duke, and Williams, together with Enron Incorporated (which is not a generator to California, but created a commodities market role for itself as a middleman in the state)—provided substantial funds for congressional candidates and for the Bush administration. All of those companies posted unprecedented profits during the third and fourth quarters of 2000 due to their sales of power to California; Enron executives played a major role in fashioning the Bush administration's 2001 energy policy through Vice-President Dick Cheney.

On February 5, 2001, as California entered its 22nd straight day on Stage 3 Alert, Governor Davis invoked his emergency powers and seized the existing PG&E and SCE energy contracts held by the California Power Exchange. The PX presented the Governor with a bill for $1 billion, its valuation of the contracts taken. These contracts, which the PX was preparing to auction off because neither utility had paid the PX for power they had purchased, provide for energy delivery at relatively low rates (6–13 cents/kwh). The state is obligated to pay the "reasonable value" of the contracts using public money.

On February 6, the PUC announced that it may undertake an investigation into whether power utilities have violated Commission rules governing their diversification into "unregulated businesses." All three utilities formed parent holding companies since 1986 (PG&E formed PG&E Corporation, SCE formed Edison International, and SDG&E formed Sempra Energy). The two PUC-ordered audits of SCE and PG&E found that almost all of the income of the parents was traceable to utility profit. (Note that utilities are designedly confined to cost recovery plus a "fair rate of return" on "used and useful capital" committed to utility purposes.) The utilities and their parent companies contend that these funds are unavailable to them to pay for power—all of which must be borne by ratepayers.

On February 9, 2001, Duke Energy gave the *Orange County Register* an internal letter dated July 31, 2000 from Duke president James Donnell offering to sell California 2,000 megawatts at five cents/kwh for five years. The offer was not accepted. Also on February 9, the Governor announced special incentives to bring new powerplants on line.

On February 12, 2001, California's 28th consecutive day on Stage 3 Alert, U.S. District Judge Ronald Lew rejected SCE/PG&E's motions for injunctive relief requiring the PUC to increase their rates. Judge Lew said that it would be "wholly inappropriate" for a federal court to intrude on PUC ratesetting. In light of the PUC's plans to hold hearings in March 2001 on SCE/PG&E's requests for rate increases, the court declined to grant the PUC's motion to dismiss the actions and promised the utilities an early trial date once they had exhausted their administrative remedies before the Commission.

On February 16, 2001, Governor Davis unveiled his overall "rescue plan," which would include state purchase of the transmission grids owned by the state's three investor-owned utilities (which would help the utilities pay off the massive deficits owed to generators). The price would range from $3–$9 billion, and would be repaid from future rates. The Governor also sought a significant contribution by the utilities' parent companies to their utility subsidiaries to satisfy their creditors, cheap power from the utilities' remaining power generation facilities, and dismissal of all pending litigation. The Governor expressed hope that the deal could be negotiated with the utilities in the coming weeks and without further rate hikes. Also on February 16, the *Los Angeles Times* re-

vealed that public power agencies—including the Los Angeles Department of Water and Power—had joined in charging excessive rates for the sale of their own excess power.

On February 20, 2001, as the Governor's closed-door negotiations with the utilities for the sale of their transmission facilities continued, the state Senate approved SBX1 6 (Burton), which would create a state public power authority that could generate and sell electricity, and would authorize it to sell $5 billion in general obligation revenue bonds to finance such plant investment or conservation incentives (see 2001 SPECIAL SESSION LEGISLATION).

On February 22, 2001, the Commission ruled that PG&E and SCE are not responsible for paying the unanticipated cost of DWR-purchased power. That power was purchased in the short run from the state's general fund. But the Governor pledged a multibillion dollar bond issuance to repay that withdrawal in full. Accordingly, the decision implies future ratepayers will be assessed the cost of bond repayment, with interest over many years. Politically, this option was considered most palatable because it places the cost on future ratepayers.

Also on February 22, 2001, the state announced its need for another $500 million from surplus public funds for another ten days of energy purchases, bringing the total to $2.6 billion in direct public money for purchases to that date. This sum does not include the billions of dollars the generators claim they are owed from utilities.

On March 5, 2001, the Governor announced long-term energy contracts with 20 suppliers. At the time, the details of the contracts were not disclosed. However, a subsequent suit by the media to compel disclosure under the California Public Records Act revealed that the contracts include terms of ten to twenty years, require payment at levels double to triple historical prices, and include—in some cases—additional escalation clauses based on the price of natural gas (which may rise precipitously given evolving federal deregulation).

On March 16, 2001, FERC announced that it would order $69 million in refunds for overcharges by power generators in January 2001, and a possible $55 million for February. These overcharges were based on prices in excess of $430/mwh during Stage 3 emergencies. Commentators scoffed at the trivial nature of the ordered refunds, noting that relatively little power was sold during Stage 3 emergencies, and that the $430 ceiling is about six times the normal price for power and amounts to about 10% of the overcharge for the same period sought by California's ISO.

On March 21, 2001, the ISO filed a 100-page report with FERC on the cause of generator price increases, concluding that power generators artificially manipulated prices through "physical and economic withholding" to generate scarcity and artificially high prices, particularly through deferral to the real-time market clearing price.

On March 21, 2001, the ISO filed a 100-page report with FERC on the cause of generator price increases, concluding that power generators artificially manipulated prices through "physical and economic withholding" to generate scarcity and artificially high prices, particularly through deferral to the real-time market clearing price. Based on the typical operating costs of powerplant owners, the report said the state appears to have been overcharged $6.87 billion since May 2000. The ISO again called for regional price caps, concluding that current prices are 400% over what is needed to create incentives for new plant construction.

On March 22, 2001, the Bureau of State Audits (BSA) released *Energy Deregulation: The Benefits of Competition Were Undermined by Structural Flaws in the Market, Unsuccessful Oversight, and Uncontrollable Competitive Forces*, its report on energy deregulation that had been requested by the Joint Legislative Audit Committee in August 2000 (see above). The study concluded that a "complex combination of factors" has resulted in the failure of deregulation. That "complex combination" includes (1) the terms of the legislation mandating deregulation; (2) its implementation by the PUC—particularly the Commission's requirement that investor-owned utilities sell all the power they generated themselves into "sequential short-term markets" or "spot markets" operated by the PX and ISO, and its initial refusal to let the utilities enter into long-term contracts when prices were low; (3) the utilities' failure to immediately secure long-term contracts when the PUC finally authorized them to do so; and (4) "misjudgments" on the part of FERC and the PUC as to the effectiveness of their corrective actions. The report also noted some factors contributing to the crisis that are "outside the scope of any regulator or agency"—such as unusual weather patterns (a drought limiting the availability of hydroelectric power) and steep increases in natural gas prices.

BSA made four major recommendations: (1) "eliminate the opportunity for strategic bidding" by stopping real-time bidding and executing forward (long-term) contracts with generators, halting "ancillary services" spot market bidding and buying these forecasted advance reserve purchases through sealed bids, and considering contracting for generation capacity; (2) avoid using a single statewide wholesale price cap as a check on abuse, because that then becomes the "targeted bid price"; instead, BSA recommended that caps be imposed where "markets are found to be noncompetitive and supply is being withheld...."; (3) give the ISO authority to schedule powerplant maintenance, removing that power from the generators—who were allegedly manipulating outages to limit supply and escalate the real-time bid market clearing price; and (4) limit the amount of market data published on Web sites—here, BSA found that the posting of bid and price data immediately after the fact, combined with readily available ISO data and PX pricing models, facilitated the "gaming" of prices to artificially high levels; instead, BSA recommended that bidding and winning bid data should be delayed a full year before public release in any form.

The report's recommendations were not followed. Some were mooted by other events—including the use of long-term contracts not by utilities but by the state through DWR, and the bankruptcy of the PX entity and collapse of that market mechanism following FERC's December 15, 2000 order. At this writing, wholesale price caps remain the primary check on abuse, ancillary services remain subject to spot bidding, and information about *post hoc* bid amounts continues to be available.

By March 26, 2001, the Governor's staff, legislators, and PUC officials admitted that a rate increase would be necessary to bail out the utilities.

On March 27, 2001, the PUC unanimously approved the biggest electricity rate increase in California history—a hike of just under 50% (three cents/kwh)—for ratepayers of PG&E and SCE to yield $2.4 billion in additional revenue for the utilities. In so ruling, the Commission nonadopted the proposed decision of a PUC ALJ, who stated: "Since April 1998, ratepayers have paid billions of dollars in excess of market costs to support recovery of utility transition costs. Ratepayers did not cause the utility liquidity problems, have not benefitted from electric restructuring, and should not bear the cost recovery risks imposed by AB 1890." Consumer groups were outraged, arguing that a rate increase will do nothing to resolve the flaws that caused the crisis. The Commission also ordered PG&E and SCE to begin paying debts owed to "qualified facilities" (usually small renewable cogenerators) to assure continued power from that source. The Commission also announced "incentive programs" involving the expenditure of $138 million through the end of 2004; these programs will provide incentives for energy conservation, renewable fuel generation, and waste heat recovery for efficiency gain pursuant to the instruction of AB 970 (Ducheny) (see 2000 LEGISLATION). The funds will come from "electric distribution revenues" (that is, they will be added to utility bills and paid by ratepayers).

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On March 28, 2001, FERC's governing board indicated it would not award substantial refunds to California arising from allegedly excessive and unreasonable wholesale energy prices paid to the out-of-state generators. Of the $6.87 billion in overcharges claimed by the ISO and utilities, FERC indicated that only $3 billion is eligible for consideration. Of that amount, only $124 million is being closely examined by FERC for refund.

Also on March 28, 2001, the PUC's Office of Ratepayer Advocates accused SDG&E of padding electricity bills by $170 million in recent months. The utility obtained below-market prices in a long-term contract with Louisville Gas & Electric, and—instead of passing on those reductions—charged ratepayers at market levels and pocketed the difference for its stockholders. Consumer critics charged that if costs are above established market level, the utility expects ratepayers to pay; if below, it proposes to keep the difference. ORA is seeking refunds for SDG&E ratepayers. The charges were made amidst disclosure of a new compensation package of $7 million per year for Stephen Baum, who chairs the board of SDG&E's parent (Sempra Energy).

On April 3, 2001, the Commission finally ordered an investigation of transactions between PG&E, SCE, and SDG&E and their respective holding companies. Consumer advocates argued that substantial sums were extracted from utility revenues and assets (including the high prices paid for generating plants sold by the utilities) and transferred to holding companies and their other subsidiaries. At the same time, many of these holding company assets have interests in generation and have profited from the high prices. The Commission announced that its inquiry is appropriate given the rate increases just announced.

On April 5, 2001, in the Commission's proceeding to investigate the reasonableness and prudence of SDG&E's procurement practices required by AB 265 (Davis) (see above), the PUC's Office of Ratepayer Advocates charged that SDG&E failed to enter into long-term contracts when able to do so during the previous year, costing ratepayers $98 million. ORA noted that PG&E and SCE aggressively hedged in the PX's forward market during 2000; SDG&E had the same opportunity but failed to implement any risk management program or take advantage of the forward market. Instead, it overly relied on the short-term "spot market" which hit extraordinarily high levels in late 2000.

Also on April 5, 2001, Governor Davis made a televised speech in which he reported progress in solving the state's energy crisis. He stated that twelve new powerplants have been licensed during his administration (whereas no new powerplants were built during the twelve years prior to his term). He ticked off the steps taken by the state—its purchase of power because the utilities can't; its entry into long-term contracts with generators; its progress in negotiating state purchase of utility transmission lines; its incentive programs to conserve energy; and its ongoing investigation into possible market manipulation by the generators. He also acknowledged that rate increases are necessary to "keep our lights on and our economy strong," but suggested that the PUC revised its rate increase proposal to "reward those who conserve and motivate the biggest users to cut back."

On April 6, 2001, PG&E—claiming debts of $8.9 billion—shocked public officials by declaring Chapter 11 bankruptcy.

On April 6, 2001, PG&E—claiming debts of $8.9 billion—shocked public officials by declaring Chapter 11 bankruptcy. The filing threw the state's negotiations with the utilities for their transmission facilities into chaos. U.S. Bank-

ruptcy Judge Dennis Montali of San Francisco received the complicated case. Consumer advocates sought and were refused permission to represent ratepayers in the bankruptcy proceedings, which normally focus on the rights of creditors.

On April 9, 2001, Governor Davis and SCE agreed in principle on the state's purchase of the utility's 32,000 miles of transmission lines for $2.76 billion. As part of the deal, Edison's parent agreed to refund back to the utility some $420 million in profit from its plant sales to the power generators to help pay some of the debt owed to those generators. The deal was opposed vigorously by the Foundation for Taxpayer and Consumer Rights (FTCR) as a "massive, unadulterated, ratepayer-funded bailout of Edison."

On April 18, 2001, energy experts testified before an Assembly committee that El Paso Natural Gas sold capacity on the only natural gas pipeline into southern California to its own affiliate in a scheme to profit from monopoly power. Paul R. Carpenter of the Brattle Group from Cambridge, Massachusetts contended that El Paso took advantage of lax federal regulation to add $750 million in extra revenues from SCE customers alone. The Brattle Group report concluded that El Paso sold one-third of its pipeline capacity to Dynegy (one of the five power generators)—an amount well in excess of Dynegy's need or ability to sell to other marketers. Dynegy then raised the price to those then forced to seek its captured portion of the pipeline, inflating prices. Then El Paso awarded another capacity contract to a sister company. The resulting manipulation, combined with the removal of federal regulatory oversight, drove California natural gas prices to levels twelve times the price in Texas.

On April 21, 2001, the San Diego County Board of Supervisors announced plans for state legislation to authorize a municipal utility district to generate and sell electricity. Los Angeles, Sacramento, and San Francisco currently have such districts. Sempra Energy expressed public support for the concept, but its behind-the-scenes opposition eventually scuttled the whole proposal.

By April 24, 2001, the state had spent $5.1 billion—an average of $54 million per day—for electricity purchases from January to April, all in addition to current amounts allegedly owed energy producers by utilities.

On April 25, 2001, FERC voted 2–1 to issue a "price mitigation order" purportedly limiting prices that may be charged by power generators; however, the effect of the order fell far short of the regional price caps California sought. The plan includes the following three elements: (1) sellers with participating generator agreements must offer all available power in real time; (2) the ISO should establish a single market clearing price for the real-time auction; and (3) "price mitigation" (ceilings) will apply during a Stage 1 emergency (when contingency reserves fall below 7%). That ceiling is marginal cost for natural gas-generated power, plus $2/mwh for administrative overhead. If a generator has higher costs, it may bill and justify at the higher figure. Further, the plan is contingent upon the ISO and the state's investor-owned utilities submitting a regional transmission organization (RTO) proposal to FERC by June 1—something California has thus far been unwilling to do.

Most consumer advocates dismissed FERC's order as too limited to correct the market imbalance. They argue that the only limitation on high prices is a new FERC $150/mwh "breakpoint" where refunds may be claimed if rates are charged without cost justification above that level. However, that level is over four times the cost of energy production—and double the historical cost of utility power in California. Price controls below this level are imposed only during power emergencies. Hence, last-minute bidding at the real-time auction could still yield bid prices up to four times cost and those prices could be collected through utility assessment—so long as a 7% reserve remains in place. The marginal cost limitation would be imposed less than 5% of the time and would not address the overall problem. At this writing, the likely failure of this April 25 order will probably compel FERC to reconsider, expand, and tighten its order before the end of summer 2001.

◆ ***Consumer Critique.*** According to consumer advocates (including TURN in northern California, FTCR in Los Angeles, and UCAN in San Diego), deregulation as implemented is seriously flawed and is based on a misunderstanding of utility economics. The advocates argue that decisions by the legislature, FERC, and the PUC have exacerbated those flaws and threaten those relying on electricity for business and domestic purposes with ruinous rates. Those decisions have resulted in substantial subsidies to existing utilities to divest themselves of uneconomic powerplants, price spike problems as unregulated electricity generators take advantage of scarcity to exact excessive prices and profits, failure to adequately provide for external benefits (renewable energy stimulation), and failure to expand generation capacity.

Consumer advocates point to a 1996 decision by FERC as critical to the current conundrum. From 1992–95, the California Energy Commission recommended the development and stimulation of substantial alternative energy supply sources. This policy decision was driven by several years of study of future energy supplies, and by the long-run advantage of developing renewable energy sources for future consumers in the millennia to come. It would have produced 1,400 megawatts of power for a capacity cushion, which conservationists and consumer advocates argued was prudent. However, the utilities appealed to FERC, arguing that some of the costs of this alternative generation would be higher than the cheapest available power (generally hydro- and gas-powered generators). They contended that utilities had a right to the lowest-price sources; indeed, they argued that a failure to pursue the lowest price could be "imprudent" under regulatory law standards and subject them to liability for the difference. In addition to the cost argument, the utilities also contended that supply was adequate without the 1,400 megawatts of additional capacity. SCE CEO John Bryson wrote in 1994 that it would not need new power sources until "at least 2005." Regrettably, FERC sided with the utilities.

To this day, the utilities contend that their projections were accurate, that demand has not increased inordinately, and that the "scarcity" problem leading to high prices in the bidding process is the result of price manipulation by the five major private generator companies. However, consumers and environmentalists point out that such manipulation would be much more difficult if substantial capacity beyond the 11% now coming from "green power" were available to defeat that alleged manipulated scarcity by the five major generators.

Apart from the 1996 lost opportunity for renewable energy stimulation and scarcity insurance, the higher prices were exacerbated by the high concentration of energy assets in the hands of five major energy providers—Mirant, Dynegy, Reliant, Duke, and Williams. Those producers are all advised by a group of firm interchanging "advisers" who predict demand and "game" offers of supply and bid prices. The producers are able to learn what their competitors are doing through instantaneously arranged Web site communication arranged by the ISO. Critically, most energy is bid on a "spot market" basis, where producers bid a day ahead, an hour ahead, and then on a "real-time" basis as demand dictates. Power is purchased at whatever price necessary to secure it, and revenue requirements are adjusted accordingly *post hoc*.

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Exacerbating the setting's *bona fide* market dynamic are three flaws. First, as described above, market participants are able to bid "a day ahead" for a given supply and price, and then if demand rises so that energy is needed the following day, renege on that offer, pay a penalty, and instead sell that power on a "real-time" basis at a "market clearing price" many times cost or previous levels. That artificial and high "market clearing price" applies to all "real-time bidders," even those who bid lower prices during the same time increment (either one hour or, more recently, ten-minute intervals). Accordingly, all energy producers gain when any one of them is left alone at the last minute in real time to bid at an excessive price of ten to fifty or more times normal market level. All suppliers have an incentive to restrict supply, stimulate scarcity, and achieve extremely high real-time market clearing prices. Accordingly, even without direct unlawful collusion, the system is rigged to inhibit genuine price competition.

The second flaw is the development by all energy producers of experts called "schedule coordinators" (SCs). These are the persons who communicate with the ISO to offer supply and to bid a day ahead, an hour ahead, and real-time. They all have almost instantaneous information on bids and prices after they are set, hour by hour. They all work to provide maximum advantage for their companies, using the same data and sources. They do so in a context of a strong "non-zero sum" game—where all can benefit together simply by not signing long-term contracts, withholding capacity in the day-ahead market, and withholding some capacity in the real-time market and relying on a high market clearing price to increase profit margins more than increases in volume (market share) would achieve.

The third flaw is the segmentation of the market into many separate submarkets each subject to its own separate rules and auctions. Hence, power may be "RMR" power which is a base amount, or "ancillary services" power (either spinning or non-spinning) which generators are paid to have at the ready in case called upon, or it may be in one of five other categories. That segmentation makes gaming of the system more likely since fewer competitors are presented in each of these separate auction markets than would be the case if they were consolidated.

The excessive prices beginning in late 1999 raised electricity spending more than threefold their pre-2000 or cost-based levels, produced a serious public budget squeeze, produced substantial rate increases by all three utilities compelled to pass energy costs onto consumers, and will require a $12 billion public bond issuance to repay the general fund. Nevertheless, all such charges have not been collected by utilities from ratepayers. In addition to over $9 billion owed the general fund and higher ongoing rates, utilities purportedly owe additional billions of dollars to energy producers, forcing one utility into bankruptcy and leading the other two to seek massive rate increases.

In addition, the utilities have allegedly profited by (1) pocketing substantial sums from the sale of assets (which indicated some anticipation of excessive prices), (2) holding company involvement in natural gas and other generation assets achieving substantial (unattributed) profits, and (3) profiting from the rate freeze. Rates were frozen at a level substantially above fair rate-of-return levels in order to give the utilities an incentive to approve deregulation. The plan built in substantial profit that utilities would keep where and if efficiencies resulted from market forces as advertised. And that efficiency gain would theoretically allow the promised 20% reduction in rates following transition to competition. However, instead of efficiency gain and a 20% reduction, consumers have been assessed increases above the freeze levels of 60%, with substantial additional liability pending, and a $12 billion public bond needed to repay the general fund. This bond will be repaid by ratepayers who will bear not only the cost of the general fund repayment, but added interest over the twenty-year term of the bond. In addition, such a large bond issuance reduces general fund revenues because paid interest is deductible from otherwise received general fund revenues, and serves to limit other public bond financing opportunity.

Consumer advocates note that the utilities supported deregulation in a gamble that the freeze would provide room for substantial additional profit given those gains. They would keep that gain should they win the gamble. Having lost it,

they should not now receive compensation for their failure. Consumer representatives argue that those sums diverted to holding company parents from generator sales should be tapped, as well as other utility assets, for proper utility stockholder assessment.

