

AN OVERVIEW BY THE LEGISLATIVE AUDITOR  
OF THE  
MANAGEMENT AUDIT OF THE PUBLIC UTILITIES PROGRAM

Volume I  
The Organization for and the General Management of the  
Public Utilities Program

INTRODUCTION

The importance of public utilities to the health, safety and general welfare of the people of the State is underscored by several predominant characteristics: *first*, the services which public utilities provide (mainly energy supply, communications, transportation, and to a lesser extent in this State, water supply and sewage disposal) are urgent, essential and continuously in demand; *second*, they serve a large number of customers directly, most of whom have no alternative but to deal with them; and *third*, public utilities tend to be monopolies. Because the activities of public utilities permeate almost every facet of economic life, the protection and promotion of the public interest are paramount considerations. In Hawaii, as is generally the case throughout the United States, efforts to protect and promote the public interest in the public utilities field have centered on government control and regulation.

Unfortunately, government efforts have not always been equal to the formidable task of controlling and regulating public utilities. In 1913, the territorial legislature enacted Act 89 which created the Hawaii public utilities commission and set forth the basis for general and continuing regulation of utilities in Hawaii. This act has been amended a number of times since 1913, but it has remained basically unchanged and is still the fundamental law under which public utilities are regulated in Hawaii today. The suspicion that the State's public utility laws might be outmoded and that the organization and management for utilities regulation might be ineffective prompted the legislature to call for the audit of the public utilities program.

The results of the audit will be presented in several volumes. The first of these volumes, the central volume in the series, deals with the organization and general management of the public utilities program. It evaluates the effectiveness of the organization and management, and it makes recommendations for changes to the organization, management, and processes so that program objectives can be achieved with greater effectiveness and efficiency.

The purpose of this overview is to summarize the major findings and recommendations of the audit report and the responses of the agencies directly affected by the report.

## SUMMARY OF FINDINGS AND RECOMMENDATIONS

This particular audit report covers the public utilities program in four broad areas. *First*, the audit assesses the organizational arrangements through which the various aspects of Hawaii's public utilities program are administered. *Second*, it examines and describes the shortcomings of the various policies and procedures under which the public utilities commission and the public utilities division operate. *Third*, it assesses the effectiveness of the internal organization of the public utilities division. *Fourth*, it examines the handling of official records and the discharge of financial responsibilities. We summarize here the principal findings and recommendations with respect to each of these areas.

**Organization of Hawaii's Public Utilities Program.** During the first half-century of its existence, the public utilities commission functioned as an independent regulatory agency with its own staff. Following statehood, however, a series of statutory changes, court decisions, and rules and regulations substantially altered the role of the PUC and the staff that had served it previously, while also enlarging the scope of regulation and shifting its emphasis.

Principal among these changes were acts which placed the PUC in the department of regulatory agencies for administrative purposes; shifted the responsibility of the staff of the PUC to representation of consumer interests before the PUC; added regulation of cable television to the responsibilities of the director of regulatory agencies rather than the PUC; created an office of consumer protection; and made the attorney general and his deputies the attorneys for the staff, rather than the PUC.



The result of these and other changes was considerable confusion as to the roles of the PUC, its staff (the public utilities division or PUD), the director of regulatory agencies, and the attorney general. The confusion perhaps reached its height in the Hawaiian Telephone Company rate case, during which at various times the PUC grew hostile to the PUD; the attorney general was in the conflicting position of representing different parties in the proceeding; and the director of regulatory agencies exerted himself on the part of consumers.

Some of the confusion appears to stem from inadequate perception of the statutory changes affecting the PUC and other agencies. Thus, the PUC was inclined to view the PUD as responsive to its mandate, while legal authority over the PUD actually rested with the director of regulatory agencies. Yet by law the PUC was responsible for policy-making, adjudication, and regulation, and the PUD was staff for these programs. The PUD, then, served two masters uncomfortably, but more and more has been the representative of the director of regulatory agencies for consumer protection purposes. And the PUC, as a result, has less and less had a staff it could call its own.

This is not only the result of inadequate interpretation of the law and conflict within the law itself; the functional description of public utilities regulation within the state government's program structure also is at fault. It assigns public utilities regulation to the category of consumer protection, when, in reality, much of what the PUC does is economic in character, having to do with assuring the distribution of certain essential commodities of a quality and at a price that are economically efficient, but in a setting in which the absence of price competition does not permit market forces to function.

