

AN OVERVIEW BY THE LEGISLATIVE AUDITOR
OF THE
MANAGEMENT AUDIT OF THE PUBLIC UTILITIES PROGRAM
Volume II
The Regulation of Public Utilities

INTRODUCTION

This volume is the second in a series of audit reports on the subject of public utilities. The first, central volume examined the organization and general management of the utilities program. This volume concentrates on the actual regulatory process. The purpose of this overview is to summarize the major findings and recommendations of this volume of the report and the responses of the agencies directly affected by the report.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

This volume of our report on the public utilities program addresses three major areas of operations. *First*, it examines the economic regulation of utilities, including ratemaking, quality of service, consumer complaints, and consumer credit, and the effectiveness of utility regulation within the context of other state and federal regulations in the economic field. *Second*, it examines those regulatory activities which interact with the activities of other governmental agencies, including safety, capital improvements, and environmental protection. *Third*, it assesses the regulation of cable television.

ECONOMIC REGULATION OF PUBLIC UTILITIES

Utility Ratemaking in Hawaii. Ratemaking—the establishment and regulation of utility rates and tariffs—is the dominant regulatory activity in the utilities field. In Hawaii, the ratemaking process functions poorly.

Our principal findings are that:

The ratemaking process consumes an undue amount of time to the significant detriment of both the utilities and consumers.

As elsewhere, the use in Hawaii of the "cost-plus" approach to utility pricing (i.e., allowing rates sufficient to cover the costs of the utility company and to produce enough additional income to assure a reasonable profit to the owners of the utility) overly emphasizes profits to utilities and provides insufficient focus to questions of efficiency in utility operations.

The process tends to limit participation in rate cases so severely that significant groups of interested parties are excluded.

Rules and regulations are lacking for the handling of utility tariffs not directly involving rate increases but which can have significant effects on the overall rate structure. There have been inadequate public notices of such tariff filings, and the filings have been given inadequate review and examination.

Present practices allowing the automatic adjustment of gas and electric utility rates to reflect changes in the cost of fuel oil appear to be legally questionable and to be inadequately administered, with the result that serious inequities and overcharging seem to be occurring.

Our recommendations are that:

The ratemaking process should be speeded up by enlarging staff capabilities, engaging in forward planning and anticipating rate increase requests, developing an effective system of internal operating procedures for rate increases, and developing appropriate guidelines for ratemaking such as whether companies should be allowed to include charitable contributions in their rate bases, how rate burden should be allocated among classes of customers, and the standards by which quality of services is to be measured.

The PUC should pay greater attention to questions of efficiency in utility operations and institute a program of continuous surveillance, including requiring periodic studies of management efficiency by the utilities, development of long- and short-range objectives by the utilities, and support of all major capital expenditure proposals by cost-benefit studies. The regulators, together with the affected utilities and other interested groups, should seek to devise new formulas which will reduce or eliminate dependence on the cost-plus approach to utility pricing and provide incentives for utility companies to achieve more efficient and economical operations.

. *The ratemaking process should be made more accessible to the different interest groups which may be affected by the process. More intervenor status should be allowed to groups interested in becoming parties on the merits of the case, and greater use should be made of the limited participation status to keep the number of intervenors to a manageable number.*

. *The PUC should establish rules for the simplified handling of tariff filings not involving rate increases and assure that adequate public notice is given of proposed tariff changes, and the public utilities division staff should provide greater in-depth review and examination of tariff filings.*

. *The PUC should make a thorough examination of the fuel oil adjustment mechanism in Hawaii, including examining the legal validity of the fuel oil adjustment clauses, formulating appropriate rules and regulations for the uniform development of fuel oil adjustment formulas, developing internal procedures to ensure careful review of all fuel oil adjustment formulas, maintaining continuous oversight on the implementation of fuel oil adjustment clauses, investigating cases of overbilling of consumers and requiring rebates where appropriate, and providing for adequate notice to the public of all impending increases in rates resulting from the invocation of the fuel oil adjustment clauses.*

Quality of Service, Consumer Complaints, and Consumer Credit. The price to be paid for utility services must be fair in the light of the kind of service and treatment that the consumers receive from the utility companies. How consumer interests are protected through regulatory activities was a major aspect of our examination.