◆ ***Performance-Based Ratemaking.*** As to PG&E, SCE, and SDG&E—the remaining monopoly utilities that deliver electricity to businesses and homes, the PUC has altered traditional "fair rate of return" maximum rate regulation at the same time it has devolved power generation and some transmission to less regulation (as discussed above). As to the remaining monopoly structure (actual distribution), fair rate-of-return ratemaking has yielded to "performance-based ratemaking" (PBR). Under PBR, utilities' rates are set according to an average market price for electricity. If a UDC is able to purchase electricity for less than the benchmark price, the savings are split between the ratepayers and the utility's stockholders. The theory behind PBR is to give the utility an incentive to improve efficiency by allowing it to share in savings, to provide a reward similar to that extant in the free market for improved performance. However, the calculations made under this more nebulous standard lack the reference point of fair rate-of-return analysis which monitors excessive profit.

Prior to the crisis described in the chronology above, the PUC engaged in proceedings to set rates under the PBR mechanism for SDG&E *[17:1 CRLR 172]*, SCE, and PG&E. However, the Commission indicated in 2001 that PBR issues have been rendered substantially moot by the extraordinary events described above. PBR ratemaking is essentially a fine-tuning device to provide incentives to regulated utilities to improve performance as a market would reward. Given the enormous pass-through charges developing from generator charges at ten to twenty times historical levels, such refinements have become substantially moot for the time being.

◆ ***Annual Transition Cost Proceedings.*** During the period of transition (while utilities dispose of uneconomic generating facilities to achieve stability), the PUC continues to regulate rates through annual transition period rate adjustments. These adjustments involve cost recovery to utilities subject to competition-caused loss. Part of that loss is calculated through the CTC (discussed above). That loss also includes restructuring implementation costs—the costs that occur when a utility gives up its generating plants and associated assets. *[17:1 CRLR 172]*

All three utilities filed their first ATCP applications in September 1998 (A. 98-09-003 for PG&E, A. 98-09-008 for SCE, and A. 98-09-009 for SDG&E). On February 17, 2000, the PUC issued a final 5-0 decision (D. 00-02-048) largely reflecting settlements between the parties to the proceedings; consumers were represented through the PUC's Office of Ratepayer Advocates.

The major issue in dispute in these proceedings was the amount properly allowed to SDG&E and SCE as "employee transition" costs—that is, how much should the utility be allowed as an expense for the cost of reconfiguring its employees to match the deregulated structure (where many of its previous functions are taken over by "competitive" firms). PG&E employee transition cost issues with the ORA were resolved by agreement. Most of these calculations involved the allocation of pension and disability benefits as employees are laid off or transferred to other entities under the transition to competition.

All three utilities were ordered to revise their handling of asset depreciation prospectively. They were ordered to estimate the market value for each asset (above book value), record authorized depreciation for each, and cease taking depreciation as a part of transition costs. This issue is of particular importance in the case of SDG&E, which was taking accelerated depreciation (in violation of PUC guidelines) as a transition cost in order to write it off and assess ratepayers for those expenses in the short term (see D. 00-02-048 at 62). In addition, SDG&E was allowed to recover the "difference between actual payments" for power and "corresponding revenues from the PX, ISO, or other markets." This guarantees the utility ratepayer assessment for all its power costs up front, regardless of outside collection problems. SDG&E's "nuclear material and supply inventory" was deemed fully eligible for recovery through the Transition Cost Balancing Account (TCBA). Hence, the utility will fully recover as costs these fuel elements which may or may not qualify as "prudently" purchased under normal maximum rate regulation doctrine.

SCE won approval of most of the transition costs it sought, although training equipment, mechanical service shop equipment and certain other costs which were included were limited only to those costs truly "stranded" (made superfluous) by transition to competition.

PG&E was ordered to subtract $2.47 million in shareholder savings disallowed by the Commission in related D. 99-06-089. Otherwise, almost all of the utility's accounting methods and TCBA entries were approved. This approval included the Diablo Canyon audit costs and other housekeeping matters.

As to all three utilities, the decision tightens accounting requirements, imposing monthly entries and monthly determinations of transition cost recovery. Importantly, PG&E was ordered to enter into its TCBA the plant additions and depreciation accruals consistent with Commission D. 99-10-046. The Commission found that "as of January 1, 1998, it is reasonable to assume that PG&E, Edison, and SDG&E were aware that their generation plants were likely to sell above net book value." Hence, it prospectively modified its rate accounting procedures to require PG&E and Edison (which, unlike SDG&E, had not yet entirely divested themselves of all power-generating assets) to credit the TCBA based on market value, now higher than book value. This change applies to non-nuclear assets only, and will benefit ratepayers marginally.

The Commission disallowed carrying costs and interest on various assets within the TCBA given the fact that a TCBA

deficit to a utility already earns interest, and separately adding interest as a "carrying charge" would duplicate already granted interest assessments.

◆ ***Post-Transition Period Ratemaking Applications.*** In January 1999, PG&E, SCE and SDG&E proposed methods to mark the end of the transition period and to establish the mechanism for future revenue adjustment proceedings (A. 99-01-016, A. 99-01-019, A. 99-01-034, and A. 99-02-029). In Phase 1 of the ensuing proceeding (D. 99-10-057), the Commission addressed the mechanics of ending the rate freeze and other ratemaking matters (*e.g.*, balancing account treatment for energy procurement costs and ongoing CTC recovery), and considered post-transition rate regulation in Phase 2 during 1999–2000. *[17:1 CRLR 173; 16:2 CRLR 142–43]*

In Phase 2, the PUC considered post-transition rate regulation, including regulation of the utilities' procurement costs and various cost allocation issues. The proceeding attempted to address important post-transition issues, including the following:

- How will PBR operate for procurement spending by the utilities? That is, if procurement costs—the cost of energy purchased from the PX—decrease, how much of that reduction should be credited to the utility in the form of additional charges to ratepayers?
- In general, how will the PUC oversee utility purchases for customers purchasing power after transition who still lack a practical competitive alternative to the utility?
- Should the utilities be required to buy all their energy from the PX after transition (the so-called "mandatory buy requirement")?
- How does the PUC's jurisdiction interact with FERC jurisdiction over the power generators and the increasingly common interstate transmission of electricity?
- How should price volatility be handled? Should some price cap limits be imposed, particularly for so-called "bundled" customers (those without alternative choice to utility-provided power as selected and arranged by the utility)?
- How should ongoing transition costs (which carry over after transition) be handled after the rate freeze is lifted?
- How should "restructuring implementation costs," "nuclear decommissioning costs," and "public purpose programs" (see below) be handled post-transition?
- How do the answers to these questions translate into the ongoing Revenue Adjustment Proceedings, the distributed generation rulemaking proceeding (see below), and other issues?

All evidence and briefing in the Phase 2 proceedings were considered submitted for ALJ decision on November 5, 1999. However, prior to that submission, several major parties to the proceeding—including SDG&E, ORA, UCAN, the PX, and other parties—proposed a partial settlement to the proceeding. As a result, the Commission reopened the proceeding to enable public comment on the proposed settlement, and extended the date for final submission to the ALJ to December 13, 1999.

On June 8, 2000, the Commission issued D. 00-06-034, which included 68 findings of fact and 24 conclusions of law. By a 3–2 vote (with Commissioners Lynch and Wood dissenting), the PUC rejected the settlement arrived at by some of the parties to the proceeding. In general, the Commission suspended decisions on a proposed PBR procurement mechanism and other matters governing post-transition ratemaking, finding that "the new market structures are not sufficiently developed." Its most important elements include the following:

- During the transition period, the three utilities may procure their energy only through the PX or through "any qualified exchange, as authorize by future advice letter filings." A "qualified exchange" may not be owned, all or in part, by a California UDC or its affiliates. (Note that this prudent conflict of interest caveat was not applied to the underlying market catalyst, the ISO, which was dominated by those with a profit stake in market outcome.)
- After the end of the rate freeze period (during the post-transition period, when all three UDCs have sold their generation assets), UDCs may buy more broadly, including through bilateral contracts. However, the PUC opined that the PX system needs all utilities participating in order to become a comprehensive and effective market. This controversial ruling would prove unfortunate, as the absence of bilateral contracts facilitated the market clearing price excesses described above.
- The PUC rejected a proposal by PG&E to impose a temporary electricity price cap to insulate customers from high prices during times of high demand. Instead, the Commission improvidently found: "We did not initiate electric restructuring in order to shield consumers from the market....[M]asking prices results in incomplete and inefficient market structure and system demand, and compromises system reliability...." Within three months of this decision, this finding would also prove embarrassing to the Commission, as the chronology above indicates.
- The Commission also rejected proposals to allow UDCs to offer new commodity products and services, other than those already authorized by prior PUC decisions.
- The PUC agreed to permit utilities to continue to offer "balanced payment plans" to residential consumers (a "bill-smoothing" option allowing customers to spread large bills over several months).

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Most disturbing to consumer advocates was the Commission's continued reliance on performance-based ratemaking without reference to "used and useful" capital, "fair rate of return" analysis, or "prudent cost" standards which are all monitored and included in calculating required rev-

enue in traditional "fair rate of return" ratemaking. Consumer advocates argued that one may add "incentive" measures to such a proceeding, including those which replicate marketplace reward for enhanced efficiency, innovation, or public benefit. But such an inclusion need not exclude the basic elements necessary to monitor a monopoly utility for excessive profits. Instead of supplementing a regulatory regime which monitors variables relevant to excessive or fair profit levels, the Commission made the following finding of fact: "With properly-designed incentive regulation, once the benchmark is established, little regulatory oversight is required because the interests of shareholders and ratepayers are properly aligned." PBR starts from the assumption that the initial revenue posited is correct and is properly immutable, but for the incentive factors chosen for PBR adjustment. Consumer advocates disagree that a single benchmark (or starting position) at an historical point of time will properly monitor dynamic costs, investment, productivity, and costs of capital without reference to those concepts directly.

◆ ***SDG&E Bill Stabilization Decision and Investigation.*** As SDG&E was the first utility to sell its generating facilities and San Diegans were thus the first California residents to "enjoy the benefits" of California's electricity deregulation experiment, it may be instructive to focus on the PUC's treatment of SDG&E.

In 1999, the Commission was confronted with skyrocketing SDG&E post-transition rates. *[17:1 CRLR 173]* In July 1999, the PUC adopted a settlement applicable to SDG&E's post-transition rates in D. 99-05-051. That decision capped SDG&E rates at a level 12.5% above the previous frozen levels for the monthly bills for July, August, and September 1999 *[17:2 CRLR 172]*; the decision also provided that SDG&E would not propose a similar rate cap for the year 2000.

When San Diegans' rates soared to double and then triple their historical level during the summer of 2000, UCAN proposed a rate freeze at 1999 levels on July 6, 2000. On August 3, 2000, the PUC issued D. 00-08-021, rejecting the proposed rate freeze but acknowledging that the matter warranted further study. Accordingly, the Commission also modified D. 99-05-051 and opened investigation I. 00-08-002. The August 3 decision recognized that the wholesale markets "are not workably competitive," and noted that PG&E and SCE customers were benefitting from the continued rate freeze (because those utilities remained in "transition" to competition) while SDG&E rates were rising quickly, with a jump of more than 30% in 2000.

Responding to further requests from the Governor about SDG&E rate increases, the Commission adopted a "bill stabilization plan" on August 21, 2000 to extend through December 31, 2001. The plan was intended to set rates at no more than $68 per month for those residential consumers who use less than 500 kwh/month through January 2001, to increase to $75 per month through the remainder of the year (about a 10% increase). Commercial customers using less than 1,500 kwh/month were ceilinged at $220 per month through January 2001, to rise to $240 for the remainder of 2001. The plan also imposed some limited retroactive caps, prorated to apply most to low-use customers and partly ameliorating the July–December 2000 increases. It also provided for a "levelized payment plan" on an "opt out" basis—so consumers subject to high summer bills will average their costs unless they affirmatively choose not to. Commissioners Lynch and Wood dissented from the decision.

Less than a month later, the PUC's August 21 decision was superseded by AB 265 (Davis), urgency legislation capping electricity rates at 6.5 cents/kwh for residential, small commercial, and street lighting customers of SDG&E through December 31, 2002, retroactive to June 1, 2000 (see above and 2000 LEGISLATION). AB 265 also directed the Commission to establish a voluntary bill stabilization plan for larger customers by allowing them to elect to have the energy component of their bills set at 6.5 cents/kwh, subject to true-up after a year. In December 2000, the Commission established a voluntary program for larger customers in D. 00-12-033. That rate produced an average bill of $72 per month for large customers.

Following these decisions, on January 24, 2001, SDG&E petitioned the Commission for an immediate 17% increase in rates, to $83.50 for the average residential user. (Note that many users—particularly low-income persons and commercial enterprises in inland areas subject to high desert heat—have to use substantially more than 500 kwh/month. Their bills would increase substantially to $300 per month for residential and $2,000 per month for commercial rates.) The requested 17% hike was on top of the 30% increase from 1999 assessed during 2000 (see discussion above).

The new plan and SDG&E's petition were then influenced by additional urgency legislation, SBX1 43 (Alpert) and ABX1 43 (Correa), enacted in early 2001 and signed by the Governor in April (see 2001 SPECIAL SESSION LEGISLATION). The new laws essentially extend the ceiling of 6.5 cents/kwh on the energy component of SDG&E's electricity bills to large industrial customers through December 31, 2002, retroactive to June 1, 2000. They provide that the PUC may extend the ceiling through December 2003. As discussed above, the PUC decided (D. 00-02-048) that all funds charged SDG&E by power generators which are not paid for from these ceilinged amounts must go into a "Transition Cost Balancing Account"—to be assessed at the end of 2001 (or at a further date as legislation subsequently provides). However, SBX1 43 and ABX1 43 provide that no such later billing may occur and that such arrearages may not be collected from consumers. Given the utility's constitutional right to a fair rate of return on investment, however, it is unclear how such a prohibition can be enforced. UCAN Executive Director Michael Shames commented that these assurances of "no later assessment" were politically motivated—made with knowledge that such funds would be assessed as constitutionally required, and as provided for in the PUC order discussed above.

◆ ***PG&E and SCE Rate Increases and Rate Design.*** On January 4, 2001, the PUC granted SCE and PG&E an emergency one cent/kwh rate increase. The hike amounted to about 9% of the supposedly frozen rates, already increased once during 2000. Then on March 27, 2001, the Commission approved another increase for PG&E and SCE in D. 01-03-082. The previous 9% temporary increase was made permanent by the decision, and another 47% was added on top—the largest increase in PUC energy regulation history. It will cost the customers of the utilities approximately $2.5 billion dollars annually.

The decision orders the utilities to enter the revenues from the rate increases into balancing accounts subject to refund if, at a later date, they fail to use the funds to pay for future power purchases. And the decision reiterated that the utilities must spend the previously-authorized one cent increase similarly. The warning is important because the PUC-ordered audits of both utilities found that those funds were not applied exclusively for power purchases. The Commission later determined that DWR should receive a pro rata share of rates collected by the utilities (including these increases), based on its power purchases provided for utility use.

The decision also "expect[s] the utilities to join with the State and take any and all actions necessary to assure that California and its utility customers realize refunds for or repayment or disgorgement of power seller overcharges." The PUC noted: "The utilities possess market information and expertise that place them in a unique position to understand market behavior and to pursue legal remedies. To date, however, the utilities appear to have been hesitant to take legal action against the generators and sellers who are responsible for, and have profited by, the utilities' financial distress." The PUC declared that it would make the rate increase subject to refund in two circumstances: (1) to the extent that generators and sellers make refunds for overcollections, "those refunds should either be passed through to ratepayers or applied to unrecovered power purchase costs"; (2) to the extent that any administrative body or court denies refunds of overcollections in a proceeding where recovery has been hampered by a lack of cooperation from a utility, the rate increases will also be subject to refund.

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Although requested by the utilities to end the "rate freeze," the Commission concluded that the freeze of AB 1890 is still in effect technically, notwithstanding the obvious mootness of its application given subsequent increases and events.

The decision did not finally determine the "rate design" (which customers will be charged how much to yield the revenue the utility is due). It did increase the coverage of the California Alternate Rates for Energy (CARE) program, which provides a small discount for low-income families (see below).

On April 25, 2001, the Commission announced hearings scheduled to occur through May 2001 on its initial proposed rate design. That design adds higher-percentage increases as energy usage grows beyond average use levels for each category of user. Although this criterion is intended to stimulate conservation, it could work substantial inequities where residential users living in hot interior climates require more energy for basic comfort, or where commercial or industrial users unavoidably use substantial energy and have substantial sunk cost investment in appliances and machinery requiring electricity.

◆ ***Energy Efficiency and Demand Side Management.*** When the PUC regulated power comprehensively, it was able to impose cross-subsidies through its rate design to reward customers for conservation, notwithstanding the lack of such incentives in a market lacking the "internalization" of such "external" or future costs—as is typical under current liability regimes. With the imposition of competition, the Commission needs to formulate new ways to stimulate energy conservation, which provides long-term economic and social benefit. In 1999, the PUC conducted two proceedings concerning energy efficiency and demand side management programs (D. 99-08-021 and R. 98-07-037). D. 99-08-021 addresses standards for conservation which may apply in 2000 and 2001, including low-income weatherization programs. Hearings on the policy and procedural issues were held during the last week of August and first week of September 1999. *[17:1 CRLR 175]* On September 27, 1999, the utilities filed their compliance applications seeking approval of proposed program year (PY) 2000 and 2001 energy efficiency programs, budgets, performance incentive mechanisms, and market assessment and evaluation studies.

In December 1999, the PUC issued D. 99-12-053, which authorized the utilities to implement their proposed PY 2000 energy efficiency programs and budgets on an interim basis, subject to mid-year adjustment after further hearings. The decision deferred a determination regarding the utilities' program-specific performance award mechanisms to the final decision. Evidentiary hearings concluded February 2, 2000 and the Commission issued a related decision later that month, adopting D. 00-02-045 concerning the structure and operating procedures of the California Board for Energy Efficiency (CBEE) and the Low-Income Governing Board (LIGB). In this decision, the Commission disbanded the CBEE effective March 31, 2000, while continuing the LIGB. The Commission also changed LIGB's name to the Low Income Oversight Board (LIOB).

◆ ***Low-Income Programs.*** The PUC maintains two programs to assist low-income ratepayers: the California Alternate Rates for Energy (CARE) and Low-Income Energy Ef-

ficiency (LIEE) programs. CARE provides eligible low-income households with a 15% discount on their electric and gas bills. In theory, it currently applies to 2.7 million households, almost one in five. However, the utilities have implemented it for only 1.6 million households. The LIEE provides funding to weatherize and install other energy-saving devices to reduce the amount of energy required by eligible low-income families. Only a small fraction of eligible families receive this assistance. Funding for these programs comes from a "public purpose" surcharge on utility bills, providing $140 million per year for CARE and $60 million for LIEE.

In its March 27, 2001 rate decision markedly increasing SCE and PG&E rates, the Commission reiterated its commitment to the CARE program. It had exempted CARE-eligible customers from its previous January 2001 9% rate increase, and it similarly exempted them from the new increase. And it actually expanded coverage for CARE from 150% of the poverty line to 175%, raising eligibility for the benchmark family of three from $21,500 annual income to $25,000.

Related to the CARE subsidy is the "baseline" level of energy assumed in PUC rates. Use up to that baseline is often excluded from rate increases as a way to both encourage conservation and to assure a minimum quantity of power to low-use consumers.

"Baseline" calculation is an important part of the rate design decisions of the Commission. Consumer advocates argue that the baseline, which has not been raised in over ten years, is well below the amount of electricity needed. On March 2, 2001, the Commission announced proceedings to review that level given the implications of high rate increases during early 2001 on many consumers who were compelled to use energy well above the baseline level for minimal comfort, particularly lower-income consumers who tend not to live along the more temperate coastline of the state. The baseline varies by area, generally from 300–1,300 kwh/month, with rates increasing beyond specified levels. It is also increased somewhat for families with electric heating.

In early 2001, the legislature enacted SBX1 5 (Sher) and ABX1 29 (Kehoe), both signed by the Governor on April 11, 2001 (see 2001 SPECIAL SESSION LEGISLATION). The former provides a one-time supplement of $100 million for CARE, and the latter provides a one-time appropriation of $20 million for LIEE and another $50 million to replace inefficient appliances. The Commission is expected to implement the legislation during late 2001.

Distributed Generation Rulemaking

In rulemaking commenced in December 1998 (R. 98-12-015), the PUC examined the potential for competition in electricity distribution services, including distributed generation (electricity produced on or near a customer's premises) and the roles and responsibilities of big electric distributors. Distributed generation (also referred to as "distributed energy resources") refers to small, modular electric generation and/or storage devices installed close to the customer's premises. The rulemaking, which was initiated to consider whether the Commission should pursue further reforms in the structure and regulatory framework governing electricity distribution services, was initially undertaken as a collaborative effort among the PUC, the California Energy Commission, and the Electricity Oversight Board. Its goal was to identify the range of issues on distributed generation and distribution competition and their interrelationships, and to explore options.

Over 61 parties submitted opening comments in March 1999, leading to the PUC's adoption of D. 99-10-065 on October 21, 1999. *[17:1 CRLR 174]* That decision, which closed R. 98-12-015, set forth the procedural roadmap that the Commission will follow to address the issues of distributed generation, electric distribution competition, and the role of the UDCs. The decision bifurcated the issues into two tracks. The first track will address distributed generation issues, which is being accomplished through a new rulemaking proceeding, R. 99-10-025. The goal of R. 99-10-025 is to develop policies and rules regarding the deployment of distributed generation. The second track issues will address electric distribution competition and the roles of the UDCs in a competitive retail electric market. The second track issues are addressed in a PUC staff study and report.