This unsuitable designation of public utility regulation as a consumer protection function is still further clouded by arguments that the PUC should not simultaneously adjudicate matters pertaining to utility rate-making and investigate and administer performance of the same companies it judges; that the PUC relies overmuch on court-like proceedings and uses its policy-making initiatives too little; and that the PUC tends to be a captive of the industries it regulates. Various remedies are proposed, including limiting the commission to an adjudicative role, but there is no conclusive evidence that this is a more suitable arrangement than combining adjudicative, policy-making, and administrative powers in a single agency.

Our approach to these matters is to separate economic from non-economic functions, and seek a distribution of organizational responsibilities that will reflect this distinction without detracting from either function. Within this context, we also note that the questions pertaining to adjudication, policy-making, and administration are procedural in nature and not subject to automatic resolution by some different organization. Rather, what are required to guarantee proper performance are procedural safeguards which may take the form of improvements to the performance of existing adjudicative, policy-making, and administrative responsibilities.

Our recommendation is that:

The legislature should overhaul the basic public utility laws to reflect the distinction between economic and non-economic functions in regulation; assign to the public utilities commission full adjudicative, policy-making, and administrative authority over those activities with economic objectives; and assign to other state agencies those activities having to do with non-economic objectives. More specifically, the highway safety coordinator should develop standards for motor carrier safety and county police departments should enforce them; the department of labor and industrial relations should assume responsibility for safe working conditions and public safety aspects of public utilities operations; certification and licensing necessary for consumer protection should be the responsibility of the director of regulatory agencies.

The staff for the public utilities commission should serve the commission directly, and the director of regulatory agencies should have such additional staff as is necessary to represent consumer interests before the commission.

The public utilities commission should have its own legal counsel, and the attorney general should represent the director of regulatory agencies.

The department of budget and finance should amend the state government program structure to reflect the economic objectives of utility regulation, and the public utilities commission should be transferred to the department of planning and economic development.



. The sale, lease, installation, and maintenance of telephone interconnect systems should be deregulated, because regulation of the systems serves no economic purpose.

. The regulation of motor carriers should be discontinued, except as to their safety.

. The regulation of privately owned water supply and sewage disposal systems should be transferred to the county governments.

. The regulation of cable television should be transferred from the director of regulatory agencies to the public utilities commission.

. Recognizing the large commitment in time which is required of members of the public utilities commission, we also recommend that the legislature make the commission a full-time body, and determine the number of members and the term of their office on the basis of whether the legislature desires a body of experts or public representation.

**Policies and Procedures of Hawaii's Public Utilities Program.** Formal policies and procedures are an essential feature of most governmental functions, and they are even more important and significant in the regulatory fields. This is especially true in the regulation of public utilities where many interests are involved, where proceedings tend to be highly legalistic, and where decisions of the public utilities commission are directly appealable to the state supreme court. In Hawaii's case, there are serious and extensive shortcomings in the formal policies and procedures which govern the public utilities program.

. The formal policies and procedures of the PUC are dated. Policies have not been reviewed often enough to keep them abreast of statutory changes, with the result that several are at variance with the law, and thus illegal.

. There are extensive gaps and voids in existing policies and procedures, so much so that the existing policies are not comprehensive and are a major source of shortcomings in the regulatory process.

. There are no guidelines for the commission to use in many matters, and the PUC makes decisions on a case-by-case basis, with no assurance of general application or consistency. Thus, the question of whether promotional expenses are properly chargeable to consumers has arisen repeatedly in individual rate cases, without a firm, general decision on the part of the PUC.

. There are no time constraints on completion of PUC proceedings, though such constraints are not uncommon in other and larger jurisdictions. Major utility rate cases here have consumed more than four years, and the PUC has dockets that have been open for as much as nine years without a decision.

. The PUC exercises wide discretionary authority over public participation in proceedings in the absence of clear rules. In important rate cases this has led to the exclusion of so prominent a consumer as the federal government, and in other instances, to participation by the State in one part of a case but not in another. Similarly, the operation of automatic fuel price escalators has produced drastic electricity price increases with scant public notice.

. Failure to comply with the Administrative Procedure Act has led to repeated rebukes from the courts, and PUC decisions have been overturned on procedural grounds.