Our principal findings are that:

. The quality of service rendered by the utilities receives insufficient attention by the utility regulators. Such standards as exist pertaining to quality of service are incomplete, vague, and indefinite. Moreover, there is no functioning administrative machinery for monitoring the quality of service and for enforcing adherence to whatever standards there might be.

. There is no integrated system for the handling, recording, and analyzing of data on consumer complaints; there are insufficient PUC rules on the matter; and there is no state administrative machinery to give consumer complaints the attention they deserve.

. Regulatory activities relating to consumer credit in the utilities field are woefully lacking. Consequently, the policies and practices of the utilities are arbitrary, discriminatory, harsh, and insensitive to the individual rights of the consumer, particularly with respect to deposits, credit information, bill collections, and termination of services.

Our recommendations are that:

The regulatory authorities should develop complete, meaningful, and quantifiable standards by which utility performance may be measured, include appropriate sanctions to encourage compliance with standards, develop a system for monitoring performance in the various service areas by the utility companies, and establish an ongoing public information program concerning quality of service standards and their enforcement.

The PUC should devise a comprehensive system for complaint handling for the purpose of monitoring the operations of the utilities and encouraging utilities to provide high levels of service.

The PUC should establish clear and definitive rules governing the extension of credit and deposit requirements. Pending the development of appropriate rules, the various utilities should take steps to correct the deficiencies in their credit policies and practices. Additionally, the PUC and the PUD should develop administrative machinery to monitor the credit practices of the utilities.

Utility Regulation Within the Context of Other State and Federal Regulations in the Economic Field. Utility regulation should consider the State's policy against monopolies as expressed in the State's antitrust law. The question is what, if any, are the limits to which the utilities may be monopolies. State regulation should also be concerned with the impact of federal regulations and how the State might influence their formulation.

Our principal findings are that:

Although the State's antitrust law is apparently applicable to the public utilities, no state policy has been developed on the limits of the monopolistic standing that the utilities may enjoy and on mergers, acquisitions, and consolidations of utility companies. Consequently, the PUC has been approving mergers, acquisitions, and consolidations of utility companies almost routinely, without considering the antitrust ramifications of such corporate actions.

There is no consistent, coordinated program for the representation of Hawaii's interest before federal regulatory agencies on matters affecting the utilities in Hawaii.

Our recommendations are that:

. *The department of the attorney general and the department of regulatory agencies should jointly form a task force or some similar cooperative effort to develop a consistent, coherent, and coordinated approach to antitrust matters in the public utilities field. In addition, the attorney general and the PUC should examine existing mergers and combinations, determine whether they are in the public interest, and take appropriate action.*

. *The PUC and the department of the attorney general should develop guidelines by which they may distinguish by their programmatic function matters requiring representation of Hawaii's interest before federal regulatory bodies, undertake representation accordingly, and devise guidelines for those situations which might require cooperative or concurrent representation.*

OTHER ASPECTS OF UTILITY REGULATION

Safety Regulation in the Utilities Field. In addition to economic regulation, the one other major function which is specifically assigned to the public utilities commission is that of regulation to promote and protect the safety of both the users of utility services and of the employees of the regulated utility companies.

Our principal findings are that:

. While other state agencies (department of labor and industrial relations and department of transportation) also have responsibility for safety in the utilities field, there is no coordination between and among the agencies in the performance of this responsibility. There are serious jurisdictional problems relating to safety regulation as a result of the multiplicity of federal and state laws and programs.

. There is no real, comprehensive safety program, and plans, objectives, and guidelines for carrying out the safety responsibility are completely lacking. Many of the rules and standards which have been adopted by the PUC are vague. There is no program to monitor safety in the individual utility companies, and little, if any, on-site safety inspections and investigations of accidents are performed.

. The PUC and PUD are failing to perform all of the tasks agreed upon with the federal government in the area of gas pipeline safety.