The staff report was filed in June 2000, and covers the benefits and disadvantages of distributed generation, end user side-distributed generation (a plant generating some of its own electricity also provides some to another plant), grid side applications of distributed generation (a plant with its own generating capacity for itself has excess power to contribute to the grid), interconnection issues, sale of excess electric capacity, rate design issues, stranded costs, California Environmental Quality Act issues, and local government impacts. In addition, the report sets forth twelve additional issues inherent in competition in these distributed services (from line extensions to rights of way and metering procedures). Finally, the report lists broader impacts to examine, including labor, consumer education, natural gas infrastructure impacts, and requests from the Solar Development Cooperative. The report is intended to set the agenda for future proceedings.

Energy Affiliate Transaction Rules

On January 4, 2001, the Commission announced its commencement of a rulemaking proceeding (R. 01-01-001) to review its energy affiliate rules adopted in December 1997 (D. 97-12-088, as amended in D. 98-08-035). These rules attempt to establish standards of conduct governing relationships between California's natural gas local distribution companies and electric utilities and their affiliated, unregulated entities providing energy and energy-related services. The 1997 proceeding set forth two objectives to guide the Commission's formation of the appropriate rules: (1) to foster competition, and (2) to protect consumer interests. The Commission was then concerned with the behavior of Commission-regulated utilities, not their affiliates. One purpose

of the rules was to ensure that utility entities competing to provide energy services face uniform rules so that no advantage or disadvantage accrues to any one utility.

This subject area is of great importance given the advantage accruing to the incumbent utility in competition for related products and services. Thus, the Commission anticipated the need for rules to promote a level playing field and to prevent the utility with monopoly power advantage from leveraging that advantage to limit competition from otherwise superior competitors to its affiliates. In addition, the Commission wished to avoid cross-subsidization and self-dealing, so that a utility's customers would not subsidize the affiliate's operation.

The PUC's current affiliate rules prohibit preferential treatment. The same policies must apply to affiliates and nonaffiliates in the provision of utility services. Transactions between a utility and its affiliates are limited to tariffed products and services, or products and services made generally available by the utility or affiliate to all market participants through an open, competitive bidding process. The utility may not condition the provision of any services provided by the utility, any discounts, rebates, or waivers of terms and conditions of any services on the taking of any goods or services from its affiliates. There can be no assignment of customers to an affiliate. There must be a separation between the utility and its affiliates on issues of business development and customer relations so that there is no soliciting of business, acquisition of information, sharing of proprietary information, passing of customer information, or giving the appearance that either speaks on behalf of the other. If a utility provides a discount, rebate, or waiver of any charge to its affiliates, it must electronically notice it.

In addition, a utility may not provide customer information to affiliates exclusively, and without customer consent. Any non-customer-specific non-public information the utility makes available to its affiliates must be contemporaneously available to all other service providers. A utility may only provide information on its affiliates to its customers with a Commission-approved list of service providers. A utility must maintain records of all transactions with its affiliates, maintain a record of all contracts and bids related to its affiliates, and may not favor its affiliates in providing customers with advice or assistance.

Under the current rules, a utility and its affiliates must be separate corporate entities, keep separate books and records, may not share plants, facilities, equipment or costs, and may not make joint purchases of goods and services associated with traditional utility merchant function. A utility may share with its affiliates certain joint corporate oversight, governance, support systems, and personnel. A utility may not trade upon, promote, or advertise its affiliates association with the utility, nor allow the affiliate to trade upon, promote, or advertise their affiliation with utilities. If a utility shares its name or logo with an affiliate, that affiliate must disclose in plain legible or audible language that the affiliate is not the same company as the utility, is not regulated by the Commission, and that the customer does not have to buy the affiliate's products to continue to receive services from the utility. In addition, a utility and its affiliates may not jointly employ the same employees, including board of directors and corporate officers, except in specified circumstances. Any movement of employees between a utility and its affiliates must meet enumerated provisions, including the payment of a transfer fee.

New products and services must be offered through affiliates, unless they satisfy the affiliate rules and are approved by the Commission. The affiliate rules specify the requirements to be met for approval of a new category of nontariffed products or services.

The new proceeding will review each of these rules, and consider additional rules. These proceedings have special importance given the continued activity of California's three major private utilities in the "competitive" sector, including natural gas and other assets related to energy interests. At this writing, the proceeding is expected to continue through 2001 and reach decision in mid-2002.

Competition in the Natural Gas Industry

In January 1998, the Commission initiated a rulemaking proceeding (R. 98-01-011) to look into extending the "benefits" of deregulation to the natural gas industry. Related legislation—SB 1602 (Peace) (Chapter 401, Statutes of 1998)—was enacted in August 1998, effective January 1, 1999. The bill enacted section 328 of the Public Utilities Code, which allows the Commission to explore natural gas deregulation, but prohibits the Commission from "enacting" [sic] any gas restructuring changes until after January 1, 2000. *[16:1 CRLR 168]* On October 8, 1998, the Commission responded to the Peace legislation by issuing D. 98-10-028 to adjust its proposed rulemaking schedule consistent with the legislation.

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On July 8, 1999, the Commission issued D. 99-07-015 to begin a broad investigation (I. 99-07-003) into prospects for natural gas deregulation. The investigation is intended to identify the most promising options and to explore problems. Consistent with the Peace bill, the Commission also is examining the costs and benefits of various options, and may recommend statutory changes to the legislature to facilitate healthy competition. In D. 99-07-015, the PUC identified the following options to be examined:

• Enhance consumer protections for "core customers" (residential and small commercial customers that rely on the utility for all their natural gas needs) to enable them to make informed decisions regarding their options, protect themselves from unscrupulous providers, and seek assistance if problems arise.

• Improve access to transmission and storage services, and transmission, storage, and balancing rights trading. In addition to companies using the utilities as a primary source for transmission and storage services, the Commission will consider creating a secondary market.

• Improve the "balancing service" whereby gas is added to the pipeline system by the utility pipeline operator when supplies are low and gas is drawn off the system when supplies are high.

• Identify appropriate conditions for offering "hub services," which include holding extra gas supply somewhere in the system, or selling some of a utility's gas to a customer for short-term use.

• Refine gas utility procurement practices and expand competitive options for core customers.

• Improve the flow of information related to market transactions. The Commission is looking at the information the gas utilities currently provide to customers and competitors to determine if it is sufficient or if more should be provided.

• Assure accountability for system safety and meter choice by requiring utilities to be responsible for installation, operation, and maintenance of their system and the meters they use, as well as provision of after-meter services. Standards will be developed for manufacture and utility procurement of alternative metering technologies.

• Consider billing options that allow competitors to bill for their services through the utilities' bills.

• Separate costs and rates for all gas utility services.

• Review inconsistencies in programs administered by PG&E and SoCal Gas to determine if they need to be consistent.

The Commission is seeking to develop a structure that preserves the utilities' traditional role of providing full service to core customers while clearing obstacles to the competitive offering of gas, transmission, storage, balancing, and other services for all customers throughout the state. *[17:1 CRLR 175–76]*

Also on July 8, 1999, the PUC ordered an investigation into one aspect of natural gas regulation relevant to the list of identified options. The investigation (I. 99-07-003) explored one of the so-called "promising options" for deregulation—the "balancing issue" described above—and led to D. 00-02-050 issued on February 17, 2000. The decision discusses PG&E's practice of declaring an "operational flow order" (OFO) when it believes "that pipeline inventory would be above or below a tolerable range." In other words, if gas is in short supply, the utility may charge more for it, thus discouraging demand peaks at times of short supply (presumably replicating the market's reaction to scarcity). The concept in theory is that if one imposes higher prices (here, "penalties") as available supply is low, demand is discouraged and sudden price spikes are avoided. Excessive supply, which also causes disposition problems for the utility, similarly triggers an OFO and a penalty. PG&E gives at least twelve hours of warning to customers before it issues an OFO and raises prices for further increased use.

A major issue raised by the investigation but not yet addressed by it is the possibility of gratuitous "rigging" of short supply by PG&E to justify self-enriching OFO assessments. Indeed, since the implementation of a "Gas Accord" in 1997 (D. 97-08-055), PG&E has been permitted to establish a relatively narrow "tolerance band" as a target free from penalty. When projected supply falls above or below that narrow band, the utility issues an OFO and collects additional revenue. Evidence in the proceeding established that PG&E had called OFOs about five times per month since 1997. Note that although market forces will stimulate a higher price where demand approaches projected supply, suppliers can be expected to have reserve capacity. Large customers will favor a supplier with the security of such a reserve and a sophisticated market will produce such reserves. But a monopolist can eschew such reserves, and will have an incentive to so limit them where it directly profits from short supply.

In its decision, the PUC partly sided with customers who suffer increasing penalty assessments, noting that the utility could provide basic information so supply variations could be predicted more accurately by large users subject to penalty assessment, allowing them to modify usage and avoid penalties. The Commission, while moving toward competitive principles, also encouraged customers and utilities to "work together cooperatively" to share information (not the presumption commonly underlying competitive behavior).

The final decision was largely driven by a proposed settlement reached by the involved parties. It requires PG&E to disclose additional operational information on its Web site accessible to customers, thus facilitating their ability to predict and mitigate OFO assessments. Those unable to monitor data and usage electronically may carry imbalances over a longer period to allow more latitude to reconcile an "operating imbalance."

Regrettably, the decision does not require the addition of storage assets by PG&E, which could remove the need for such a tight range between supply and projected demand. Instead, it merely orders a "report describing the costs of adding such assets." Tellingly, the decision reduces penalties during a Stage 1 OFO from $1 per Dth to 25 cents per Dth, and creates a Stage 2 penalty at the previous $1 level (which is not assessed until limits are exceeded by more than 20%).

Consumer advocates expressed concern that the Commission's investigation missed the major source of possible price excess: the federal permission to deregulate pipeline transmission into southern California. That "deregulation" did not end government oversight in lieu of a competitive market. Rather, it left a single pipeline carrier in some areas able to effectively control prices and extract excess profit. Southern California is served by a single major pipeline firm and, according to consumer advocates, other major energy firms are capable of collusion and price manipulation apart from the monopoly power of the pipeline. As 2001 began, natural gas prices rose in California to two, and then five, and then ten times price levels at the pipeline source in

Texas. According to consumer critics, the Commission's study of "more competition" in the gas industry thus far misses the overriding dangers and misunderstands the deep reliance of industrial and consumer infrastructure on predictable and reasonable prices in relation to cost. The prospective replication of the electricity debacle in natural gas would magnify the impact of the former given the reliance of most generators on natural gas as the low-cost energy fuel.

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Implementation of AB 1149: Utility Line Undergrounding

In 1999, the legislature enacted AB 1149 (Aroner) (Chapter 844, Statutes of 1999), which is intended to stimulate additional undergrounding of unsightly and sometimes dangerous overhead lines, particularly in populated areas. *[17:1 CRLR 180]* The bill required the PUC to study and report to the legislature by January 1, 2001 on improving the conversion of existing overhead utility lines (both power and telecommunications). The legislature directed the PUC to include the following specific issues in its study: (1) the elimination of barriers to establishing continuity of the existing underground system and ways to eliminate uneven patches of overhead facilities; (2) how to enhance public safety; (3) how to improve reliability; and (4) how to provide more flexibility and control to local governments. In addition to these enumerated issues, the PUC was ordered to look at both the broad policy issues raised by its undergrounding program as well as the details of program implementation, including the overall cost-effectiveness of the program and the current level of funding.

On January 6, 2000, and in compliance with the legislation, the PUC issued an Order Instituting Rulemaking (OIR 00-01-005). The 12-page rulemaking order was accompanied by a 19-page *Undergrounding White Paper* issued on November 19, 1999 by the Commission's Energy Division, which sets forth relevant background information.

Prior to1967, property owners desiring to replace an overhead system with an underground system had to form an assessment district to bear the costs. That year, the Commission adopted a policy of encouraging undergrounding, and applied it uniformly to all utilities by prescribing tariff amendments (D. 73078). New housing subdivisions (and those that were already undergrounded) were required to provide underground service for all new connections. Utilities (both electric and telephone) would bear the costs of installation except for trenching, conduit, and backfilling. Utilities were authorized to request exemptions from undergrounding requirements where house lot sizes were very large or where undergrounding was otherwise impractical. The Commission recognized, however, that it was not generally practical to put transmission facilities underground.

The Commission also established three programs that allowed customers, localities, or utilities to replace overhead with underground service if specified conditions were met. The Commission asked each utility to submit a budget for the new programs, and adopted tariff rules that required communications utilities to coordinate with electric utilities in order to place their lines underground as well.

In 1969, the Commission clarified its policy. In particular, it required all service extensions to be placed underground, with utilities bearing all costs except those of trenching and backfilling, which remained the responsibility of developers (D. 76394). In 1970, the Commission confirmed that underground service was mandatory in new subdivisions (D. 77187). In 1976, the Commission extended its policy regarding undergrounding to cover distribution lines of any voltage classification (D. 85497). A number of subsequent resolutions and decisions ordered utilities to increase budgets for replacement of overhead with underground facilities. In 1981, Resolutions E-1930 and E-1931 ordered such increases for PG&E and SCE in order to "maintain construction activity at the historical level..." (D. 82-01-18).

The Commission also changed the formula used to allocate available funds among local governments. At first, funds were allocated to local governments based on population. In 1982, the Commission recognized that some areas (where most service was already underground) had relatively little need for undergrounding, and approved a formula based on the number of meters served by overhead lines. The Commission also adopted a procedure for shifting funds away from communities that were not using their allocation promptly. Finally, the Commission allowed local governments to require utilities (for example, through franchise agreements) to install the first 100 feet of utility-owned underground facilities free (D. 82-01-18).

In 1990, the Commission reexamined the allocation issue and struck a compromise between the two previous policies. Henceforth, allocations would be based on 1990 levels, with increased funding allocated half-and-half on the basis of total meters and overhead meters, respectively. To the extent that funds exceeded 150% of the previous year's allocations, however, those funds were allocated according to the number of overhead meters.

The current undergrounding program consists of two parts. The first (under Tariff Rules 15 and 16) requires developers to put utility services underground in new subdivisions. Utilities, both electric and telephone, bear the costs of installation, except for trenching and backfilling expenses, which are the responsibility of developers. The second part of the program (under Tariff Rule 20) governs both when and where a utility may remove overhead lines and replace them with new underground service, and who shall bear the cost of the conversion. Rule 20 dictates three levels—A, B, and C—of ratepayer funding for undergrounding projects. Under Rule

20C, any electric customer may convert to undergrounding so long as it reimburses the utility for all costs (less the estimated net salvage value and depreciation of the replaced overhead facilities). Under Rule 20B, limited ratepayer funding is available to pay the cost of cables, transformers, and other electrical equipment, but the balance of the costs (including conduits and structures) must be paid by the customer requesting the undergrounding. Under Rule 20A, utility ratepayers bear most of the cost of the undergrounding conversion, but only for projects that are "in the public interest." Rule 20A funds are very limited, the demand for them is high, and the potential for controversy over these funds is great.

In its OIR, the PUC concluded that the ratepayers' current share of the cost of conversion appears to be between $130 and $180 million annually. At this current rate of expenditure, it could take many decades to underground the entire state's distribution system. The Commission proposed to evaluate the history, costs, and accomplishments of the program; its potential future costs and projected benefits; a desirable level of funding; cost containment; allocation to high-priority projects; the rather momentous problem of its relationship to electric restructuring and other Commission programs; and the interaction with telecommunications issues. The order stated that the PUC would address these issues through a combination of workshops, testimony, hearings, and briefs.

Staff's white paper cites the benefits of undergrounding, including aesthetics and increases in property value. Increased public and worker safety is another undergrounding benefit. The potential reduction in fatalities and injuries due to contact with overhead facilities, as well as reduction of power outages caused by overhead incidents, are desirable goals. In addition, undergrounding may reduce the danger of fire and other threats to life and property. Other potential advantages include a reduction in utility and public costs due to less maintenance, and a reduction in overall public exposure to electromagnetic fields. However, these benefits must be subject to a cost-benefit analysis. Perhaps the same benefits could be achieved at lower cost than undergrounding. Underground lines may provide a higher level of service reliability than overhead lines because of their protection from aircraft, the elements, trees, or even fog, but if there is a failure underground it may be harder to inspect, detect, diagnose, and repair.

During 2000, the Commission held a workshop on February 10 and eight public participation hearings throughout the state. It deliberately confined its inquiry to non-controversial matters, deferring to a "phase 2" the difficult questions such as third-party bidding to underground, incentive mechanisms, unbundled payments via utility billing (that is, the itemization of undergrounding costs on utility bills), and handling telecommunications inclusion underground. Despite this deferral to a "phase 2," the Commission failed to comply with the January 1, 2001 legislative deadline and did not even conclude phase 1 by that date, noting that the energy crisis occupied its attention as a higher priority.

On April 23, 2001, Commissioner Duque—the assigned commissioner in this proceeding—issued a letter to the legislature with recommendations for legislative action. He suggested that the legislature provide funding for an "undergrounding ombudsperson" to assist consumers stymied by utilities and the PUC from achieving undergrounding goals; create different funding mechanisms for Rule 20B and 20C projects; fund an appeals process at the PUC for citizen complaints; and increase underground funding (perhaps by adding taxpayer funds). To the extent these recommendation draw upon general fund resources, favorable legislative response is dubious given the state's budget situation. Commissioner Duque's recommendations were not approved by the full Commission, and the more germane PUC policy issues have been put off for later phase 2 deliberations with no set deadline.

Telecommunications Utility Regulation

Telecommunications deregulation preceded California's electricity deregulation by several decades. The seminal 1982 consent decree in *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), divested AT&T of its existing national telephone monopoly, spinning out the so-called "Baby Bells" to substantial regulation by state public utilities commissions, and introducing competitive choice in long distance service, telephone equipment manufacture, inside wiring of homes, and other aspects of telephone service then subject to AT&T control. This divestiture created 22 local operating companies known as Bell operating companies (BOCs). These BOCs were then grouped into seven unaffiliated regional BOCs (RBOCs). Because of subsequent mergers—including the takeover of Pacific Bell by SBC, only four RBOCs are now in operation: SBC/Pacific Bell, Qwest, Verizon, and BellSouth.

The newly competitive environment has created serious problems in telecommunications, including (1) the unclear division of jurisdiction between state commissions and the Federal Communications Commission (FCC); (2) the pervasive local monopoly power held by cable providers in virtually every community, and more recently the concentration of power nationally as Time Warner and AT&T now control over three-fourths of national cable enterprises; (3) government's failure to apply "cross-ownership" media restrictions to cable (thus allowing Time Warner and AT&T to consolidate significant holdings in newspapers, magazines, entertainment production, theaters, *et al.*, and—together with the enterprises of Rupert Murdoch—to dominate television satellite transmission); (4) government's failure to regulate maximum rates by cable providers, allowing them to achieve monopoly power profit to cross-subsidize and undercut potential competitors unfairly, and (5) Internet access problems—including the contention of the cable industry that the single available provider of cable (and, for many, the single high-speed Internet provider) can restrict Internet access to its designated service provider. The recent U.S. Ninth Circuit Court of Appeals decision in *AT&T v. City of Portland* (see

LITIGATION) essentially declares the Internet to be a part of the national telecommunications system under FCC jurisdiction. Hence, that federal agency will determine available competitive choice as to Internet access, costs, and competition. Regrettably, the FCC has to date indicated little concern over anticompetitive abuses and dangers involving the cable industry, the Internet marketplace, or telecommunications generally. The growing number of individual channels and market choices have distracted policymakers and the public from the growing concentration of "choke points"—cable and Internet access decisionmakers who are consolidating vertically into production and programming, and who exercise concentrated economic power to an extent inconsistent with a competitive free market governed by consumer sovereignty.

Many of these background issues lie beyond the direct purview of the PUC, but they affect the market position of telecommunications licensees within its jurisdiction. For example, Internet access increasingly depends on cable/telephone intermodal competition, with the latter subject to substantial PUC jurisdiction while the former enjoys extraordinary unregulated status. Reliance on such intermodal competition may pose problems where each mode has areas of cost or locational advantage (*e.g.*, in many areas, high-speed Internet access may be available only by telephone; in other areas, it is available only via cable). Such a setting stimulates below-cost competition where both alternatives exist, and extraction of excess profit where choice is lacking. Where one mode has no price impediments and substantial monopoly power, imbalances and distortions are magnified.

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Within the telephone service market, the legal history of regulation outside of California also imposes complications. The 1982 *AT&T* final judgment precluded the BOCs from providing interLATA services. "InterLATA" refers to service that crosses different "local access and transit areas" (LATAs). In common parlance, the regional Bell companies are not allowed to provide "long distance" service themselves (except to deliver the message locally). The court included this prohibition to prevent the BOCs from using their local exchange monopoly to bar competitive entry into the long distance field. The BOCs may request permission to enter the long distance market if they can show that they are no longer capable of using monopoly power to stifle competition. Several BOCs outside California have now been granted permission to do so; Pacific Bell is currently in the process of applying for permission (see below).

The federal Telecommunications Act of 1996, Pub. L. No. 104-104 (1996), was enacted to enhance competition in telecommunications, including local markets (see LITIGATION for further discussion of the 1996 Act). The law forces incumbent local exchange carriers (ILECs) to open their markets to competitors. At the same time, BOCs may potentially enter into the regional and interstate markets now open to competition under section 271 of the Act. However, that section effectively requires BOCs to prove that they have opened their respective local exchange markets, including the interLATA calls within their own territorial jurisdictions. To meet this requirement, the BOC must demonstrate that it has complied with a 14-point "competitive checklist."