. Absence of internal procedures produced confusion among the staff of the PUC, creating a credibility gap between the PUC and the PUD in a major telephone company rate case. This contributed to delays in the case, in which legal expenses ran into hundreds of thousands of dollars.

. Water companies which the PUC is responsible for regulating are not covered by general rules.

. There are no uniform standards of service for utility companies, with the result that some companies pursue more stringent standards than others. However, even the standards that are pursued are so lenient that in the case of the Hawaiian Telephone Company, a consultant to the PUC resorted to the standards of another jurisdiction to measure telephone company performance. Procedures and standards for complaint handling, safety inspections, and accident reporting are inconsistent or lacking.

. The disarray in the PUC's policies and procedures makes it impossible for the PUC to maintain consistent and thoroughgoing surveillance of utility company



practices, and prevents the PUC from enforcing regulatory requirements. Tariff changes which may have substantial effect on consumers but which are not part of formal rate cases tend to be handled routinely, and the initiative lies with the utility companies.

Our recommendation is that the PUC establish a system for the development and maintenance of comprehensive and integrated rules; that rules be established for the various facets of its regulatory responsibilities, including rules on the internal operations of the PUD, so as to enable the PUC and the PUD to perform effectively and efficiently; and that the PUC give its rule-making function the attention it deserves.

**Internal Organization for Regulating Public Utilities.** The public utilities division occupies the central organizational focal point within the public utilities program. It is the full-time, professionally staffed agency through which the functions and responsibilities for the regulation of public utilities are carried out. Despite the importance of the division, its internal organization and its management systems have never been properly designed. As a consequence, there are a number of organizational and management deficiencies which require attention.

The public utilities division is operating under an organizational plan that has never been approved. The last prior approved plan dates from 1966 and provides for engineering and safety, audit, tariff, and finance and economic branches within the PUD. An unapproved 1970 reorganization of the PUD, under which the PUD operates, increased the number of branches from four to six. So long as the current organization is unapproved, the plan is illegal and does not permit the job upgrading that appears to have been its intent.

Moreover, the unapproved organization assigns a small professional staff (24) to a large number of branches, with the result that separate branches perform similar operations, coordination is fragmented, and branches duplicate effort and fail to contribute to the efforts of other branches. The clerical staff, organizationally divided, is not responsive to the needs of the professional staff and tends to dictate the nature and timing of the work that the PUD does.

The position of executive director, the key management post, has been vacant since the end of 1973, and the division has suffered from the lack of management leadership and direction.

The job descriptions of the positions in the PUD are obsolete and require modification. For example, duties assigned to the public utilities administrator are in fact performed by the head of the engineering branch. A typist III position in the clerical services section is responsible for duties in a branch that no longer exists. Some employees do not even know what their job descriptions are.

The PUD lacks qualified personnel to administer the regulatory program. The audit staff does not have the qualifications to play a large policy role in utility rate-making and finance. The research and statistics branch compiles data, but does not analyze them. The engineering branch verifies utilities data, but leaves sophisticated analysis to consultants, for whom it gathers data. Investigations branch personnel do not have the training or experience to pursue complaints, administer the motor carrier safety program, inspect gas pipelines, enforce overhead utility line regulations, and investigate accidents involving public utilities, as they are required to; nor has the branch received strong administrative support. A key position in the clerical section of the PUD has long been vacant, and records are a shambles. The important position of chief clerk, analogous to that of court clerk, is now vacant, but in any case the chief clerk did not perform the duties set forth in the job description. As a consequence of the lack of qualified personnel, the PUD relies heavily on outside consultants, especially for legal services. Overall, executive leadership and direction have been weak.

Our recommendations are that the PUD disband its unofficial organization and follow Administrative Directive No. 12 in future organizations; that the director of regulatory agencies fill the position of executive director as soon as possible and that, in the meantime, the director and the acting executive director pull the staff of the PUD together; that the director of regulatory agencies cause the position descriptions within the PUD to be brought up to date; that skills and qualifications required for each position in the PUD be carefully delineated to ensure that qualified personnel are hired for these positions in the future; that in-service training programs be developed to upgrade the skills and competencies of the staff; and that the attorney general develop expertise in his office in public utility matters to eliminate the need for continuously retaining outside legal counsel.