Our recommendations are that:

. *The department of labor and industrial relations should assume responsibility for both industrial and public safety with respect to the utilities field.*

. *Whether or not a single agency assumes responsibility for safety in the utilities field, formal, updated safety standards and requirements should be adopted, a program to monitor industry compliance with the standards and to investigate accidents should be developed and implemented, a training and information program to alert employees to safe work practices and industrial job hazards and to inform the general public of hazards associated with public utilities and proper emergency procedures should be formulated, and sanctions against violations of safety standards and requirements should be strengthened and applied.*

. *The contract between the PUC and the federal government for gas pipeline safety should be renegotiated to make the industrial safety division the contracting party for the State, and the division should expand the program to meet Hawaii's contractual requirements.*

Regulation of Utility Capital Improvements and Promotions. Capital improvements and promotions directly affect the rates that consumers must pay for utility services, for the costs of improvements and promotions (including advertising) are recognized as allowable expenditures for ratemaking purposes. In addition, utility capital improvements influence the general economic development of the State, and state and county economic and community plans affect when and where capital improvements are required.

Our principal findings are that:

. Utility capital improvements are given only cursory attention by the regulating authorities. There are no rules, standards, criteria, or guidelines and no administrative mechanism by which the capital improvements programs and projects of the utility companies might be fully reviewed, evaluated, and controlled.

. Extensions of utility lines are being permitted to be constructed without the establishment by the utility regulators of appropriate rules and standards. Rules are also lacking regarding the apportionment of costs, between the utilities and customers, of constructing such extensions. The result is that costs are being apportioned in different ways by the various utilities, and customers are not being treated equally within a utility area and within a utility company.

The PUC has formulated no rules governing utility promotional practices. Without such rules, the utilities have engaged in illegal, wasteful, unreasonable, and unnecessary promotional activities at the expense of consumers.

Our recommendations are that:

The PUC and PUD should develop a system for a full and in-depth review of the utility companies' capital improvement long-range plans, five-year plans, and specific project proposals. As part of that system, standards and guides for evaluating the utilities' capital improvement plans and proposals should be developed, a mechanism should be established whereby other state and county agencies involved in economic and community development may comment on the utilities' plans and proposals, there should be a requirement that a comprehensive financial plan accompany capital improvement plans and proposals, the time for staff and commission review of the utilities' plans and proposals should be lengthened, and rules should be formulated that will eliminate evasion of PUC review of specific capital projects.

The PUC should formulate rules governing utility line extensions and apportionment of construction costs, develop a system for monitoring the construction of utility line extensions, resolve the question of what portion of the cost of construction should become a part of the rate base, and determine what constitutes a fair rebate to customers who pay advances for utility line extensions.

The PUC should develop rules on utility company promotional practices and should apply them consistently to the various utilities. The rules should specify the purposes for which promotional expenditures may be incurred; the specific practices that are prohibited; and the standards, criteria, and considerations by which proposed promotional expenditures will be evaluated.

Regulation of Environmental Protection in the Utilities Field. There are many interrelationships between public utilities operations and the natural environment in which these operations are carried out. The nature and scope of the impact which public utilities operations have upon Hawaii's environment should be matters of significant concern.

Our principal findings are that:

The regulating authorities are generally ignoring the subject of environmental protection and for the most part are failing to take any significant action to promote environmental protection in the public utilities field. The PUC and the PUD have not involved themselves in the activities of other state and county agencies concerned with environmental protection. No rules, regulations, plans, and practices have been adopted to promote environmental protection on the part of the utilities.

Our recommendations are that:

The public utilities agency should establish a mechanism to afford all other agencies and groups concerned with environmental matters full opportunity to participate in the PUC's decision-making process and to be assured that their views and positions will be taken into account before actions are taken which affect the environment.

A long-range plan should be developed which takes into account environmental factors and means of achieving both the State's environmental objectives and the objectives of utility regulation.

A research and development program should be maintained to identify the changing needs of the utility industries, promote awareness of new technologies and the means to conserve resources and to meet the ends of environmental concerns.