The Act explicitly removes or preempts any state or local regulation which impinges on the open competition goal. Because of preemption, state public utilities commissions are now subject to FCC guidance in most telecommunications regulation. State PUCs have acted as local agents of the FCC when dealing with the local BOC under acknowledged FCC jurisdiction. When a BOC attempts to enter the long distance market, it does so by initially filing an application with the state PUC, which processes it through one of two tracks and holds hearings to determine whether the BOC has satisfied the "checklist" and can be passed on for FCC approval.

◆ ***PacBell Reapplies for Permission to Enter Long Distance Market***. PacBell is undertaking its second attempt to secure PUC permission to provide long distance service to California residents. In order to obtain approval to provide in-region long distance service, PacBell must demonstrate that it provides non-discriminatory access to competitive local exchange carriers (CLECs) pursuant to a 14-point checklist enumerated in section 271(c)(2)(C) of the Telecommunications Act of 1996, and that "the requested authorization is consistent with the public interest, convenience, and necessity." In December 1998, the PUC ruled that the utility had failed to comply with all of the checklist requirements that must be met before entering the long distance market, and that PacBell must refile its application. The FCC has stated that the most probative evidence of non-discriminatory access is actual performance data, including third-party testing. Accordingly, in D. 98-12-069, the Commission authorized PacBell to contract for third-party testing and directed the utility to file an operations support system master test plan by January 11, 1999.

PacBell is undertaking its second attempt to secure PUC permission to provide long distance service to California residents.

PacBell refiled its application on July 15, 1999, claiming that it has complied with the checklist requirements and the local market is currently open to competition. However, consumer advocacy groups and other competitors contend that PacBell has not yet fully opened its lines to competition. Competitors complain of problems of dropped connections and errant billing while trying to hook up their computer systems to PacBell lines, and other opponents insist that consumers do not really have a realistic choice when choosing a

local phone company. *[17:1 CRLR 177; 16:2 CRLR 145–46; 16:1 CRLR 162]*

On April 2, 2001, 11 CLECs submitted their respective lists of difficulties, problems, and concerns with PacBell's current operations. The central argument of the CLECs is that in some 50 enumerated respects, PacBell continues to stymie competition in the local California market. These alleged barriers involve technical database and connection impediments for competitor computer hook-up onto PacBell lines, and the failure to meet checklist due dates in opening up the local loop facilities for competitive use. Competitors cite the four findings that the Commission must make under Public Utilities Code section 709.2(c) prior to PacBell entry, including (1) fair and non-discriminatory access to exchanges and interchange facilities (consistent with the Commission's Open Access in Network Architecture proceedings); (2) no anticompetitive practices by the LEC (PacBell), including unfair use of subscriber information or customer contacts; (3) no improper cross-subsidy of intrastate telecommunications through accounting or cost allocation methods; and (4) no harm to competitive intrastate markets.

The new entrants contend that these requirements have not been met. They remain vigorously opposed to PacBell entry into long distance markets while it allegedly blocks their attempts to compete with it in the local market where it retains control of the wired loop into homes and businesses. The Commission is requiring evidence of bona fide compliance with the requirement to facilitate fair local competition prior to its support of a long distance *quid pro quo* entry for PacBell. At this writing, a final decision is expected sometime in late 2001 or early 2002.

◆ ***Open Access Rulemaking.*** On December 9, 1999, the FCC released a decision requiring ILECs to provide competitive access to the high-frequency portion of their local loop. In other words, PacBell, GTE California, and other telephone utilities retaining the home and business wire connection must permit competitors to use their lines. As described above, the failure of local phone companies to do so has led regulators to bar their concomitant entry into long distance. The high-frequency traffic here at issue involves non-voice data and information transmission, including high-speed DSL lines which promise competitive access to the Internet. The issue takes on critical importance given its market context. The cable industry has available high-speed Internet connection capacity in some (but not all) areas. As noted above, two cable firms (Time Warner and AT&T) control 80% of the market nationally, and almost all local areas are served by only one provider. Further, cable firms contend that they can limit consumers to their chosen Internet service provider, or at least require its use—even where the local jurisdiction conferring a cable franchise would order open access (see LITIGATION). Hence, for most consumers, Internet access is subject to an anticompetitive "choke point." A typical consumer may have a cable provider with high-speed access and a designated Internet service provider. The only competition may be from a telephone DSL line. Accordingly, in order to prevent a duopoly (or worse), local DSL lines must be open to more than one carrier.

In 1999, the legislature enacted AB 991 (Papan) (Chapter 714, Statutes of 1999), which required the PUC to implement the FCC's December 9, 1999 order to open local access lines to competition by April 10, 2000. *[17:1 CRLR 181–82]* Accordingly, on January 31, 2000, the PUC's chief ALJ issued a ruling requiring PacBell and GTE California to file an offer to amend existing interconnection agreements to provide "line sharing agreements" for such competition. Hence, the "line sharing" phase of two longstanding proceedings (R. 93-04-003 and I. 93-04-002) began.

Instead of formal proceedings, the Commission opted for an arbitration format. Testimony was submitted by the two major utilities and by a number of prospective CLECs, and arbitration hearings occurred from April 7–17, 2000. No settlements were reached, so briefs were filed on April 21 and April 26, 2000. A draft arbitrator's report was filed on May 8, 2000, for final comment, further settlement negotiations, and "dueling clause" proposals (where objectors present alternative terms for interconnection agreements which allow competitors to use PacBell and GTE California local loop lines for DSL transmission to homes and businesses).

The overall goal of the "line sharing" proceeding was to ensure the possibility of competition by June 6, 2000—the deadline set by the FCC. The final arbitrator's report of May 26, 2000 is broken into four parts: network architecture for line sharing issues, operational issues, pricing, and general terms and conditions. The vast majority of issues were decided in favor of the ILECs, over the objections of challengers seeking broader competitive opportunity. The most important aspects of the decision include the following:

- The ILECs (PacBell and GTE California) are only required to provide a requesting carrier with access to the high-frequency portion of the loop if the ILEC is providing analog voice service on the particular loop for which the requesting carrier seeks access.
- The ILECs are not required to share their fiber-based lines until within 30 days of offering those particular lines to its own customers.
- The ILECs may own the splitter that patches into the line, even if used by a competitor.
- If an ILEC voice customer terminates that ILEC as its voice provider, the competing service must purchase the entire loop—including the voice transmission element, in order to continue to provide data service (Internet access).
- The standard for "trouble response time" by the ILEC where the shared line is not working is "parity with retail service"—a rather liberal 24 hours, rather than the two-hour mean time standard proposed by the competitors. (Note the competitive difficulty for a challenger where Internet access is blocked for 24 hours at a time, with correction depending upon more expeditious response by the challenger's direct competitor.)

• As proposed by PacBell, the rate for access to PacBell lines is $5.85 per month. This represents 50% of the cost of an entire PacBell loop if purchased by a competitor, including both voice and data; as such, it is far above the marginal cost of providing the space on the line (which is nil). The access rate for GTE is $3 per month.

On September 21, 2000, the full Commission approved the final arbitrator's report in D. 00-09-074.

◆ ***PUC Suspends Planned Area Code Overlays and Implements Number Conservation Measures.*** Over the last three years, California consumers have endured a proliferation of PUC-required area code changes—rendering stationery obsolete, interfering with businesses that are telephone service-sensitive, and inconveniencing all involved. Moreover, the proliferation has resulted in toll billing for calls within a city that had long been within the same area code. The problem stems partly from the need to accommodate new competitors, and partly from the demand for new lines for fax machines, cellular phones, pagers, Internet access, and other new uses. However, consumer groups discovered in 1999 that the creation of new area codes due to an alleged lack of numbers has been artificially stimulated by FCC policies allowing existing utilities to reserve tens of thousands of numbers based on projections of possible use by potential competitors. *[17:1 CRLR 177–78; 16:2 CRLR 147–48]*

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While waiting for the FCC to revise its rules, the PUC "split" many area codes into two areas—one that retains the existing area code and another whose residents must assume a new area code. From 1991 to 1997, the number of area codes in California almost doubled to 13, and further increased to 25 by March 2000. Exacerbating the problem was a 1998 PUC decision approving a new concept called an "overlay." Planned initially for the 310 area code in Los Angeles, it was intended as an alternative to the unpopular "split" maneuver. Rather than splitting the 310 area into two area codes (310 and a new 424), the PUC's overlay plan would require all residents in the 310 area (some of whom would be assigned a 424 area code) to dial eleven digits (1 + area code + seven-digit phone number) on all calls, even if the call is to next door. The new 310 overlay was scheduled to take effect on July 17, 1999. The PUC also approved overlays for the 408 area code in the San Jose area (scheduled for October 1, 1999), the 909 area code in San Bernardino and Riverside counties (scheduled for February 12, 2000), the 415, 510, and 650 area codes in Bay Area counties (scheduled for September 2000), and the 714 area code in Orange County (scheduled for October 7, 2000). The overlay concept imposes most of the costs and annoyances of an area code split, and also complicates automatic dialing and numerous other systems which assume that local phone numbers involve seven digits rather than eleven.

In June 1999, Assemblymember Wally Knox and U.S. Representative Henry Waxman filed a petition with the PUC, urging it to suspend—and ultimately reverse—its overlay decision regarding the 310 area code in Los Angeles. While the Commission was deliberating the petition, the legislature passed AB 406 (Knox) (Chapter 809, Statutes of 1999), which directs the PUC to allocate phone numbers more efficiently *[17:1 CRLR 181]*, and the Governor announced his opposition to the overlay concept.

Anticipating an FCC rule change, the PUC suspended the 310 overlay in September 1999 and suspended the other six planned area code overlays on December 16, 1999. One factor stimulating the suspension decision was an agency number utilization study of the 310 area code revealing that no less than three million telephone numbers remain unused.

On March 17, 2000, the FCC adopted new rules doing away with the allocation of blocks of 10,000 numbers at a time for prospective future use by competitors hoping to gain subscribers. Instead, numbers will be reserved and allocated in blocks of 1,000. Hence, small competitors with little prospect of obtaining more than one or two thousand subscribers will receive the number matching their projected business need. The FCC also ordered then-unused numbers to be returned to local rate centers so they could be reassigned more precisely in relation to need.

On March 18, 2000, immediately after the FCC's decision, the PUC started the process of reallocating numbers in blocks of 1,000. Further, the Commission ordered allocated numbers to be "pooled" for use by more than one competitor, further cutting unused numbers awaiting prospective customer allocation. In July 2000 in D. 00-07-052, the PUC adopted several number conservation measures for use in numbering plan areas statewide; when the FCC subsequently issued superseding orders in December 2000, the PUC conformed its rules in an April 30, 2001 order.

As of 2000, FCC policy prohibited the use of separate numbering systems for separate "technologies" or types of lines. This prohibition adds to the pressure on area codes, threatening existing "land lines" (voice transmission by hard wire traditionally dominating phone service) with disruptive new area codes and/or overlays. Accordingly, in September 2000, the Governor signed SB 1741 (Bowen) (Chapter 907, Statutes of 2000), which requires the PUC to seek FCC approval of "technology-specific" or "service-specific" area codes or overlays for cell phones, pagers, and other strictly data transmission lines (see 2000 LEGISLATION). If allowed by the FCC, new area codes or overlays would be applied only to the new devices which form the basis of much of the new demand, and would not apply to the land lines of residential and business customers who rely on continuity of numbers. The policy change would limit new area code

designations (or overlay systems) to those specified devices (*e.g.*, cell phones, pagers, data-only services in retail stores doing credit card checks), allowing land lines to retain their existing area codes notwithstanding continued overall expansion.

The FCC has not yet abrogated its ban on technology specific numbering differentiation, but is scheduled to issue a decision in December 2001 which is expected to allow "case-by-case" waiver to states and area codes where expansion is stimulating numbering disruption, particularly New York and California.

◆ ***PacBell Service Charges: Increases and Decreases.*** On November 18, 1999, the PUC announced a new pricing scheme applicable to "unbundled network elements (UNEs)." Translated, these are distinct telephone services or functions provided by PacBell which can be offered by PacBell. Alternatively, competing companies are allowed to pay PacBell a lease charge for those services, and then compete in providing them to consumers. Examples include call waiting, repeat dialing, speed calling, three-way calling, white page listings, operator directory services, inside wiring repairs, and high-speed data transmission.

Theoretically, these unbundled prices are "cost-driven." That is, they are to be based on what is termed the "total element long-run incremental cost" (TELRIC) plus a markup of 19% to recover "shared and common costs" incurred by PacBell. Hence, each service designedly pays its own marginal (or "out-of-pocket") cost, plus an equivalent share of overhead. Accordingly, effective competition is stimulated and PacBell, although controlling the necessary conduit, may experience competitive challenge. The PUC's November 18, 1999 decision also adopted price floors for certain access line and other local exchange services; these price floors were set according to a different standard called "total service long-run incremental cost" (TSLRIC), which generally results in a higher cost floor. At the same time, the Commission rejected the requests of PacBell and others to allow varying charges by geographic location, based on the varying costs of serving different locations. Cost formulas and pricing remain tied to statewide averages.

The PUC granted PacBell authority to raise the fee for 411 directory assistance calls from 25 cents to 46 cents per call—an 88% increase.

However, the Commission did grant substantial rate increases for unbundled services in applying its adjusted formula and in allowing PacBell more liberal credit for non-recurring costs. For example, the PUC granted PacBell authority to raise the fee for 411 directory assistance calls from 25 cents to 46 cents per call—an 88% increase. The decision also eliminates free 411 calls for businesses and reduces the number of free 411 calls made by residential consumers from five per month to three. Callers are permitted to ask for up to three listings on each call, and exemptions from the charges are available to customers with certain physical and visual disabilities.

The decision infuriated customers, consumer groups, and even some dissenting commissioners. PacBell's request generated some 42,000 letters and emails, almost all opposing the price hike. Opponents contended that the fee increase will especially hurt the elderly, customers on fixed incomes, and those with limited English skills. There is also a belief that customers are being forced to use directory assistance more frequently because of changing area codes (see above) and phone books with limited coverage and outdated listings.

PacBell, on the other hand, insisted that the previous rate did not cover its cost of providing the service, and also argued that the increase is necessary in the face of strong competition from Internet directory assistance services as well as from other long distance carriers. In addition, PacBell claimed that even with the price increase, its rates are still lower than fees charged in 25 other states. A 3–2 majority of the PUC insisted that the rate increase and reduction in free call allowance will not affect most consumers because the majority of residential customers make three or fewer directory assistance calls per month.

In addition to the rate increase for 411 calls, the PUC's November 1999 order also granted rate increases for PacBell's busy line verification (BLV) and emergency interrupt (EI) services. BLV, which is used when callers ask an operator to verify if someone's phone service is busy or out of order, increased from 50 cents to $1.20. EI service, which is used when customers ask the operator to interrupt a busy call, increased from $1.00 to $1.25 per request.

On December 22, 1999, Administrative Law Judge Maribeth Bushey issued a proposed decision requiring PacBell to pay $44 million in penalties for deceptive and misleading practices in advertising optional services.

Not all of PacBell's requests and the PUC's decisions were in the direction of increase. The charge for one unbundled service of particular importance—high-speed transmission use of PacBell's facilities—was reduced significantly. The Commission lowered previous PacBell prices for a DSL high speed line, or "data loop," from $148.96 to $12.67. One impetus for this reduction is PacBell's desire to compete with high-speed cable services in providing Internet access. The non-DSL phone connection to the Internet is markedly slower than DSL. Without DSL, PacBell cannot serve as a conduit for competitive Internet access where cable (high-speed) competition is available. Although the PUC issued press releases accurately pointing to the beneficial impact of this price reduction on consumer prices and competition, consumer critics pointed out that it was driven by "intermodal" competition—that is, by cable competition not within PUC regulatory ambit.

◆ ***PacBell Fined for Deceptive Marketing Practices.*** On December 22, 1999, Administrative Law Judge Maribeth

Bushey issued a proposed decision requiring PacBell to pay $44 million in penalties for deceptive and misleading practices in advertising optional services. The ALJ's findings were remarkably similar to a 1987 case in which the PUC fined PacBell $16.5 million and ordered substantial consumer refunds for deceptive marketing practices. *[8:2 CRLR 121; 7:2 CRLR 106]*

The proposed decision cited PacBell for engaging in deliberately misleading sales practices by tricking or pressuring consumers into buying expensive or extra services that they do not need or understand. PacBell customer service representatives testified at evidentiary hearings that they were instructed to wait until customers repeatedly asked for a price before giving it to them, and that they were not to take "no" for an answer until a customer refused at least six times. PacBell had been marketing a package of optional phone services as "The Basics," leading customers to believe it was the lowest-price plan even though there was a cheaper alternative for which many customers would have opted. PacBell also pushed higher-priced rates on its inside wire repair service without telling customers of a cheaper alternative until they declined the higher price. *[17:1 CRLR 178–79]*

In addition, the ALJ found that PacBell had persuaded people to switch from Caller ID "complete blocking" to "selective blocking" without giving them complete information. A majority of customers sign up for Caller ID blocking so that their names and phone numbers will not appear on another person's Caller ID box. Although complete blocking better protects a consumer's privacy rights, it renders Caller ID—a feature which PacBell markets for $6.50 per month—less effective and valuable to companies that are trying to capture personal information from those who call them. PacBell, therefore, had been trying to push customers to switch to selective blocking, which means that their names and numbers will be displayed unless they dial *67 before making a call. Some customers were offered a "free upgrade" to selective blocking by a telemarketer without being informed of their privacy rights. Because selective blocking offers less privacy protection than complete blocking, the switch is actually a downgrade rather than an upgrade.

As noted above, the proposed decision found that the utility had "failed to sufficiently inform customers regarding (1) the number blocking options to prevent a caller's number from being displayed on a Caller ID device, and (2) the two inside wire maintenance plans it offers," and that "Pacific Bell's marketing policy of sequentially offering packages of services in descending order of price fails to sufficiently inform customers because they are not told of the lesser-priced package unless they refuse the more expensive option." In addition, the ALJ determined that "unlimited potential sales commissions for service representatives is not consistent with the incentive compensation guidelines we have previously stated with regard to Pacific Bell. We hold that Pacific Bell may not use the Universal Lifeline Telephone Service subsidy program as a link to market other optional services. In its marketing of 'The Basics,' a package of optional services, we conclude that the name inaccurately suggests a relationship with basic telephone service."

The proposed decision declared that "wide-ranging efforts by Pacific Bell are required to remedy the violations we find. Unfortunately, the record does not contain detailed remedial proposals, so we direct the parties to prepare such proposals for our further consideration. These proposals should address customer notification and refunds, including customer outreach plans to ensure that Pacific Bell reaches as many customers as possible. We direct Pacific Bell to make all necessary refunds directly to customers and to provide sufficient funds for the customer outreach effort."

While consumer groups applauded the ALJ's proposed decision, PacBell denied the findings and claimed the ruling was "ill-informed and unfair." PacBell contended that the PUC was aware of its marketing of "The Basics" and even approved it. It claimed that the PUC received only 15 complaints over a time period when the company handled 36 million calls from customers. PacBell officials stated that the ALJ's proposed decision "legally flawed, anticompetitive, and dangerous to California businesses." On January 21, 2000, PacBell filed an appeal of the proposed decision. In addition, PacBell took out full-page newspaper advertisements and aggressively lobbied legislators.

Consumer groups counter-lobbied, but complained bitterly about the impact of PacBell's campaign contribution influence and the intervention of Davis administration officials in PUC deliberations. On the same day that PacBell filed its appeal, San Diego-based UCAN filed its own appeal of the ALJ's decision, claiming that the decision did not punish the company sufficiently. UCAN argued that PacBell should be penalized about $100 million instead of $44 million.

Following a reopening of the record and further argument, ALJ Bushey filed a "modified draft decision" on July 13, 2000. The "modified draft decision" included very few changes to the original proposed decision, and actually increased the proposed fine to $49 million, including a required consumer education plan funded at $29 million (an increase of $5 million) and a fine of $20 million to be deposited into the general fund (with $10 million of that fine suspended if PacBell complies with all of the PUC's orders).

Although the PUC's proceeding produced substantial evidence of misleading, unfair, and unlawful marketing practices by the utility, PacBell continued its aggressive lobbying campaign after July 2000. Some observers believe that the success of that effort undermines the integrity of the Commission's regulatory process. Due to the tenacity of PacBell's resistance to the outcome of these proceedings, finality has been elusive. In October 2000, Commissioner Neeper issued an alternate proposed decision finding entirely for PacBell on all issues of alleged unfair marketing, finding no fault by the utility as to the complained-of practices, and contrary to the factual findings of the ALJ. Later in 2000, Commissioners Bilas, Wood, and Brown all contributed their

own proposed decisions in this matter; at this writing, a final PUC decision is not expected until late 2001.

◆ ***PUC Approves Bylaws for Consumer Protection Fund.*** On May 4, 2000, the PUC published Resolution T-16388 to implement bylaws for a "Consumer Protection Fund Oversight Corporation," a nonprofit organization established to administer a compensation fund of $4.8 million created to address alleged telephone marketing abuses by GTE California.

The Oversight Corporation is the culmination of proceedings initiated on February 18, 1998 (I. 98-02-025), an investigation of alleged marketing abuses filed by the PUC's Consumer Services Division. That investigation led to the intervention of the Greenlining Institute and the Latino Issues Forum, two Bay Area public interest organizations. These intervenors sought to represent limited-English speaking victims of those alleged abuses. A settlement agreement was reached among the parties on December 17, 1998 (D. 98-12-084), and GTE California contributed $4.8 million to resolve the matter.