**Records and Financial Management.** Despite the fact that the PUC is a quasi-judicial agency with highly legalistic proceedings and has a status comparable to circuit courts in that appeals of its determinations may be taken directly to the state supreme court, the agency's records are in a shambles.

Files are clogged with obsolete records. Whole groups of records are scattered in many different places. Others are dumped in drawers and boxes. Similar types of records are kept in different ways. Misfiling is common. Numbering, dating, and referencing are slipshod. Confidential records are accessible. Staff members keep individual files for fear of being unable to find key documents.

There is no policy for closing dockets, so there is uncertainty over which are closed and which are not. Clerical errors and oversights result in dockets being represented as being closed when they are not. Other dockets are removed from the pending list from time to time so the list will not grow too long and reflect badly upon the commission.

The PUC collects a great deal of data that are neither useful nor accurate, but does not collect other data that would be of material value to the administration of the agency and its programs. Statistics which are collected are filled with inconsistencies, inaccuracies, discrepancies, and omissions. The motor carrier accident log is maintained in haphazard fashion. No meaningful analysis of data is performed.

There are gross deficiencies and inadequacies in financial management and fiscal controls. Commissioners have been paid improperly and illegally. Motor carriers are being assessed fees illegally on the basis of passenger seat capacity, instead of gross weight, and the PUC does not identify and assess all carriers subject to fees, nor correctly identify and assess some of those from which it does collect fees. In other cases fees are assessed in an inequitable, discriminatory, or improper manner: vehicles subject to semiannual inspection are being double-charged; government vehicles are being charged a preferential rate; and many vehicles are not being charged. Enforcement is lax, and extreme leniency characterizes the imposition of penalties.



We present in our report numerous specific recommendations to correct the many defects found in the records and financial management operations of the PUC and PUD. Generally, however, we recommend that the PUC immediately move to reform its records management and information handling system, and to clearly fix responsibility for its continuing proper maintenance; that the PUD develop an effective, reliable, and useful statistical system; that the PUC develop and adopt clear policies governing compensation of commissioners; that the PUC and PUD eliminate illegal, improper, and discriminatory billings, take all necessary steps to assure uniform assessment of all vehicles subject to fees, and enforce penalties imposed on violators.

## RESPONSES OF AFFECTED AGENCIES

On March 5, we transmitted our preliminary report to the agencies affected by the audit and asked them to submit comments on our recommendations. We received responses from the public utilities commission as well as from the director of the department of regulatory agencies, and these responses have been included as part of the final report. Both the commission and the director are in substantial agreement with the findings and recommendations.

There is one specific disagreement by the commission. We recommend in our report that some facets of public utility regulation serve no useful economic ends and should therefore be deregulated. Among the areas that we believe should be deregulated is the field of telephone interconnect systems (e.g., such things as color telephone sets, telephone rotary system, intercommunication systems which can be plugged into the basic telephone lines). It would appear that telephone interconnect systems should be excluded from PUC regulation for at least two reasons. *First*, the sale, lease, installation, and maintenance of these systems are a highly competitive business. There are a number of firms, including the Hawaiian Telephone Company, offering these systems. One of the elements making governmental regulation of public utilities necessary is that the utilities operate under monopolistic conditions. Since the interconnect systems business is not conducted under monopolistic conditions, competition should ensure the production of goods and services in the quantity and of the quality the public wants and is willing to pay for. *Second*, these systems are to a great extent luxuries and beyond the basic instruments required to use the telephone lines, interconnect devices can hardly be classified as necessities or essentials. Governmental regulation is justified where goods and services are produced not only under monopolistic conditions but where the goods and services are essential.



In its only direct disagreement with the report, the commission believes that "interconnect should be regulated rather than deregulated." The commission states: "Deregulation [of interconnect systems] would not be in the public interest because of the many service and other problems that would arise." However, the commission does not identify in its response what those problems might be.

## CONCLUSION

Many of the recommendations which we have made in the audit report are matters for legislative deliberation and determination. However, there are also many recommendations which can be implemented by the public utilities commission and the department of regulatory agencies. Indeed, the two organizations have been very positive in their response to the audit report and indicate that they are ready to proceed with the implementation of the recommendations as expeditiously as possible. With the positive approach expressed by the commission and the director of the department of regulatory agencies, the conditions are hopeful for improvements to be made in the State's public utilities program.

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