Policies, rules, regulations, and criteria should be developed which cover such aspects as siting of utility facilities, impact statement for the construction of utility facilities, undergrounding of utility lines, conservation of energy, and allocation of the costs incurred in complying with environmental standards.

CABLE TELEVISION

Present Regulation of Cable Television in Hawaii. In 1970, the state legislature enacted a statute on the regulation of cable television. In the interest of expending CATV services as rapidly as possible, it vested responsibility for CATV regulation in the director of regulatory agencies rather than in the PUC.

Our principal findings are that:

In accordance with the legislative priority to expand cable television service throughout the State, the CATV regulators have moved fairly expeditiously to attain this objective despite limited resources.

However, by placing overwhelming emphasis on the early extension of services, less attention has been given to other matters. Consequently, there are serious shortcomings in the present approach to and handling of ratemaking, standard-setting, complaints, consumer credit, representation before the FCC, and ownership of CATV systems. In addition, the regulators have yet to come to grips with such major CATV issues as access to CATV programming, fiscal responsibilities of CATV systems, and the safeguarding of individual rights against electronic intrusions into areas of personal privacy.

There is no reason why CATV regulation should be kept separate and apart from the regulation of other public utilities or why funding for CATV regulation should be any different from the funding for the regulation of other public utilities.

Our recommendations are that:

The CATV regulators should proceed, pursuant to the State's Administrative Procedure Act, to formulate rules, regulations, and guidelines to deal with those aspects of regulation identified in our report as requiring attention.

The CATV regulators, in conjunction with the attorney general, should formulate a program to represent Hawaii's interest before the Federal Communications Commission.

The legislature should merge the regulation of CATV with the regulation of other public utilities, review the need or desirability for the appointment of a CATV advisory committee, and treat funding for the CATV regulatory program in the same manner as funding for the regulatory program of other utilities.

Staff capabilities for CATV regulation should be reviewed to enable the regulators to accomplish the tasks which up to now have been neglected.

RESPONSES OF AFFECTED AGENCIES

On August 4th, we transmitted our preliminary report to the agencies affected by this portion of the audit and asked for their comments on our recommendations. We received responses from the public utilities commission, the department of regulatory agencies, the department of the attorney general, and the department of labor and industrial relations. Those responses have been included as part of the audit report.

The chairman of the public utilities commission has responded that the commission has no specific comments at this time. The commission had previously expressed general agreement with volume I of the report, which more directly and more substantively affects its organization and operations. The chairman has indicated that, pending the legislature's final decision on our recommendations, the commission, in cooperation with the public utilities division and the department of regulatory agencies, will strive to correct the deficiencies noted in our findings.

The director of regulatory agencies, responding for the public utilities division, states: "We concur with the general overviews of the report and recognize many of the deficiencies mentioned in your report." He especially welcomes the report's observation that PUD has a severe staff limitation. He states: "In attempting to implement the suggestions made in your first report, we have been hampered by our inability to do all the things we want to do in the time we have. Rate increase investigations have continued to be our first priority and many suggestions contained in the second volume will be implemented as soon as possible."

The attorney general has declined to submit specific comments, stating: "The limited time frame within which you request our comments precludes us from studying your recommendations in depth in order to do justice to the evident time and effort your office undoubtedly went through in its preparation."

The department of labor and industrial relations, to which we recommend assignment of safety responsibility in the utilities field, responded that it would be willing to assume responsibility for employee safety but opposes the transfer of the public safety function. We note that, while the

department of labor and industrial relations is heavily engaged in occupational health and safety, it also currently performs public safety functions, such as those for construction, amusement park rides, elevators and escalators, and the manufacture, sale, and transportation of explosives. It would not be incongruous for the department to assume responsibility for public safety in the utilities field.

CONCLUSION

Legislative action is required to implement a number of the recommendations contained in the report. However, there are many more recommendations which are within the prerogatives and capacity of management to implement. Given the generally positive response of the agencies most affected by the report, to this volume as well as to volume I, we remain hopeful that needed, basic improvements to the public utilities program will be made.

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