The Corporation has the task of selecting and monitoring a Fund Administrator, a third party capable of fulfilling the assigned tasks consistent with the corporate bylaws. The settlement decision states that the purpose of the Fund is to "facilitate and further telecommunications consumer protection and education in non-English and limited-English speaking communities in the GTE California service area." The Corporation will issue a request for proposals from nonprofit organizations wishing to engage in telecommunications education projects; the money is to be distributed within three years, and all grantee programs are to be completed within one year of the receipt of a grant. The Corporation is to be dissolved by December 31, 2003 "unless the Commission directs otherwise." The termination of the funding vehicle is important to the intervenors, who contend that it should be used as a continuing vehicle to distribute restitutionary PUC- or court-ordered *cy pres* monies involving regulated utilities. The Commission has created a Board of Directors with no Commission representation (outside of one person in a non-voting liaison role). The Commission allocated $48,000 for the first year as operating expenses, and $32,000 for each of the two following years.

◆ ***Rulemaking to Establish a "Telecommunications Consumer Bill of Rights."*** On February 3, 2000, the PUC instituted a rulemaking proceeding (R. 00-02-004) for the purpose of finding new methods of protecting consumer rights in today's ultra-competitive telecommunications market. While regulations have been changing in order to promote competition within the market, the changes have paved the way for marketing abuses (as reflected above). The Commission hopes to first establish a "telecommunications consumer bill of rights" and then set up consumer protection rules to secure them. Also on February 3, 2000, the staff of the PUC's Telecommunications Division released its report and recommendations entitled *Consumer Protections for a Competitive Telecommunications Industry*. The report recommends that the Commission officially recognize and protect the following consumer rights:

- Disclosure—consumers have a right to receive clear and complete terms and conditions for service agreements and disclosure of prices for goods and services, and to affirmatively accept all terms and conditions before being charged for services.
- Choice—consumers have a right to select their service vendors, and to have that choice respected by industry.
- Privacy—consumers have a right to personal privacy, and to have protection from unauthorized use of their records and personal information and to reject intrusive communications and technology.
- Public participation—consumers have a right to participate in public proceedings and shall be informed of means to participate.
- Oversight and enforcement—consumers have a right to be informed of their rights and what agency enforces those rights. Consumers have a right to address how well state and federal regulators monitor and implement consumer protections on their behalf.
- Accurate bills and redress—Consumers have a right to understandable and accurate bills for services they authorize and the opportunity for redress for problems they encounter. Vendors of telecommunications services shall provide clear information explaining how and where consumers can complain. Consumers shall have their complaints addressed without harassment.

Telecommunications Division staff argued that the bill of rights should be applicable to services provided by all telephone companies (including wireless carriers), noting that consumer protections for customers of wireless services were ordered by the PUC in D. 96-12-071 but have yet to be established. Staff also recommended the replacement of the "fully competitive" service tariffs filed with the PUC by telecommunications companies with consumer protection rules. Note that the background for these proceedings involves deregulation to competitive forces. Normally, the competitive sector is subject to a phalanx of general consumer protection statutes and remedies. However, these may be limited as to a newly deregulated industry, because legislators have long relied on state regulators and have not enacted protective statutes in the relevant subject area. And even court remedies for general and serious abuses may be limited by continued respect for the regulatory authority of the now-absent regulator, with deferral to an absent watchdog often continuing through "exhaustion of administrative remedies" requirements, application of the "primary jurisdiction" doctrine, or other bars to redress normally available against market abusers.

On February 3, 2000, the PUC instituted a rulemaking proceeding (R. 00-02-004) for the purpose of finding new methods of protecting consumer rights in today's ultra-competitive telecommunications market.

Finally, Telecommunications Division staff suggested that the Commission reexamine its longstanding limitation of liability protections in filed tariffs. While some liability limitations may be appropriate where a utility is closely regulated and must clear much of what it does in advance, the advantage to consumers is less clear when the limitation is applied to competitive services for which the Commission no longer sets rates based on cost of service.

The Commission asked stakeholders to provide input on the development of the new rules. Written comments were requested by April 3, 2000, and reply comments by May 3, 2000. Extensive public participation hearings were scheduled throughout the state, running from June 15 in the San Fernando Valley to August 15, 2000 in Fullerton (and including ten other locations, with both afternoon and evening sessions in most locations).

In January 2001, Assigned Commissioner Carl Wood expressed support for many of the proposed rules. He also sought stakeholder comments on two new sets of rules—standards governing the inclusion of unauthorized, misleading, or deceptive charges for products or services on the subscriber's telephone bills ("cramming"), and rules addressing the switching of customers' service without their permission ("slamming"). Both of these problems were the subject of extensive testimony during the public participation hearings. Accordingly, the rulemaking was essentially expanded into three sets of rules, with PUC staff drafting proposals for the latter two. Commissioner Wood's January 2001 order anticipates a new "telecommunications consumer protection general order" which will consolidate all three sets of rules. In addition, the Commissioner anticipates that growing out of the "rights" general order should be a "consumer telecommunications education program" to stimulate consumer knowledge of and industry adherence to the final standards. At this writing, Commissioner Wood is expected to release interim rules governing cramming in July 2001; a final PUC decision on all three subject areas is scheduled for early 2002.

◆ ***Lifeline Program: Rulemaking and Report.*** On October 11, 2000 in D. 00-10-028, the PUC adopted revisions to the Universal Lifeline Telephone Service (ULTS) program and General Order (GO) 153. The ULTS program was created in 1984 in response to the enactment of the Moore Universal Telephone Service Act, Public Utilities Code section 871. Local phone utilities are required to provide basic telephone service to low-income households at substantially reduced rates. Utilities then recover these subsidies from the ULTS Fund (based on the difference between each utility's normal tariffed rates for basic service and the discounted rates charged to ULTS customers). The fund is fed by a surcharge assessed all end users of intrastate services. *[17:1 CRLR 179; 16:2 CRLR 145–46]*

As of 1999, 3.2 million California households participated in the ULTS program. The ULTS program budget for 2000 was approximately $276 million; of this amount, $268.6 was expended on subsidies paid to utilities to provide ULTS; $6.6 million funded marketing and outreach efforts; and the remainder was spend on ULTS program administrative costs.

The rule changes adopted in October 2000 are intended to update the ULTS program based on the changes extant since the PUC's adoption of GO 153 in 1984. According to the PUC, the revisions also conform to specific aspects of the federal Lifeline and Link Up programs; expand ULTS program benefits to provide more low-income households with access to affordable basic telephone service; and revise ULTS program administrative procedures to make the program more effective and efficient. The specific revisions to GO 153 and the ULTS program adopted by this decision include the following:

- ULTS program benefits are expanded to allow ULTS customers to pay a discounted service-connection charge each time they reestablish ULTS at the same residence, move to a new address, or switch from one ULTS provider to another.
- ULTS program benefits are expanded to provide two ULTS lines to low-income households that have (a) a disabled member who needs "two-line voice carryover" to access basic telephone service, or (b) at least two members, one of whom is disabled and uses a text-telephone device.
- Utilities and the PUC's Deaf and Disabled Telecommunications Program (DDTP) are required to develop and deploy a system by July 1, 2001, to provide utilities with real-time access to the DDTP's database of customers who satisfy the disability and equipment-related eligibility criteria for two ULTS lines.
- Utilities are prohibited from requiring customers who have an unpaid toll bill to post a service deposit in order to initiate ULTS if such customers elect to subscribe to toll blocking.
- The amount of lost revenues that utilities may recover from the ULTS Fund is limited to the amount that the incumbent local exchange carrier may recover from the ULTS Fund.
- Utilities that are qualified to become federal "eligible telecommunications carriers" (ETCs), but which are not currently ETCs, are not required to seek designation as an ETC in order to draw from the ULTS Fund.
- Utilities that sell ULTS to customers in a language other than English are required to provide these customers with (a) Commission-mandated ULTS notices, certification forms, and recertification forms that are in the same language in which ULTS was originally sold; and (b) Commission-mandated ULTS notices that include the toll-free number of customer service representatives who are fluent in the same language in which ULTS was originally sold.
- Utilities are required to (a) inform potential ULTS customers during the screening process about ULTS eligibility criteria, and (b) ask potential ULTS customers if they meet the ULTS eligibility criteria without having to disclose specific household income levels.
- Carriers that are late in remitting ULTS surcharge revenues are required to pay interest equal to a 10% annual rate beginning on the date that the remittances are due.

• The scope of Commission audits of ULTS surcharge remittances and ULTS claims is limited to five calendar years following the year in which the surcharge revenues are remitted or the claims submitted, except in cases where there appears to be malfeasance. Where there is an indication of malfeasance, the scope of an audit shall depend on the circumstances at the time the malfeasance is suspected or discovered.

• The charter of the ULTS Administrative Committee (ULTSAC) is revised to replace the members of the Committee who represent carriers and utilities with the directors of the PUC's Consumer Services Division, Legal Division, and the Office of Ratepayer Advocates, or their designees.

Meanwhile, on December 1, 1999, the Commission submitted a report to the legislature pursuant to SB 207 (Polanco) (Chapter 750, Statutes of 1996). The report discussed the PUC's five public purpose programs created to stimulate society-wide access to telecommunications, including: (1) the ULTS program, which discounts rates to low-income consumers (see above); (2) the California High Cost Fund-A, which cross-subsidizes 17 small LECs to reduce any disparity in the rates charged by these companies; (3) the California High Cost Fund-B, which similarly subsidizes LECs serving high-cost (*e.g.*, rural) areas of the state; (4) the California Teleconnect Fund, which provides discounted services to qualifying schools, libraries, publicly-owned health clinics and hospitals, and certain community organizations making telecommunications services (including Internet access) available to those otherwise lacking access; and (5) the Deaf and Disabled Telecommunications Program (see below).

The report documents improvement in universal service achievement for basic telephone service, with 95.2% of the state's households subscribing as of 1998—1% above the national average. Further, the trend toward universality is up, given somewhat lower levels in the 1980s (92.5% in 1984). The number of low-income subscribers receiving assistance has increased steadily from 3.1 million in 1996 to an estimated 3.6 million in 2000. Effective November 1, 1999, PacBell's new ULTS installation rate was $9.50, the flat rate was $5.34 per month, and the measured rate was $2.85; these numbers average a 5% decrease from pre-1999 levels.

The rulemaking was spawned by concerns raised by the public and some government agencies that the Commission's relaxed regulatory barriers for easing entry into the local exchange market may not be in compliance with CEQA.

The report also discussed the Public Policy Payphone Program, created in D. 98-11-029 (Nov. 5, 1998), whose purpose is to provide payphones to the general public at no charge where they would otherwise not exist. The private market requires substantial volume of use to support a payphone investment. However, the public benefit of having telephone access for emergency or other critical use may not be reflected in that market, and the PUC provides such facilities at locations it designates as "emergency gathering places."

◆ ***Rulemaking on Telecommunications Services for the Deaf and Disabled.*** Since 1979, the PUC's Deaf and Disabled Telecommunications Program (DDTP) has assisted the deaf, hard-of-hearing, and disabled communities to gain access to the public switched telephone network. Currently, the DDTP consists of three components: (1) the distribution of telecommunications devices (TDDs) at no cost to certified deaf and hearing-impaired telephone subscribers, to schools and organizations representing the deaf or hearing-impaired, and to state agencies with significant public contact; (2) the California Relay Service, which improves the communication potential for the deaf and hearing-impaired by providing them direct access to California's public switched telephone network; and (3) the provision of other specialized telecommunications equipment to consumers with hearing, vision, mobility, speech, and cognitive disabilities.

In 1999, the legislature enacted SB 669 (Polanco) (Chapter 677, Statutes of 1999), which codified the Deaf and Disabled Telecommunications Administrative Committee (DDTPAC) which the Commission has long had in place through its own administrative action. The statute requires telephone corporations to collect and fund the three programs described above. *[17:1 CRLR 182]* One of the motivations for this enactment was concern by some that the PUC lacked constitutional or statutory authority to maintain the program on its own regulatory authority alone.

On April 20, 2000, the Commission adopted Resolution T-16379 setting the DDTP's budget at $57.3 million for calendar year 2000. The amount is $4 million above the 1999 level, but $9.7 million below the recommendation of the DDTPAC.

On May 4, 2000, the Commission instituted a rulemaking proceeding (R. 00-05-001) to implement the changes called for in SB 669. As noted above, most of this statute simply replicates in statutory form the longstanding practice of the PUC in administering the three existing programs. The preliminary scoping memorandum indicates that most of the rulemaking proceeding will pertain to internal housekeeping matters, such as how the DDTPAC and PUC should communicate with each other and the timing of the PUC's adoption of the DDTP budget. The most important issue to be decided appears to be whether the utility representatives and/or Commission representatives on the DDTPAC should continue their membership. At this writing, a final decision is expected in July 2001.

◆ ***Rulemaking to Assess the Impact of New Communications Facilities on the Environment.*** On February 3, 2000, the PUC initiated a rulemaking proceeding (R. 00-02-003) to address the Commission's enforcement of the California Environmental Quality Act (CEQA) as it applies to telecommunications companies in California. The rulemaking was spawned by concerns raised by the public and some government agencies that the Commission's relaxed regulatory barriers for easing entry into the local exchange market may not

be in compliance with CEQA. The PUC eased entry requirements in order to facilitate competition, promote technological change, and reduce prices to customers. However, due to environmental concerns, the PUC has expressed concern that CLECs may need to be subject to more stringent requirements.

For example, in the months prior to the rulemaking order, PUC staff ordered several carriers to stop construction of telecommunications facilities following communications from other government agencies and members of the public who expressed concerns about the carriers' compliance with CEQA. In December 1999, the Commission issued two decisions modifying its previous practice of issuing authority to provide local exchange service to new CLECs. Rather than giving it out in "batches," the Commission will review each application, placing more emphasis on the potential environmental impacts that construction may cause. The problem with this system, however, is that only new CLECs are subject to stringent review, while existing LECs such as PacBell and AT&T are not, thereby creating an unequal system. Commissioners are concerned that carriers will not have an equal opportunity to compete. As part of the rulemaking, the PUC will consider these factors and try to assess the best way to keep the market competitive and fair while complying with CEQA. On April 7, 2000, the PUC conducted a roundtable discussion on this issue as part of its ongoing study. At this writing, the proceeding is still pending.

Auditor Criticizes PUC Contract Management Practices

On March 16, 2000, the Bureau of State Audits (BSA) released *California Public Utilities Commission: Weaknesses in Its Contracting Process Have Resulted in Questionable Payments* (No. 99117.2), a 25-page report critical of the PUC's contract management practices. BSA examined a sample of 25 Commission contracts entered into during fiscal year 1998–99. Problems cited include failures to seek competitive bids, clearly define scope of work, and/or prepare reasonably detailed budgets and progress schedules. As a result, the report concluded that "the Commission has made hundreds of thousands of dollars in questionable payments to its consultants." The report identified $662,000 in facially questionable payment in its audit of $11 million in expert consulting contracts entered into during the audited year. The audit found that the work itself was monitored adequately, but faulted Commission staff for failing to require competitive bidding, proper documentation, and specificity. Interestingly, the audit revealed that the Commission had conducted its own internal audit which made similar findings (see agency report on BSA for related discussion of this audit).

2000 LEGISLATION

Power Utilities Legislation

AB 265 (Davis), **AB 1156 (Ducheny and Battin)**, and **AB 970 (Ducheny)** comprise a three-bill package intended to ease the effects of the state's energy crisis on San Diegans, whose utility bills unexpectedly doubled and—in some cases—tripled during 2000 (see MAJOR PROJECTS), and to move the state toward construction of new power generating facilities:

◆ ***AB 265 (Davis)***, as amended August 29, 2000, requires the PUC—retroactive to June 1, 2000—to establish a ceiling of 6.5 cents/kwh on the energy component of electric bills for residential, small commercial, and street lighting customers of SDG&E through December 31, 2002; if the PUC finds it in the public interest, this ceiling may be extended through December 2003. The bill also requires the PUC to establish an accounting procedure to track and recover reasonable and prudent costs of providing electric energy to retail customers unrecovered through retail bills due to the application of that ceiling, and to review that procedure periodically; "the accounting procedure and review shall provide a reasonable opportunity for San Diego Gas and Electric Company to recover its reasonable and prudent costs of service over a reasonable period of time." The bill also requires the PUC to establish a voluntary program for large commercial, agricultural, and industrial customers who buy energy from SDG&E to set the energy component of their bills at 6.5 cents/kwh with a true-up after a year; and to institute a proceeding to examine SDG&E's prudence and reasonableness in procuring wholesale energy on behalf of its customers, and to issue orders it determines to be appropriate affecting the retail rates of SDG&E customers if it finds that SDG&E acted unreasonably or imprudently. This bill was signed by the Governor on September 6, 2000 (Chapter 328, Statutes of 2000).

◆ ***AB 1156 (Ducheny and Battin)***, as amended August 30, 2000, would have set aside $150 million in general fund money to be used by the PUC to assist SDG&E and San Diego ratepayers in the event that the difference between rates as capped by AB 265 (and as documented through the accounting procedure required by AB 265) and the price paid for power by SDG&E becomes unmanageable. After consumer advocates called the bill a public bailout of SDG&E and the out-of-state energy generators, Governor Davis vetoed the bill on September 29, 2000, stating: "This legislation is premature, sets a troubling precedent, and encourages merchant generators and energy traders to continue to act irresponsibly." The Governor noted that he had signed AB 970 (see below) to encourage new energy production in California, called upon FERC to halve its $250/mwh cap on wholesale electricity prices, and urged FERC to meaningfully regulate "the merchant generators and energy traders who are unconscionably profiteering in the deregulated marketplace."

◆ ***AB 970 (Ducheny)***, as amended August 31, 2000, enacts the California Energy Security and Reliability Act (CESRA) of 2000. The bill establishes the Governor's "Clean Energy Green Team" (Green Team), consisting of a chair and not more than 15 members appointed by the Governor, consisting of various federal, state, and local agency representatives with jurisdiction over powerplant siting activities in the

state; and requires the Green Team to undertake various activities designed to expedite construction of new, clean energy. The bill establishes expedited processes for California Energy Commission (CEC) siting of both temporary "peaking" and permanent thermal powerplants, and expands energy conservation and demand-side management programs administered by the CEC and PUC. This bill was signed by the Governor on September 6, 2000 (Chapter 329, Statutes of 2000).

AJR 77 (Keeley), as amended August 31, 2000, calls on the PUC and the EOB to petition FERC to modify rates of the ISO to ensure they are just and reasonable. Whenever those entities find that prices are not just and reasonable, they shall recommend to the FERC that remedial actions ("including the retroactive recalculation of the market-clearing price to just and reasonable levels as may be necessary to achieve fair and reasonable wholesale prices") be taken.

The resolution also calls upon the PUC, in consultation with the EOB, to investigate "the most effective mechanisms to protect consumers from price volatility, energy exports, and unreasonably high prices caused by an uncompetitive market." The resolution requires the EOB to direct the ISO to demonstrate why the price for wholesale energy in the ancillary services and real-time energy markets should not be capped at $100, and report back to the legislature by December 1, 2000. This resolution also calls on the PUC to commence an investigation by September 21, 2000 into the impact of high wholesale electric prices on consumers and electrical corporations under the rate freeze. AJR 77 was adopted in the Assembly on August 31, and in the Senate on September 1, 2000 (Chapter 153, Resolutions of 2000).

SB 1388 (Peace), as amended June 20, 2000, requires the PUC to conduct a pilot study of certain customers of each electrical corporation to determine the relative value to ratepayers of information, rate design, and metering innovations using specified approaches; the bill requires the PUC to report initial results of the study to the legislature on or before March 31, 2002. SB 1388 also requires the PUC and the EOB to facilitate efforts to obtain federal authorization to recover certain expenses of electrical corporations related to reconfiguration, replacement, or expansion of transmission facilities. The bill authorizes the PUC to periodically review and adjust depreciation schedules and rates authorized for an electric plant that is under the jurisdiction of the Commission and owned by electrical corporations and to periodically review and adjust depreciation schedules and rates authorized for a gas plant that is under the jurisdiction of the PUC and owned by gas corporations. This bill was signed by the Governor on September 30, 2000 (Chapter 1040, Statutes of 2000).

AB 2866 (Midgen), as amended June 15, 2000, authorizes the PUC to investigate issues relating to multiple qualified exchanges. The bill requires the PUC to prepare and submit findings and recommendations to the legislature if it determines that allowing electrical corporations to purchase from multiple qualified exchanges is in the public interest. This bill was signed by the Governor on July 8 (Chapter 127, Statutes of 2000).

SB 1709 (Kelley), as amended May 16, 2000, excludes corporations or persons employing digester gas technology for the generation of electricity for certain purposes from the definition of an electrical corporation subject to regulation by the PUC. Digester gas is the methane (natural gas) that comes from the treatment or decomposition of organic materials (including cow manure and human waste). This bill was signed by the Governor on July 21, 2000 (Chapter 174, Statutes of 2000).

AB 1002 (R. Wright), as amended August 25, 2000, requires the PUC to establish a surcharge on all natural gas consumed in California to fund certain low-income assistance programs, cost-effective energy efficiency and conservation activities, and public interest research and development. AB 1002 requires public utility gas corporations to collect the surcharge from natural gas consumers; the money from the surcharge will be deposited in the Gas Consumption Surcharge Fund created by this bill, and continuously appropriated to specific entities. Governor Davis signed this bill on September 29, 2000 (Chapter 932, Statutes of 2000).

SB 1194 (Sher), as amended August 21, 2000, restates the policy of the state that each electrical corporation operate its electric distribution grid in a safe, reliable, efficient, and cost-effective manner and that electric corporations continue to make prudent investments in their distribution grids; and reaffirms California's doctrine, as reflected in regulatory and judicial decisions, regarding the reasonable opportunity of investor-owned utilities to recover costs and investments associated with their electric distribution grid and the reasonable opportunity to attract capital for investment on reasonable terms.

SB 1194 also extends the collection by investor-owned utilities of a nonbypassable system benefit charge to fund energy efficiency and conservation activities; public interest research, development and demonstration; and in-state operation and development of existing, new, and emerging renewable energy resources. The bill requires the CEC to develop investment plans for renewable energy and public interest research, development, and demonstration; and requires the PUC and CEC to continue to administer energy efficiency programs following prescribed guidelines. SB 1194 requires the Governor, on or before January 1, 2004, to appoint an independent review panel that, on or before January 1, 2005, is required to report to the legislature and the CEC on, among other things, the benefits secured for residential customers. The bill requires the CEC to report to the legislature on renewable energy and research and development, develop and submit to the legislature certain investment plans, and recommend allocations among specified projects.

SB 1194 requires the PUC to require investor-owned utilities to inform all customers who request residential service connections via telephone of the availability of the California Alternative Rates for Energy (CARE) program and how

they may qualify for and obtain these services (see MAJOR PROJECTS), and permits such utilities to recover the reasonable costs of implementing these provisions. Additionally, the bill requires investor-owned utilities to accept applications for the CARE program according to procedures specified by the PUC, and authorizes the PUC to include misrepresentations of a material fact by an applicant obtaining a registration as an electric service provider as a reason to suspend or revoke their registration. SB 1194 was signed by Governor Davis on September 30, 2000 (Chapter 1050, Statutes of 2000).

AB 995 (R. Wright), as amended August 18, 2000, reaffirms state policy that each investor-owned utility shall continue to operate its electric distribution grid in its service territory and have a reasonable opportunity to recover its costs. AB 995 also extends, until January 1, 2012, the current surcharge on electricity to fund specified public purpose programs, including energy efficiency and conservation activities; public interest research, development, and demonstration (RD&D) programs; and in-state operation and development of existing, new, and emerging renewable energy resources. AB 995 requires the CEC to develop investment plans for renewable energy and RD&D programs, and requires the PUC to continue administering specified energy efficiency programs. The bill also requires the Governor to appoint an independent review panel to prepare and submit a report evaluating the public purpose programs funded by this bill. Governor Davis signed AB 995 on September 30, 2000 (Chapter 1051, Statutes of 2000).

Telecommunications Legislation

AB 1263 (Thomson). Existing law requires all 911 emergency telephone calls made from cellular telephones to be routed to the California Highway Patrol (CHP) for emergency response, and charges the Department of General Services (DGS) with the responsibility for administering the 911 system. As amended August 25, 2000, this bill—which applies to all wireless communications services, including cellular telephone service and personal communications service—provides that 911 calls made from wireless telephones may be routed to a public safety agency other than the CHP if (1) the call originates from a location other than from a highway or county road under CHP jurisdiction; (2) it is economically and technically feasible; (3) it will benefit public safety; and (4) if the CHP, DGS, and the public safety agency, in consultation with the wireless industry, producers of 911 selective routing service, and local law enforcement officials believe it will provide more efficient 911 service. This bill also bars any charges for wireless telephone calls to 911 and requires wireless 911 calls from non-customers to be completed. This bill was signed by the Governor on September 29, 2000 (Chapter 981, Statutes of 2000).

SB 1712 (Polanco). The Moore Universal Telephone Service Act requires the PUC to establish a class of "lifeline" service necessary to meet minimum residential communications needs and establish rates and charges for that service (see MAJOR PROJECTS). As amended June 12, 2000, this bill adds findings and declarations stating the intent of the legislature that the PUC redefine universal telephone service by incorporating two-way voice, video, and data service as components of basic service; and requires the PUC, on or before February 1, 2001, to initiate an investigation to examine the current and future definitions of universal service, seeking input from a wide cross-section of providers, users, state agencies, and convergent industries and reporting findings and recommendations, consistent with specified principles, to the legislature. This bill was signed by the Governor on September 29, 2000 (Chapter 943, Statutes of 2000).

AB 994 (R. Wright), as amended June 19, 2000, requires the PUC—on or before January 1, 2002—to prepare and submit to the Governor and the legislature a report on the feasibility of establishing rural telephone cooperatives or other alternative service configurations to promote rural telephone service, including voice and data transmission service.

Existing law, until January 1, 2001, requires the PUC to develop, implement, and maintain a program to establish a fair and equitable local rate structure designed to reduce any disparity in rates charged by small independent telephone corporations serving rural and small metropolitan areas, and a program to provide for transfer payments to telephone corporations serving areas where the cost of providing services exceeds rates charged by providers, as determined by the PUC. AB 994 extends the operative date of those provisions until January 1, 2005.

Until January 1, 2001, existing law restricts the type of charges that can be included in a telephone bill to communications-related goods and services. This bill extends that sunset date until July 1, 2001 to allow the PUC time to complete its ongoing rulemaking procedure to adopt consumer protection rules (see MAJOR PROJECTS). This bill was signed by the Governor on September 29, 2000 (Chapter 931, Statutes of 2000).

AB 2757 (Committee on Utilities and Commerce). Existing law requires the PUC to establish a rate recovery mechanism through surcharges on intrastate telephone service, until January 1, 2001, to recover the costs of providing telecommunications devices capable of serving the needs of the deaf, hearing impaired, and disabled (see MAJOR PROJECTS). As amended June 21, 2000, this bill would have extended the requirement for those telephone surcharges until January 1, 2005, and required the PUC to design and implement, on or before July 1, 2002, a program to provide free access to telephonic reading systems for individuals with print disabilities. The bill would have authorized specified entities to apply to the PUC for funding to establish a new telephonic reading system, and for the operation of this system, and required the PUC to reimburse any authorized operational expenses paid or incurred by a telephonic reading system on or after January 1, 2001.

On September 29, 2000, the Governor vetoed this bill, citing his concern that implementation of this program could

negatively affect funding for other important activities within the Deaf and Disabled Telecommunications Program (DDTP). In addition, the Governor opined that spending caps within the DDTP could be impacted by the implementation of a telephonic reading system, particularly when there are no complete estimates of the level of use anticipated for these systems, and indicated that it would be premature to enact this measure without the data sufficient to estimate the impact of the program.

AB 1825 (Strom-Martin), as amended August 8, 2000, would have expanded the California High-Cost Fund Program to fund a grant program within the PUC for rural telecommunications infrastructure, and would have provided grants to community-based organizations to construct telecommunications infrastructure in rural areas. Governor Davis vetoed AB 1825 on September 29, 2000, saying that it would divert up to $10 million per year from the California High-Cost Funds, and could result in increased rates for other rural ratepayers.

AB 1082 (Calderon and Maddox). Existing law requires PUC approval before a telephone company may issue stock or long-term debt with a maturity date of more than twelve months. As amended June 20, 2000, AB 1082 would have permitted telephone companies that are regulated under a "price cap" regulatory structure to issue stock or debt unless the PUC can prove that such an issuance would not be in the public interest. Governor Davis vetoed this bill on September 30, 2000. According to the Governor's veto message, "AB 1082 duplicates existing PUC procedures that allow the PUC to exempt telephone companies on a case-by-case basis from regulatory review of their financing proposals. It also places ratepayers at risk if local telephone companies make bad financial decisions and must seek additional forms of revenue to offset the losses. It is important that local telephone companies obtain state review before issuing stock or debt so the public can be protected from imprudent corporate finance decisions."

SB 1741 (Bowen), as amended July 3, 2000, requires the PUC to request authority from the FCC to require telephone corporations to establish technology-specific area codes based on wireless and data communications and to allow seven-digit dialing within that technology-specific area code and the underlying preexisting area code(s) (see MAJOR PROJECTS). SB 1741 requires the PUC to use any authority so granted unless it makes specific findings. The bill prohibits the PUC from approving new area code splits or overlays unless a telephone utilization survey has been performed and reasonable telephone number conservation has been implemented, a technology-specific area code has been established (if authorized), and further area code relief is warranted. Governor Davis signed SB 1741 on September 29, 2000 (Chapter 907, Statutes of 2000).

Other PUC Legislation

AB 1398 (Papan). In 1998, SB 779 (Calderon) (Chapter 886, Statutes of 1998) made substantial changes in the judicial review process of PUC decisions. In relevant part, SB 779 provided for judicial review of major PUC decisions by both the California Supreme Court and courts of appeal, and changed the courts' standard of review from abuse of discretion to substantial evidence review. *[16:1 CRLR 170–71]* This provision was operative for all PUC-regulated entities on January 1, 1999, except for decisions affecting water corporations, for whom the expanded judicial review was set to begin January 1, 2001. As amended June 15, 2000, AB 1398 indefinitely extends the deferential judicial review standards of PUC decisions affecting water corporations. According to the bill's sponsor, the California Water Association, the conversion of the energy, telecommunication, and transportation utilities to competitive markets not fully regulated by the PUC requires expanded access to the court system at all levels. However, water corporations remain fully subject to "traditional, rigorous PUC regulation....The PUC's broader regulatory authority over water corporations makes greater judicial involvement unnecessary; statewide continuity and consistency is obtained through Commission regulation." Governor Davis signed AB 1398 on September 29, 2000 (Chapter 953, Statutes of 2000).

SB 1491 (Leslie), as amended May 24, 2000, authorizes, on an application-by-application basis, the Commission to supervise the operation of pilot projects for the purpose of evaluating proposed railroad crossing warning devices or new technology at designated crossings, with the consent of the local jurisdiction, the affected railroad, and other interested parties. The Governor signed SB 1491 on August 29, 2000 (Chapter 263, Statutes of 2000).

AB 2762 (Committee on Utilities and Commerce). Existing law establishes a PUC program to ensure the safe operation of passenger carriers (*e.g.*, shuttles, limousines, charter buses); this program is paid for by fees on the carriers, and those fees are based on a uniform percentage of their individual gross revenues. As amended August 7, 2000, this bill permits the PUC to move away from a revenue-based assessment system and to instead use a system based on a per-vehicle assessment. Governor Davis signed AB 2762 on September 6, 2000 (Chapter 341, Statutes of 2000).

The following bills reported in Volume 17, No. 1 (Winter 2000) died in committee or otherwise failed to be enacted during 2000: **AB 365 (R. Wright)**, which would have required the PUC to develop and post on the Internet information about local and long distance telephone services offered by providers and other consumer information; **AB 651 (R. Wright)**, which would have required telecommunications providers to pay the actual costs associated with installation and maintenance of the equipment needed to provide services; **AB 1003 (R. Wright)**, related to the restructuring of the electrical services industry; **AB 1352 (Longville)**, which would have created the California Trucking Advisory Board; **SB 310 (Peace)**, which would have prohibited the PUC from enacting or implementing any decision, order, or rule that interferes with the rights and obligations of the directors of a corporation to ef-

ficiently and effectively discharge their fiduciary duties to shareholders; **SB 427 (Peace)**, which would have required electrical corporations to mitigate for the removal of trees under utility lines by planting an unspecified amount of trees; **SB 640 (Perata)**, relating to settlements in certain proceedings before the PUC; **SB 932 (Bowen)**, which would have enacted the "Telephone Consumers Bill of Rights"; and **SB 1217 (Polanco)**, which would have enacted the Internet Enhancement Act of 1999.

2001 SPECIAL SESSION LEGISLATION

As the energy crisis unfolded, Governor Davis called the legislature into special session commencing January 3, 2001 (concurrent with its regular session) to deal with urgent issues (see MAJOR PROJECTS). During a special session, traditional legislative rules and deadlines are suspended, permitting the legislature to act on an expedited basis. Some of these measures are also discussed in the chronology of events above.

ABX1 5 (Keeley), as amended January 16, 2001, replaces the 26-member ISO governing board with a five-member independent governing board of directors appointed by the Governor. The bill prohibits any member of the independent governing board appointed by the Governor from being affiliated with any actual or potential participant in any market administered by the ISO. The bill also prohibits the ISO from entering into a multistate entity or a regional organization unless that entry is approved by the board; requires the board to require the ISO's articles of incorporation and bylaws to be revised and filed with FERC as the board determines to be necessary; and requires the ISO to make publicly available a list of all powerplants located in the state that are not operational due to a planned or unplanned outage on the Internet, updated daily. This bill was signed by the Governor on January 18, 2001 (Chapter 1, Statutes of 2001–02, First Extraordinary Session).

ABX1 6 (Dutra), as amended January 16, 2001, prohibits California utilities from selling power generation assets prior to January 1, 2006; requires those facilities to continue to be subject to PUC regulation until the Commission has authorized the disposition of those facilities; and requires the Commission to ensure that public utility assets remain dedicated to service for the benefit of the public. This bill was signed by the Governor on January 18, 2001 (Chapter 2, Statutes of 2001–02, First Extraordinary Session).

SBX1 7 (Burton), as amended January 18, 2001, authorizes—for a period not to exceed twelve days from its effective date—the Department of Water Resources to purchase electric power from any party and to make that electric power available to the ISO, any public utility, or retail end-use customer at the cost of its purchase (plus any specified administrative costs, transmission and scheduling costs, and other related costs incurred by DWR). The bill transfers $400 million from the general fund to DWR to purchase electric power during this period, and requires the PUC to adopt and implement emergency regulations to provide for delivery and payment mechanisms relating to the sale of electric power purchased by DWR for sale directly or indirectly to the ISO, public utilities, or retail end-use customers. This bill was signed by the Governor on January 19, 2001 (Chapter 3, Statutes of 2001–02, First Extraordinary Session).

ABX1 1 (Keeley), as amended January 31, 2001, authorizes DWR—until January 1, 2003—to enter into long-term contracts for the purchase of electric power and to sell that power to retail end-use customers and to local publicly owned electric utilities at not more than DWR's acquisition costs; the bill appropriates $500 million from the general fund to DWR to purchase power. The bill also authorizes DWR to issue revenue bonds, with the authorization of the Department of Finance and the State Treasurer, to finance electricity purchases, and limits the amount that they may be issued to four times the amount of annual revenues generated from wholesale power.

ABX1 1 also establishes in the State Treasury a new Department of Water Resources "Electric Power Fund," and requires all revenues payable to DWR under the bill to be deposited in the fund. The bill requires the Bureau of State Audits to conduct a financial and performance audit of DWR's implementation of the bill. This bill was signed by the Governor on February 1, 2001 (Chapter 4, Statutes of 2001–02, First Extraordinary Session).

SBX1 43 (Alpert), as amended April 4, 2001, reduces rates for large industrial customers of SDG&E. Specifically, SBX1 43 requires the PUC to establish an initial frozen rate of 6.5 cents/kwh for all SDG&E customers not subject to Public Utilities Code section 332.1(b). The bill also requires the Commission to consider the comparable energy components of rates for comparable customer classes served by PG&E and SCE and, if it determines it to be in the public interest, to increase SDG&E's rates to a statewide average level if it deems necessary; any such rate increase would be retroactive to the date rate increases ordered in the PUC's March 27, 2001 decision become effective (see MAJOR PROJECTS). Finally, the bill prohibits any retroactive recovery of undercollections by any investor-owned utilities. This bill was signed by the Governor on April 6, 2001 (Chapter 5, Statutes of 2001–02, First Extraordinary Session).

ABX1 43 (Correa), as amended April 5, 2001, is the Assembly counterpart of SBX1 43 (Alpert) (see above), and was signed by the Governor on April 11, 2001 (Chapter 6, Statutes of 2001–02, First Extraordinary Session).

SBX1 5 (Sher), as amended April 5, 2001 and as it relates to the PUC, appropriates $708.9 million to various state agencies to implement energy efficiency programs and supplement existing energy efficiency programs. Of that amount, $246 million is allocated to the PUC to be expended in the following amounts: $50 million to encourage the purchase of energy efficient equipment, with priority given for purchases

of efficient appliances or retirement of inefficient equipment in low- and moderate-income households, and for the replacement of oldest and least efficient equipment; $100 million to provide immediate assistance to electric or gas customers enrolled in or eligible for the CARE program (see MAJOR PROJECTS); $20 million to augment funding for low-income weatherization services; $16.3 million for high-efficiency and ultra-low-polluting pump and motor retrofits for oil or gas producers and pipelines; and $60 million to provide incentives to encourage replacement of low-efficiency lighting with high-efficiency lighting systems. Governor Davis signed the bill on April 11, 2001, but exercised his line-item veto authority to reduce several of the appropriations, including—with respect to the funds allocated to PUC—reducing the amount provided for pump and motor retrofits for oil and gas producers and pipelines from $16.3 million to $12 million (Chapter 7, Statutes of 2001–02, First Extraordinary Session).

ABX1 29 (Kehoe). Under existing law, the PUC requires every electrical and gas corporation to file a schedule of rates and charges providing baseline rates. In establishing these rates, the PUC must avoid excessive rate increases for residential customers, and establish an appropriate gradual differential between the rates for the respective blocks of usage. Additionally, in establishing residential electric and gas rates, including baseline rates, existing law requires the PUC to assure that the rates are sufficient to enable the electrical corporation or gas corporation to recover a just and reasonable amount of revenue from residential customers as a class, while observing the principle that electricity and gas services are necessities, for which a low affordable rate is desirable. As amended April 5, 2001, this bill—among other things—requires the PUC, at least until December 31, 2003, to require that all charges for residential electric customers are volumetric, and to prohibit any electrical corporation from imposing any charges on residential consumption that are independent of consumption unless the charges are in place prior to the effective date of the bill.

ABX1 29 also appropriates $408.65 million for a variety of new programs relating to energy conservation, efficiency and distributed generation, including $20 million for the PUC's Low-Income Energy Efficiency (LIEE) program. The bill requires the PUC to designate a baseline quantity of gas and electricity and to require every gas and electric corporation to file a schedule of rates and charges providing baseline rates. The bill also requires the PUC, until December 31, 2002, to ensure that errors in estimates of demand elasticity of sales do not result in material over- or undercollections of the electrical corporations. Although the Governor deleted about $154 million of the appropriated funds, he signed the bill on April 11, 2001 (Chapter 8, Statutes of 2001–02, First Extraordinary Session).

SBX1 6 (Burton), as amended April 26, 2001, would create the California Consumer Power and Conservation Financing Authority (CPCFA), which would be authorized to issue up to $5 billion in revenue bonds to finance electricity generation projects, natural gas transmission and storage projects, and energy efficiency programs. Specifically, SBX1 6 would create the CPCFA, to be governed by a five-member board of directors consisting of four gubernatorial appointees (confirmed by the Senate and serving staggered terms) and the State Treasurer. The bill would establish that the purposes of the Authority are to finance, purchase, lease, own, operate, acquire, or construct generating facilities to supplement private and public sector power sources currently in operation or under development. The CPCFA could finance projects on its own or through joint ventures with public or private entities. The CPCFA would be authorized to finance energy efficiency programs administered by the PUC, the CEC, and other qualifying entities; finance retrofits and/or expansions of existing powerplants for energy efficiency and environmental improvements; and finance natural gas transportation or storage projects as recommended by the PUC and pursuant to a needs analysis to be prepared by the PUC within 90 days of the effective date of the bill.

SBX1 6 would require all generation projects financed by the CPCFA to provide electricity to California consumers at the costs of generating that power, including the cost of financing the project. (The power can be sold outside the state at just and reasonable rates if it is not needed or if it is financially advantageous to the state's consumers to do so.) The bill would also authorize the CPCFA to issue up to $5 billion in revenue bonds for the stated purposes, but would limit the amount available for energy efficiency programs to $1 billion; the bill would also establish a special fund for expenditure of bond proceeds and collection of revenues by the CPCFA. All monies in the fund are continuously appropriated, except for the CPCFA's annual operating budget, which is subject to appropriation in the Budget Act. At this writing, SBX1 6 has passed both the Senate and the Assembly, but has been returned to the Senate for that house's concurrence in Assembly amendments. *[S. Floor]*

ABX1 3 (Wright), as amended April 26, 2001, would permit any existing gas customer who enrolls in the CARE program before October 1, 2001 to be deemed to have enrolled in the program as of the effective date of this bill; as a consequence, the customer would receive a discount equal to the prorated average monthly CARE discount for that gas corporation from October 2000 to March 2001. This bill would also require the PUC to adjust CARE program income requirements annually to account for inflation; require utilities to offer payment arrangements to customers having trouble paying their bills, with payments spread over not more than twelve months; prohibit utilities from disconnecting CARE customers if the customer is in compliance with the payment arrangements or if the utility has been provided with notification that an energy assistance provider is forwarding payment sufficient to prevent disconnection; provide for expanded notification of the availability of the CARE program; and require the PUC to conduct targeted outreach to low-income and senior households. *[S. EU&C]*

2001 LEGISLATION

Power Utilities Legislation

SB 1055 (Morrow). Existing law requires the PUC to establish priorities among the types or categories of customers of every electrical corporation and every gas corporation, and to include specified considerations when establishing these priorities. As introduced February 23, 2001, this bill would require the PUC to include as a consideration when establishing these priorities a determination that certain health facilities shall have access to uninterruptible supplies of electricity. *[S. EU&C]*

SB 47 (Bowen), as amended April 18, 2001, would delete the Electricity Oversight Board's exclusive right to decline to confirm the appointments of members of the ISO's governing board. SB 47 would instead require the appointment of these members to be confirmed by the Senate, and change the terms of the members from one to three years. SB 47 would also specify that a member of the PX governing board is not considered to be affiliated with a market participant solely because of service on the governing board of the PX. *[S. Appr]*

AB 1233 (Pescetti), as amended April 26, 2001, would prohibit assessment of local transmission rates on natural gas if (a) it is delivered to an end-use customer, (b) it is delivered through a transmission system owned by a gas corporation that is not interconnected with a local utility transmission system , and (c) it is blended with gas supplies produced from an in-state source for the purposes of achieving a usable thermal rate. The bill would require the Commission to administer this provision in a manner that prohibits any cost shift to core customers resulting from the rate exemption required under the bill. *[A. Appr]*

AB 1 (Aanestad). Under AB 995 (R. Wright) (Chapter 1051, Statutes of 2000), the PUC— until January 1, 2012— requires electrical corporations to identify a separate rate component to collect a system benefits charge to fund energy efficiency, renewable energy, and research, development, and demonstration programs (see 2000 LEGISLATION). As amended April 16, 2001, AB 1 would require the Commission to establish a single universal rebate rate for all energy efficiency technologies used for large nonresidential standard performance contract programs allocated funds under those provisions. *[A. Appr]*

AB 69 (Wright), as introduced December 13, 2000, would require the Governor's Clean Energy Green Team— which was created in AB 970 (Ducheny) (Chapter 329, Statutes of 2000) (see 2000 LEGISLATION) to provide assistance to persons proposing to construct powerplants—to make the repowering of existing powerplants a top priority, and would require it to ensure that any expedited repowering is subject to conditions that ensure a reduction in the environmental impact of the facility. The bill would also require the Green Team to encourage regulatory agencies to promote and accelerate the repowering of existing powerplants within their existing authority. *[A. NatRes]*

AB 621 (Corbett), as amended April 5, 2001, would require the ISO to notify local air pollution control districts or air quality management districts of all electrical customers with whom it has, or enters into, interruptible service contracts or similar arrangements. The bill would also require electrical corporations to notify local air pollution control districts or air quality management districts of all electrical customers with whom it has, or enters into, interruptible service contracts or similar arrangements. *[A. Appr]*

AB 1031 (Canciamilla), as introduced February 23, 2001, would make legislative findings and declarations with respect to natural gas price increases and the intent of the legislature to address the long-term risks of high natural gas prices by reducing California's dependence in winter months on out-of-state supplies and passing comprehensive legislation to increase in-state pipeline capacity, increase in-state storage, and increase in-state production of natural gas. *[A. U&C]*

Telecommunications Legislation

AB 219 (Committee on Utilities & Commerce). Existing law requires the PUC—until January 1, 2001—to establish a rate recovery mechanism through surcharges on intrastate telephone service to recover the costs of providing telecommunications devices capable of serving the needs of the deaf and hearing-impaired and telecommunications equipment for the disabled. As introduced February 9, 2001, this bill would extend the requirement for those telephone surcharges until January 1, 2006, and delete an obsolete provision. *[S. Appr]*

AB 870 (Wesson). Existing law authorizes the PUC to control and regulate the use of automatic dialing-announcing devices and specifies the hours during which the devices may not be operated. As amended April 19, 2001, this bill would prohibit the use of automatic calling devices (ACDs) which are capable of sequentially or randomly calling telephone numbers with no person or prerecorded message available for the person called on or after July 1, 2002; and authorize the PUC to establish an acceptable error rate for such devices on or after July 1, 2002. *[A. Appr]*

AB 140 (Strom-Martin), as amended April 26, 2001, would require the PUC to establish a grant program to fund telecommunications infrastructure projects in areas currently without such service. The bill would limit the grant funding to $10 million per year from California High-Cost Fund-A or the California High-Cost Fund-B, or both, and sunset the program after four years. AB 140 would also require the PUC to establish a government-industry work group to develop technical criteria for evaluating grant proposals which would be submitted by community-based groups. *[A. Appr]*

SB 896 (Poochigian), as introduced February 23, 2001, would amend existing laws that impose taxes, surcharges, and fees on mobile telecommunications charges, including emergency telephone surcharges, to reflect changes made by the federal Mobile Telecommunications Sourcing Act, Pub. L. No. 106-252. *[S. Appr]*

Other PUC Legislation

SB 201 (Speier). Under existing law, the PUC's Office of Ratepayer Advocates (ORA) represents the interests of public utility customers and subscribers in Commission proceedings. The ORA director is appointed by and serves at the pleasure of the Governor, subject to Senate confirmation. On January 1, 2002, these statutes are scheduled to be repealed and replaced with new provisions requiring the PUC to create an organization or division within the PUC to represent the interests of public utility customers and subscribers in PUC proceedings. As introduced February 8, 2001, this bill would delete the repeal of the provisions that provide for ORA, ORA's director, and its funding source; and would repeal the provisions that were to become operative January 1, 2002. The bill would require that the ORA Director be paid a salary equal to 90% of the salary received by PUC commissioners. *[S. Appr]*

AB 1325 (Negrete McLeod). The Political Reform Act (PRA) of 1974 regulates the lobbying of the Governor, the legislature, and regulatory agencies; the Fair Political Practices Commission (FPPC) is the agency that administers and implements the PRA. A "lobbyist" is defined as an individual who receives $2,000 or more in a calendar month or whose principal duties are to communicate directly or through agents with an elective state official, agency official, or legislative official for the purpose of influencing legislative or administrative action. Most individuals who engage in substantial "lobbying" activities (as that term is defined in the PRA and FPPC regulations) are required to register as a lobbyist with the FPPC, comply with ethical rules, and submit quarterly reports on expenses incurred in lobbying and contributions made to covered officials. According to Assemblymember Negrete McLeod, current FPPC interpretations of the PRA exempt from lobbyist qualification, and significantly reduce the reporting of spending on, attempts to influence specified types of proceedings before the PUC—while similar proceedings at other regulatory agencies are subject to the full application of the PRA and the FPPC's regulations. As amended April 5, 2001, AB 1325 would ensure that individuals and entities that lobby the PUC comply with the same lobbying and lobbyist reporting rules that apply to individuals and entities that lobby other state agencies.

AB 1325 would define the term "administrative action" to include PUC ratemaking proceedings and quasi-legislative proceedings—thus subjecting those who attempt to influence PUC administrative action to the PRA's lobbyist registration, reporting, and ethical requirements. However, communications made at a PUC public hearing, public workshop, or other public forum, and communications that are included in the official record of a PUC proceeding, would not be considered "lobbying." This bill would also define a payment made for the purpose of influencing a PUC ratemaking or quasi-legislative proceeding as a "payment to influence legislative or administrative action" under the PRA, thus requiring its reporting to the FPPC. *[A. Appr]*

LITIGATION

Energy

As the energy crisis hit San Diego and then the rest of California in late 2000, a number of challenges to utility and generator practices were filed at the state and federal trial court level. At this writing, none of these cases has reached the appellate level or resulted in a published decision, but they are significant to future evolving caselaw. PG&E's April 4, 2001 bankruptcy proceeding is discussed above (see MAJOR PROJECTS). Also mentioned in the chronology above are other major filings which are now pending at the trial level and warrant monitoring, including the following:

◆ ***Hendricks v. Dynegy Power Marketing Inc.***, No. GIC758565, was filed in San Diego County Superior Court, removed to federal court, and then remanded back to state court. This case was filed on November 29, 2000 on behalf of a single ratepayer against 16 power generators. Similar suits were filed by three San Diego County water districts. These suits allege violation of federal antitrust law prohibiting unreasonable restraints of trade (Sherman Act section 1).

◆ ***SCE v. Lynch***, No. CV-00-12056-RSWL (C.D. Cal.), and ***PG&E v. Lynch***, No. CV01-1083 (N.D. Cal.), filed by SCE and PG&E in late 2000, seek a court order compelling the PUC to order rate increases to pay for the higher energy costs allegedly imposed by power generators. On February 12, 2001, Judge Ron Lew denied the utilities' motions for injunctive relief requiring the Commission to raise their rates. At the time, the court recognized that the PUC had scheduled emergency ratesetting hearing on the utilities' rate increase requests; the PUC subsequently approved 50% rate increases for ratepayers of SCE and PG&E (see MAJOR PROJECTS).

◆ ***Berg v. Southern California Gas Co.***, No. BC 241991, and ***City of Los Angeles v. Southern California Gas Co.***, No. BC 247125, are class actions filed in Los Angeles County Superior Court on December 18, 2000 against Southern California Gas Co., SDG&E, Sempra Energy (parent of SoCal Gas and SDG&E), El Paso Natural Gas Co., and other companies related to El Paso. The suits allege a conspiracy to limit the supply of natural gas resulting in restraint of trade, unfair competition, and unlawful business practices. Specifically, the suits allege that the companies agreed not to compete against each other in the southern California and Baja California markets, and to work together to prevent the construction of other natural gas pipelines that would compete against them and lower natural gas prices in these markets.

◆ ***People v. Dynegy Power Marketing Inc.***, No. SCV318189, was filed on January 18, 2001 in San Francisco Superior Court by the City of San Francisco against the 13 major power producers, contending that they had unlawfully colluded to manipulate the wholesale market.

◆ ***Bustamante v. Dynegy***, No. BC 249705, was filed by California Lieutenant Governor Cruz Bustamante on May 2, 2001 in Los Angeles County Superior Court. The suit names the major five power producers and alleges that they (and 14

named executives) violated federal and state antitrust laws in conspiring to fix prices and supplies of power for California sale.

On December 30, 1999 in ***Wise, et al. v. Pacific Gas & Electric Co.***, 77 Cal. App. 4th 287 (1999), the First District Court of Appeal held that the primary jurisdiction doctrine temporarily precludes court jurisdiction over alleged overcharges by PG&E.

The case arose after PG&E initiated a gas regulator replacement program (GRRP) to replace approximately 2,000,000 old regulators; during a ratemaking proceeding, the PUC increased PG&E's rates to enable the utility to pay for the program. Later, PG&E unilaterally ceased the GRRP program and failed to inform the PUC that it had curtailed the program and was not incurring the costs of the program it had previously represented. Plaintiffs brought an action against PG&E for fraud and unfair business practices in violation of Business and Professions Code section 17200 and 17500 and Public Utilities Code section 2106; plaintiffs alleged that PG&E charged its ratepayers over $42 million for services it failed to provide. PG&E demurred on grounds the court lacks subject matter jurisdiction because exclusive jurisdiction resides with the PUC. The trial court granted the utility's demurrer without leave to amend and plaintiffs appealed.

This case turns on the interplay between two sections of law: Public Utilities Code section 1759, which bars court interference with matters under PUC jurisdiction if the court action would hamper, hinder, frustrate, or otherwise impede the PUC's exercise of authority; and Public Utilities Code section 2106, which grants explicit and broad authority for private suit where a utility commits fraud or violates the law or a PUC order. Applying *Waters v. Pacific Telephone Company*, 12 Cal. 3d 1 (1974), and *SDG&E v. Superior Court (Covalt)*, 13 Cal. 4th 893 (1996), the court held that section 1759 bars the suit until the PUC has had an opportunity to address the issue. In so ruling, the court relied substantially on the placement of PUC authority in the constitution itself, which distinguishes the holding from primary jurisdiction coverage which might apply *vis-a-vis* other agencies of statutory origin. In addition, the GRRP issue had been brought before the PUC in an administrative proceeding, and the agency was considering its own investigation into the allegations against PG&E. Thus, the appellate court reversed the trial court's decision and remanded it with instructions to retain the matter on its docket pending further PUC proceedings.

This case turns on the interplay between two sections of law: Public Utilities Code section 1759, which bars court interference with matters under PUC jurisdiction if the court action would hamper, hinder, frustrate, or otherwise impede the PUC's exercise of authority; and Public Utilities Code section 2106, which grants explicit and broad authority for private suit where a utility commits fraud or violates the law or a PUC order.

Of particular interest in the decision is the court's strong *dicta* on PUC authority. One of the plaintiff's contentions was that the primary jurisdiction doctrine could not apply because the PUC lacks legal authority to grant restitutionary relief. Specifically, the ban on "retroactive ratemaking" prohibits the Commission from altering rates already set—for any reason. The sole remedy would be a prospective rate adjustment, which might not accrue to the same victims and may be problematic. Accordingly, plaintiffs argued that the courts offer the only practical remedy and that primary jurisdiction should not bar a civil suit. Indeed, plaintiffs' contentions here mirror the commonly-interposed defense of utilities to any restitutionary order based on allegedly excessive prior rates. In a passage which could make this decision a Pyrrhic victory for all utilities, the court wrote: "It is inconceivable that the Legislature intended the PUC would be powerless to award reparations when a public utility obtained a tariff rate by fraudulent means." Of course, that is what utilities have contended, with general success, for the last thirty years. The court expressed confidence that the PUC "in the exercise of its equitable jurisdiction would be able to fashion a remedy in the event of fraud committed by a public utility during the ratemaking process. The exercise of such equitable power will provide a remedy for the wrong committed and hopefully serve to deter such fraudulent conduct in the future."

Telecommunications

On January 8, 2001 in ***Eckert v. Bay Area Cellular Telephone Company***, 85 Cal. App. 4th 1369 (2001), *depublished* May 16, 2001, the First District Court of Appeal held that an action under California's Unfair Competition Act, Business and Professions Code section 17200, against a cellular company for failing to disclose discounted wireless (cellular) phone rates for the hearing-impaired is preempted by PUC jurisdiction. As in *Wise v. PG&E* described above, the court was required to reconcile Public Utilities Code section 1759 (which forbids courts from issuing orders that interfere with or hinder Commission policy-making in matters delegated to it under the Constitution) with Public Utilities Code section 2106 (which is the sole private remedy against any regulated utility that violates the law or a PUC order). Whereas the appellate court in *Wise* reversed the trial court's dismissal of the case, the First District in *Eckert* affirmed the trial court's dismissal of the case.

Plaintiffs—a hearing-impaired individual and a seller of hearing aids—complained that defendant cellular telecommunications firm failed to notify customers of a reduced rate for hearing-impaired persons; plaintiffs also alleged that defendant imposed requirements for participation in the reduced-rate program that exceed the terms of its tariffs filed with the Commission. In finding that judicial action would hinder ongoing administrative proceedings, the court pointed to a 1996 PUC decision following substantial federal deregulation of cellular rates, in which the PUC announced that it would "shortly" issue for public comment a set of consumer protec-

tion rules applicable to cellular providers. The court also found that the Commission initiated a proceeding on February 3, 2000 to establish a "telecommunications consumer protection bill of rights" (see above). Rejecting plaintiffs' contentions that none of these steps involve PUC enforcement actions or imminent standards, nor do they address plaintiffs' specific complaints regarding misleading advertising regarding services and charges for the deaf, the court held: "The commission is, in short, 'still actively pursuing the broad policy inquiry into [consumer protection in wireless services] that it initiated in 1996.' Given that administrative posture, we agree with the trial court's conclusion that it lacked subject matter jurisdiction over plaintiffs' action."

Critics of this holding note that its logic may be applied to almost any activity by a utility given the number and breadth of general inquiries and studies of the PUC. Most of them do not result in the exercise of Commission regulation, nor are they intended to imply exemption from the fair competition statutes which apply generally to all California businesses. As noted above, the California Supreme Court has depublished the First District's decision, thus voiding its *stare decisis* impact.

On June 8, 2000 in ***Ball v. GTE Mobilnet of California, et al.***, 81 Cal. App. 4th 529 (2000), *review denied* Sept. 27, 2000, the Third District Court of Appeal reinstated a consumer action alleging that California's major cellular phone companies routinely overcharge customers for "non-communication" time—including calls its own technology drops post-connection, and the widespread practice of "rounding up" time (charging in full-minute billing increments for any part of a minute used). Plaintiffs alleged the cellular companies' action violates California's Unfair Competition Act, Business and Professions Code section 17200. The trial court sustained defendant's demurrer, holding that the claim is preempted by the Federal Communications Act. The Third District reversed. Relying on a 1996 federal ruling, *In Re Comcast Cellular Telecommunications Litigation*, 949 F. Supp. 1193 (E.D. Pa.), the appellate court found that section 332(c)(3)(A) of the Federal Communications Act, effective August 8, 1995, preempts state law challenges to cellular ratesetting. However, the court held that plaintiff could invoke section 17200 to challenge charges that occurred prior to August 8, 1995.

The court also reinstated other section 17200 claims related to misleading advertising of rates or failure to disclose charges, rather than the rate charges themselves directly. Hence, the complaint may contend that the defendants engaged in unfair competition by misleading consumers about their rates as charged, gaining an advantage over competitors who might advertise accurately.

On March 23, 2000, the First District Court of Appeal denied PacBell's petition for a writ of review in ***Pacific Bell v. Public Utilities Commission***, 79 Cal. App. 4th 269 (2000). In this case, Pacific Bell filed an "advice letter" with the PUC attempting to amend a tariff to remove references to "yellow pages" which are not within PUC jurisdiction. In response, the PUC asked Pacific Bell to file a formal application to amend the tariff. Instead, Pacific Bell petitioned the court of appeal under Public Utilities Code section 1756, which—effective January 1, 1998—allows a court of appeal as well as the California Supreme Court to review PUC decisions. *[16:1 CRLR 171]* The First District denied Pacific Bell's petition, finding that the PUC was within its discretion when it denied the changes proposed in Pacific Bell's advice letter.

The federal courts have recently issued a number of decisions in cases brought under the federal Telecommunications Act of 1996 ("the Act"), Pub. L. No. 104-104, which is designed to foster competition in telecommunications, including local telephone markets. In *AT&T, et al. v. Iowa Utilities Board, et al.*, 525 U.S. 366 (1999), the U.S. Supreme Court succinctly described the reason for and impact of the statute—including its impact on state public utilities commissions:

The federal courts have recently issued a number of decisions in cases brought under the federal Telecommunications Act of 1996, which is designed to foster competition in telecommunications, including local telephone markets.

"Until the 1990s, local phone service was thought to be a natural monopoly. States typically granted an exclusive franchise in each local service area to a local exchange carrier (LEC), which owned, among other things, the local loops (wires connecting telephones to switches), the switches (equipment directing calls to their destinations), and the transport trunks (wires carrying calls between switches) that constitute a local exchange network. Technological advances, however, have made competition among multiple providers of local service seem possible, and Congress recently ended the longstanding regime of state-sanctioned monopolies.

The...Act fundamentally restructures local telephone markets. States may no longer enforce laws that impede competition, and incumbent LECs are subject to a host of duties intended to facilitate market entry. Foremost among these duties is the LEC's obligation under 47 U.S.C. section 251(c) to share its network with competitors. Under this provision, a requesting carrier can obtain access to an incumbent's network in three ways: It can purchase local telephone services at wholesale rates for resale to end users; it can lease elements of the incumbents network 'on an unbundled basis'; and it can interconnect its own facilities with the incumbent's network. When an entrant seeks access through any of these routes, the incumbent can negotiate an agreement without regard to the duties it would otherwise have under section 251(b) or 251(c)....But if private negotiation fails, either party can petition the state commission that regulates local phone service to arbitrate open issues, which arbitration is subject to section 251 and the FCC regulations promulgated thereunder."

◆ On September 13, 2000 in ***US West Communications, et al. v. Hamilton, et al.***, 224 F.3d 1049 (2000), the U.S. Ninth Circuit Court of Appeals issued a decision in three consoli-

dated cases dealing with the rules pertaining to interconnection agreements between the established utility (the "incumbent local exchange carrier" or "ILEC") and newly competing carriers ("competitive local exchange carriers" or "CLECs"). As described above, the Act requires the incumbent utility to give access to its conduits and rights of way to competitors in local call traffic at a fair charge, and that charge is subject to state PUC arbitration. US West is the ILEC in Oregon, and sought Oregon PUC (OPUC) approval of reciprocal access to the facilities of three CLECs—also at a fair charge. The OPUC arbitrated and ratified the terms of interconnection agreements between US West and the three CLECs. US West challenged the agreements in federal district court, which consolidated all of the cases and upheld some provisions of the agreements while invalidating others. US West appealed.

On appeal, the Ninth Circuit upheld the district court's decision. Underlying much of its ruling is an FCC policy that precludes reciprocal use of CLEC facilities by an ILEC. Although critical of this FCC policy and suggesting that it is contrary to congressional intent, the Ninth Circuit noted that the Eighth Circuit is currently presiding over multidistrict litigation challenging the FCC's policy, has the exclusive jurisdiction to overturn the relevant FCC order, and has not yet dispositively ruled (see below). Any final ruling on this subject will be momentous in California, where the same question will then confront the PUC, similarly in charge of ILEC-CLEC interconnection agreements.

◆ On July 18, 2000 in ***Iowa Utilities Board, et al. v. FCC***, 219 F.3d 744 (2000), the U.S. Eighth Circuit Court of Appeals again tackled the complex issues raised in a number of consolidated cases brought by numerous parties and state PUCs challenging the FCC's First Report and Order implementing the local competition provisions of the Telecommunications Act of 1996.

In 1997, the Eighth Circuit vacated many of the FCC's regulations implementing the Act, finding that the FCC had exceeded its jurisdiction (120 F.3d 753); in 1999, the U.S. Supreme Court largely reversed the Eighth Circuit's decision—finding that the FCC is authorized to adopt numerous kinds of rules implementing the Act—and remanded the cases for further proceedings (525 U.S. 366).

On remand, the Eighth Circuit looked not at the FCC's jurisdiction but at the merits of the rules it adopted. One of the most contested rules pertains to the prices that ILECs may charge their new competitors for interconnection, unbundled access, and resale, as well as rules regarding the prices for the transport and termination of local telecommunications traffic. In other words, how much should existing utilities charge entering companies for access to their networks? The FCC decided that these rates should be based on the future cost of operating the existing company's network, using the most efficient, modern technology. This rate is called the "total element long-run incremental cost" (TELRIC). The existing utilities (ILECs) disagreed with the pricing rule, contending that rates should be based on historical costs, including past investment decisions—even if those decisions would not now be replicated in hindsight. The Eighth Circuit agreed with the ILECs, rejecting the FCC's pricing methodology and holding that rates should be based on the actual costs of the incumbent carrier's network rather than on hypothetical future costs.

The new entrants (including WorldCom and AT&T) and the FCC sought U.S. Supreme Court review by writ of *certiorari*, arguing that the rejection of the FCC's simpler "forward-looking" pricing rules will result in a time-consuming and costly review process for new rates. AT&T argued that the compensation sought by Verizon (an ILEC) will be gratuitously excessive if it is allowed to include historical original costs for capital structure no longer "used or useful."

On January 23, 2001, the U.S. Supreme Court granted *certiorari* and agreed to review the Eighth Circuit's decision, limiting its scrutiny to the following three issues: (1) whether the Eighth Circuit erred in striking down the FCC's pricing rules that new entrants into the local telephone market must pay existing local phone service providers; (2) whether the appeals court erred in holding that the FCC need not include in its pricing rules the historical costs incumbent phone companies have incurred in constructing their phone networks; and (3) whether the Act prohibits regulators from requiring that ILECs combine uncombined network elements when an entrant agrees to compensate the incumbent company for doing so.

Although the California PUC and other state commissions initially did not agree with the FCC's pricing rules (or its assumption of jurisdiction over such rates), they are now aligned with the FCC, defending its flexible, "forward-looking" format. A decision in these cases is expected in mid-2002.

◆ On February 14, 2000 in ***AT&T Communications System v. Pacific Bell***, 203 F.3d 1183 (2000), the U.S. Ninth Circuit Court of Appeals held that exhaustion of administrative remedies is not a prerequisite to federal court review of a PUC decision under the Telecommunications Act of 1996.

In this case, AT&T sought entry as a competitor into PacBell's local exchange market. Pursuant to the Act, the two carriers attempted but failed to negotiate an interconnection agreement; they petitioned the PUC to arbitrate the unresolved issues. The PUC arbitrator issued a final agreement, and the parties submitted it to the Commission for approval. The PUC approved the agreement with some modifications. AT&T then sought judicial review of the approval in federal court, and PacBell contended that administrative remedies had to be exhausted before seeking review.

The district court held that the Act permits federal courts to review "final" state agency decisions. It stated that although the Act had been technically violated because AT&T did not petition to the PUC for a rehearing (thereby failing to exhaust all remedies), "AT&T was entitled to be excused from the rehearing requirement because 'requiring complete ad-

ministrative exhaustion in these cases would completely and unfairly bar the parties from obtaining any review of the interconnection agreements at issue.'"

The Ninth Circuit agreed with the district court's judgment to permit judicial review, but disagreed with its opinion that a "final" order is a prerequisite to receiving that review. The court held that Congress' intent in the enacting the statute was not to require exhaustion of state administrative remedies. The court first looked at the wording of the Act and found that since there is no provision requiring a "final" order (as does the Administrative Procedure Act), Congress must not have intended that a final determination be made before seeking review in federal court. The court also determined that, in the Act, Congress has called for a timely review of judgments, and that "any state law allowance for rehearing...cannot stand in the way of this federal provision." Finally, "the statute provides exclusively for federal court review and expressly forecloses state court review." All of these findings, the court held, are contrary to the notion of exhaustion of state remedies.

◆ On December 27, 1999 in ***Pacific Bell v. Cook Telecom Inc. and PUC***, 197 F.3d 1236 (1999), a case of first impression in the federal appellate courts, the U.S. Ninth Circuit Court of Appeals held that the Telecommunications Act of 1996 allows paging companies to enter into reciprocal compensation arrangements for the transport and termination of telecommunications.

On December 27, 1999 in *Pacific Bell v. Cook Telecom Inc. and PUC*, a case of first impression in the federal appellate courts, the U.S. Ninth Circuit Court of Appeals held that the Telecommunications Act of 1996 allows paging companies to enter into reciprocal compensation arrangements for the transport and termination of telecommunications.

"Reciprocal compensation arrangements" are provided for in section 251(b) of the Act, 47 U.S.C. section 153(26), as part of Congress' effort to increase competition local telecommunications markets. The arrangement requires the networks of all carriers to be interconnected to each other, and requires the carriers to compensate each other for the cost of switching calls to their networks. When a PacBell customer dials a number assigned to a Cook paging unit, the call is transferred over to a Cook pager by the interconnection mechanisms. Because Cook does not provide two-way paging service, it does not deliver any calls to PacBell's network. PacBell argued that because it sends calls to Cook's network but Cook sends no calls to PacBell's network, the requirements for a reciprocal compensation agreement were not met and Cook was not entitled to compensation from PacBell. The PUC disagreed, and disapproved an arbitrated agreement that failed to provide Cook for compensation for costs it incurred in terminating calls to its paging customers. PacBell sued Cook and the PUC in federal court. The district court upheld the PUC's decision, finding that the statute is ambiguous, the PUC's interpretation is consistent with the FCC's interpretation, and the agencies' interpretations are entitled to deference. The Ninth Circuit affirmed.

The Ninth Circuit's ruling is an important one because it could cost local phone companies such as PacBell millions of dollars. Usually the networks mutually exchange calls, so payments are made from both sides. With one-way paging, however, all of the payments come from the local exchange carrier (in this case, PacBell), but no compensation comes from the other side. This ruling is part of a larger battle over reciprocal compensation agreements being fought before the FCC. A heated issue is over whether local exchange carriers must compensate for calls transferred over to Internet service providers. Such a ruling could mean far larger amounts of money to be paid out by PacBell than in this situation.

◆ On November 4, 1999 in ***Communications Telesystems International, et al. v. California Public Utilities Commission***, 196 F.3d 1011 (1999), the U.S. Ninth Circuit Court of Appeals ruled that the federal Telecommunications Act of 1996 does not preempt a state's authority to impose sanctions against a service provider that switched customers' services without their consent—a practice known as "slamming."

Communications Telesystems International (CTS) is a California-based corporation that provides intrastate long distance telecommunications services under authority granted by the PUC. In the mid-1990s, the PUC received 56,000 complaints from consumers alleging slamming by CTS. On May 21, 1997, after more than a year of investigation and administrative proceedings before a PUC ALJ, the PUC found CTS guilty of slamming, and imposed monetary sanctions on the company, as well as a three-year prohibition on the provision of intrastate long distance services. CTS challenged the PUC's prohibition in both state and federal court, contending that it is preempted by section 253(a) of the Act, which provides that a state may not prohibit an entity from providing interstate or intrastate telecommunications service. Section 253(b), however, provides that a state is not precluded from imposing requirements necessary to protect the public health and safety, and to safeguard the rights of consumers. CTS argued that the Commission's actions were not necessary to safeguard the rights of consumers since it had already eliminated CTS's ability to engage in slamming.

While addressing numerous procedural and jurisdictional complexities, the Ninth Circuit also addressed the merits of CTS' preemption claim in its November 1999 decision. The court found that although section 253(a) contains an explicit preemption provision, section 253(b) expressly charges states with imposing requirements necessary to protect competition in the telecommunications industry and protect consumers from unfair business practices. The Ninth Circuit noted that "federal preemption of state regulation in the area of telecommunications must be clear and occurs only in limited circumstances," and that state actions may be preempted only

for conduct that is "flagrantly and patently" violative of the Constitution. The court held that the PUC's actions in fining and temporarily suspending CTS from providing long distance service serve the very purpose specified in section 253(b): "The sanctions advanced important state interests and thus were not 'flagrantly and patently' violative of the Constitution."

On June 22, 2000 in ***AT&T v. City of Portland***, 216 F.3d 871 (2000), the U.S. Ninth Circuit Court of Appeals issued a decision critical to future competition in the cable industry—with particular importance to Internet access competition. Two cable firms (AT&T and Time Warner) currently control over 75% of the residential cable market in the nation. Over 95% of their respective cable business locally is without effective competition. Cable in Portland and elsewhere increasingly offers high-speed access to the Internet. The major alternative means of access to the Internet is through phone lines. Although high-speed digital subscriber lines (DSL) are growing, they are limited geographically and by number of subscribers in many areas. *[17:1 CRLR 176; 16:2 CRLR 144–45]*

The City of Portland had granted a franchise to Telecommunications, Inc. (TCI) to provide cable services to its residents. TCI had no competition. After AT&T and TCI merged, the merged company had to seek the approval of local franchising authorities where so required by local franchising agreements; TCI's franchise with Portland permitted the city to "condition the Transfer upon such conditions, related to the technical, legal, and financial qualifications of the prospective party to perform according to the terms of the Franchise, as it deems appropriate." In December 1998, Portland voted to approve the transfer subject to an "open access condition"—in other words, Portland asked that AT&T not limit its subscribers to the single Internet service provider (ISP) associated with AT&T, but to allow competing ISPs to serve its consumers. That requirement is intended to stimulate competitive opportunity. AT&T refused to accept the condition, contending that Portland could not prevent it from confining consumer choice to its own or its selected ISP. Portland declined to approve the transfer agreement; AT&T filed suit in federal district court, which rejected all of AT&T's claims and awarded summary judgment to the City of Portland.

In a decision which surprised advocates from all sides, the Ninth Circuit reversed. The court essentially held that cable broadband facilities (including Internet access) are subject to the exclusive jurisdiction of the FCC. Although the court admitted that "the FCC has not subjected cable broadband to any regulation, including common carrier telecommunications regulation," it opined that the agency has discretion to forbear from such regulation within its domain. "Congress has reposed the details of telecommunications policy in the FCC, and we will not impinge on its authority over these matters."

The sum total of these conclusions is the deferral of regulation to the private discretion of the cable firms. Consumer advocates decried the implications of such a posture over what they contend has become the nation's largest and most politically powerful unregulated monopoly. They contend that the two dominant firms exercise effective monopoly power in the cable entertainment market within their respective markets (with only the often hidden or unmarketed "basic tier" of services subject to maximum rate regulation). They argue that the extension of that power into control of high-speed access to the Internet raises both economic and long-range first amendment implications. Some *amicus* contributors—including the Center for Public Interest Law—pointed to the importance of the Internet as a market for commerce and ideas and warned of creating "choke points" of control by limiting ISP options for consumers and precluding alternatives. That concern is heightened by a continuing trend of mergers and climbing worldwide concentration in media ownership, including satellite transmission, entertainment production, computer elements, and Internet access.

On October 2, 2000, the FCC announced that it will consider regulating the issue of Internet access, a subject it had assumed prior to *Portland* was not within its regulatory domain. The FCC's interest was partly spawned by the merger of Time Warner (the nation's largest cable firm) with America Online, the nation's largest ISP. The FCC approved an initial document outlining the questions it must address, including the assurance of Internet access competitive choice; at this writing, the matter is still pending.

In a related case, ***Time Warner Entertainment v. FCC***, 240 F.3d 1126 (Mar. 2, 2001), the U.S. Court of Appeals for the District of Columbia Circuit invalidated the FCC's modest limitation on cable/Internet marketshares, imposed to assure a measure of competition. The FCC limited a cable operator to no more than 30% of the cable market in an area, and a 40% financial interest in the ISPs used by their customers. In a baffling decision, the court ruled that the precise percentage limitations imposed by the agency impinged the first amendment rights of cable operators without substantial justification. It appears that such limitations, including tighter restrictions stimulating greater competition, diversity, and opportunity, might withstand the opinion's analysis where based on empirical data indicating the consequences of media concentration. Those consequences seem self-evident to consumer advocates, who cite cases and lessons from the record of the initial AT&T breakup, Microsoft's alleged tie-in restrictions and offenses, and the larger record of consumer abuse where concentration levels are high and market or regulatory checks are absent. The decision was viewed as facilitating the massive Time Warner/America Online merger. Had the FCC rules been upheld, the merger would have required some divestiture of assets to other firms to maintain concentration levels below the stated maximums. Consumer critics decried the decision as a major blow to competitive choice and first amendment access and diversity.

Other Litigation

In January 2001, the Foundation for Taxpayer and Consumer Rights (FTCR) filed ***People ex rel. FTCR v. Henry***

Duque, No. 318164 (San Francisco Superior Court), a *quo warranto* action against Commissioner Duque under Code of Civil Procedure section 803, alleging that Duque must be disqualified from his office because he owned stock in a telecommunications corporation regulated by the Commission.

This matter started in August 2000, when *San Francisco Chronicle* journalist Todd Wallack reviewed Commissioner Duque's 1999 and 2000 statements of economic interests and found that the Commissioner had bought 700 shares of stock in Nextel Communications, Inc., the nation's fifth largest wireless communications firm, on May 12, 1999. The stock rose 48% to a value of $14,400 by August 2000. Wallack questioned Duque about the purchase, asserting that Nextel is a PUC-regulated company whose stock Duque is not permitted to own under the California Constitution and the Public Utilities Code. Duque sold his remaining Nextel stock on August 18, 2000; Wallack reported the purchase and sale in the August 21, 2000 issue of the *Chronicle*.

In January 2001, the Foundation for Taxpayer and Consumer Rights filed *People ex rel. FTCR v. Henry Duque, a quo warranto* action against Commissioner Duque under Code of Civil Procedure section 803, alleging that Duque must be disqualified from his office because he owned stock in a telecommunications corporation regulated by the Commission.

In the furor that followed, Duque contended that his purchase of the stock was an oversight by his investment adviser; he stated that he believed wireless carriers such as Nextel are regulated by the FCC. In fact, while states are precluded from regulating the rates charged by wireless carriers, other aspects of Nextel's business are regulated by the PUC, and Duque participated in several PUC decisions involving Nextel subsequent to his purchase of the stock.

On October 4, 2000, FTCR filed an application with the Attorney General's Office for leave to sue Commissioner Duque *in quo warranto* under Code of Civil Procedure section 803, which authorizes the filing of a *quo warranto* action "against any person who usurps, intrudes into, or unlawfully holds or exercises any public office." FTCR contended that Duque's purchase of the Nextel stock while a member of the Commission violates Article XII, section 7 of the California Constitution ("a Public Utilities Commissioner may not hold an official relation to nor have a financial interest in a person or corporation subject to regulation by the commission") and Public Utilities Code section 303(a) ("a public utilities commissioner may not hold an official relation to nor have a financial interest in a person or corporation subject to regulation by the commission. If any commissioner acquires a financial interest in a corporation or person subject to regulation by the commission other than voluntarily, his or her office shall become vacant unless within a reasonable time he or she divests himself or herself of the interest").

On November 29, 2000, the Attorney General issued a ruling on FTCR's petition, finding that "it would appear that defendant's office became vacant immediately upon his acquisition of the 700 shares of stock in Nextel on May 12, 1999. The fact that defendant subsequently disposed of the prohibited interest is immaterial and did not operate to restore him to the vacant office." The AG concluded that whether Commissioner Duque forfeited his office when he purchased the stock "presents a substantial issue of law that warrants judicial resolution," and granted FTCR's petition. Because Duque refused to resign, FTCR filed its *quo warranto* action in January 2001. At this writing, the case is pending in San Francisco Superior Court.

In ***Pacific Gas & Electric Company v. PUC***, 85 Cal. App.4th 86 (Nov. 30, 2000), the First District Court of Appeal held that Public Utilities Code section 453(d), which prohibits public utilities from including political advocacy in any bill for services, "unconstitutionally infringes upon public utilities' First Amendment right to freedom of speech."

PG&E includes a newsletter in its monthly billings to ratepayers. The newsletter includes energy savings tips, stories about wildlife conservation, billing information, and even recipes. The newsletters sent in June, July, and August of 1987 included information regarding federal regulations that PG&E was seeking to have changed, advancing a lobbying position on behalf of the utility. An independent energy producers' association and others filed a complaint with the PUC alleging that PG&E had violated section 453(d). The parties stipulated that the newsletters were printed at utility expense, used otherwise unused space available in billing envelopes at no additional cost to ratepayers, and the conservation advice in the newsletters provided some economic benefit to ratepayers. The utility conceded that some of the subject matter in the newsletter violated section 453(d), but contended that the prohibition violates its free speech rights. The PUC ruled for complainants, finding that PG&E violated section 453(d) by including "with bills for services to its customers literature designed or intended to promote or defeat any change in federal legislation or regulations." The PUC ordered PG&E to refund to its customers $920,000 (representing 40% of the cost of postage for the billings in the three months at issue). PG&E appealed.

The First District held the statute is unconstitutional on its face, as it can only be interpreted as prohibiting the inclusion of political advocacy in billing envelopes. Further, the court held that the prohibition is not a reasonable time, place, or manner restriction on protected speech, a permissible subject-matter regulation, or a narrowly-tailored means of serving a compelling state interest. The court also rejected complainants' argument that the PUC's decision is necessary tc prevent forced ratepayer subsidization of PG&E's political speech as "misleading and meritless," because the PUC did not find that the inclusion of the newsletter in customers' bills resulted in ratepayers' contribution to the support of PG&E's political advocacy; because the PUC found a clear violation

of section 453(d), it did not reach the subsidization issue. The First District refused to "accept counsel's post hoc rationalizations for agency action."

On December 15, 1999, the California Supreme Court agreed to review the First District Court of Appeal's decision in ***Hartwell Corporation v. Superior Court (Santamaria, et al., Real Parties in Interest)***, 74 Cal. App. 4th 837 (Sept. 1, 1999; as modified Sept. 29, 1999). In this matter, three separate plaintiff groups of residents filed 1997 tort actions in two superior courts against various PUC-regulated southern California water companies (including Southern California Water Company, Suburban Water Systems, and Southwest Water Company), other non-PUC-regulated water companies, and general industrial companies for money damages arising from the contamination of well water in the San Gabriel Valley. The trial courts' various and conflicting decisions on demurrers were all appealed to the Second District Court of Appeal, which eventually recused itself and transferred all of the matters to the First District. The First District held that PUC's jurisdiction over water quality standards and regulated water utilities preempts the filing of tort actions for damages in court against those regulated utilities. However, the court refused to extend preemption to claims against utilities not regulated by the Commission even though issues of the same or similar subject matter are involved. Plaintiffs and the non-utility defendants all petitioned for review. *[17:1 CRLR 185–86]* At this writing, oral argument is scheduled for November 2001 and the Supreme Court's decision is expected in early 2002.

FUTURE MEETINGS

The full Commission usually meets every other Thursday in San Francisco.

Department of Real Estate

Commissioner: Paula Reddish Zinnemann ♦ (916) 227-0931 ♦ (510) 622-2552 ♦ (559) 445-5009 ♦ (213) 620-2072 ♦ (619) 525-4192 ♦ Internet: www.dre.ca.gov

The Department of Real Estate (DRE) is established in the Business, Transportation and Housing Agency pursuant to Business and Professions Code section 10000 *et seq.*; DRE's regulations appear in Chapter 6, Title 10 of the California Code of Regulations (CCR). DRE's primary objective is to protect the public interest in regard to the handling of real estate transactions and the offering of subdivided lands and real property securities by DRE licensees. To this end, DRE has established a standard of knowledge—measured by a written examination—for licensing real estate agents, and a minimum criterion of affirmative disclosure for qualifying subdivided lands offerings. DRE also works to increase consumer awareness and collaterally assists the real estate industry in expanding its standards and increasing its level of professional ethics and responsibility.

The Real Estate Commissioner, who serves as the chief executive of the Department, is appointed by the Governor, subject to Senate confirmation. The Commissioner's principal duties include determining administrative policy and enforcing the Real Estate Law in a manner that achieves maximum protection for purchasers of real property and those persons dealing with real estate licensees. The Commissioner is authorized to issue licenses; promulgate regulations that have the force of law; and revoke or suspend licenses for violations of those regulations, the Real Estate Law, or other applicable laws. The Commissioner is assisted by the Real Estate Advisory Commission, which is comprised of six brokers and four public members who serve at the Commissioner's pleasure. The Real Estate Advisory Commission must conduct at least four public meetings per year. The Commissioner receives additional advice from specialized committees in the areas of education and research, mortgage lending, subdivisions, and commercial business brokerage. Various subcommittees also provide advisory input.

DRE primarily regulates two aspects of the real estate industry: licensees (salespersons and brokers) and subdivisions. Pursuant to Business and Professions Code section 10167 *et seq.*, DRE also licenses "prepaid rental listing services." which supply prospective tenants with a list of residential real properties available for tenancy under an arrangement where the prospective tenants are required to pay a fee in order to obtain the list. Certified real estate appraisers are not regulated by DRE, but by the separate Office of Real Estate Appraisers within the Business, Transportation and Housing Agency.

A person must obtain a real estate license in order to engage in the real estate business and act in the capacity of, advertise, or assume to act as a real estate broker or salesperson in California. An applicant for real estate salesperson licensure must fulfill certain real estate education requirements and pass a real estate examination before obtaining the license. In most cases, a broker applicant, in addition to completing the educational prerequisites, must have two years of real estate experience before applying for the exam. Broker and salesperson licenses are issued for a four-year period. In general, both types of licenses may be renewed by submitting the appropriate application and fee, and evidence of completion of 45 hours of DRE-approved continuing education courses. At this writing, there are 311,845 real estate licensees in California, with salespersons (204,250) outnumbering brokers (107,595) at a ratio of just under two to one.