

## California Public Utilities Commission

It Should Reform Its Rules to Increase Transparency and Accountability, and Its Contracting Practices Do Not Align With Requirements or Best Practices

Report 2016-104

COMMITMENT  
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September 22, 2016

2016-104

The Governor of California  
President pro Tempore of the Senate  
Speaker of the Assembly  
State Capitol  
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor presents this audit report concerning the California Public Utilities Commission's (CPUC) contracting practices and the contracts that the CPUC ordered four energy utilities to enter into. In addition to entering into its own contracts for services, the CPUC has broad authority to direct utilities to enter into contracts, which it orders through public proceedings.

This report concludes that to increase the transparency and accountability of its contracting directives, the CPUC must change the rules that govern the circumstances in which commissioners can participate in its proceedings and the entities and individuals who must report private communications about those proceedings. In our audit, we found that a commissioner—the then-president of the CPUC—participated in approving a \$152 million contract despite evidence that suggested that he was unable to act impartially towards a ratepayer advocate group's request to deny the contract. Further, we found that private communications about a \$25 million contract were not reported because the CPUC does not require commissioners to disclose when they have engaged in private discussions about the CPUC's public proceedings. We also found that the CPUC often does not follow state requirements or best practices when it issues and oversees its own contracts for services. This includes a failure to conduct market research to ensure that it obtains the best value in cases where competitive bidding is not required.

We recommend that the Legislature require the CPUC to adopt new standards requiring commissioners to recuse themselves if their impartiality is reasonably questioned and to report the content of private communications they hold related to CPUC proceedings. We also recommend that the CPUC change the way it oversees its own contracts to ensure that it receives the best value when it contracts out for services.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
State Auditor

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## SUMMARY

The California Public Utilities Commission (CPUC) is a state entity that is subject to the contracting requirements in state law and the *State Contracting Manual*. In addition to entering into its own contracts, it has the authority to direct the utility companies it regulates to enter into contracts, and it also approves or denies contracts these utilities propose. For this audit, we reviewed the CPUC's actions related to both its own contracting and the energy utility contracting that it oversaw from 2010 through 2015. This report draws the following conclusions:

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**The CPUC has not effectively guarded against the appearance of improper influence in its public decision making.**

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The CPUC directed utilities to enter into sole-source contracts, for a cumulative total of about \$74 million, with a vendor who volunteered to run a statewide outreach program. Because the CPUC did not adequately explain how it knew the vendor would provide the best value for ratepayers, its decision appears influenced by the vendor. In another case, the then-president (former president) of the CPUC voted to approve a \$152 million contract despite evidence suggesting that he had discussed the contract with the utilities before they submitted it for approval.

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**The CPUC has failed to fully disclose important communications between commissioners and external parties.**

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The former president of the CPUC failed to ensure that the public knew about communications he had with Southern California Edison and the University of California. These unreported communications have cast doubt on whether a multibillion-dollar settlement protects ratepayers and on the appropriateness of the CPUC's selection of the University of California for a \$25 million contract.

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**The CPUC's contracting activity has not been consistent with state requirements or best practices.**

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We found numerous deficiencies in the CPUC's approach to contracting, including a lack of market research in 24 cases in which contracts were not competitively bid, \$2.4 million in unexplained additional contract funding, and an absence of evidence that the CPUC monitored contractor performance in nearly one-third of the contracts we reviewed.

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In addition, we reviewed the CPUC's approval of sole-source contracts that energy utilities proposed, its response to California Public Records Act requests related to contracts, and potential conflicts of interest related to the CPUC's and utilities' contracts. In some of these areas, we found that the CPUC could improve its processes, and we have made recommendations that are discussed in the *Other Areas We Reviewed* section of this report beginning on page 39.

## Summary of Recommendations

### *Legislature*

The Legislature should amend state law to require the CPUC to adopt a new standard for commissioners to recuse themselves from proceedings when their impartiality is reasonably questioned and to adopt new rules that require commissioners to publicly report private communications with any parties to its proceedings.

### *CPUC*

To ensure that the choice of a vendor is sufficiently justified, the CPUC should explain how a particular vendor was chosen in any case for which it does not competitively select the vendor with which it directs utilities to contract.

To address several deficiencies in its contracting practices, the CPUC should update its contracting manual, conduct a supervisory review of contracts, and require regular training for contract staff.

## Agency Comments

The CPUC agreed with most of the recommendations we made. It disagreed with a recommendation to explicitly require parties to disclose their interest in CPUC proceedings because it believes such a requirement is redundant.



# INTRODUCTION

## Background

The mission of the CPUC is to serve the public interest by protecting consumers and ensuring the provision of safe, reliable utility service and infrastructure at reasonable rates, with a commitment to enhancing the environment and promoting a healthy California economy. The CPUC was established by a constitutional amendment and has broad regulatory authority over privately owned electric, natural gas, telecommunications, water, railroad, rail transit, and passenger transportation companies. The CPUC consists of five commissioners who are appointed by the Governor and approved by the Senate. It employs a supporting staff and is funded by fees imposed on the public utilities it regulates. Its staff is organized into an administrative division as well as divisions for each subject matter the CPUC regulates. This audit focused on the CPUC’s practices for contracting for consultant services and the contracting that the CPUC directs or approves for four energy utilities—Pacific Gas and Electric, San Diego Gas and Electric, Southern California Edison, and Southern California Gas—to enter into.<sup>1</sup>

## State Contracting Requirements and the CPUC’s Contracting Practices

Each state agency is responsible for its own contracting program. These responsibilities include ensuring the necessity of services, securing appropriate funding, complying with laws and policies, writing contracts in a manner that safeguards the State’s interest, and obtaining required approvals, including approvals from the Department of General Services (General Services). General Services serves as a business manager for the State. It maintains the *State Contracting Manual*. The *State Contracting Manual* provides policies, procedures, and guidelines to promote sound business decisions and practices in securing necessary services for the State, and it includes guidance regarding contracting requirements found in state law as a resource for persons involved in the State’s contracting process.

**Table 1**  
**Dollar Threshold for Competitive Bidding and Department of General Services’ Approval for California Public Utilities Commission Contracts**

CONTRACT VALUE	COMPETITIVE BIDDING REQUIRED?	GENERAL SERVICES’ APPROVAL REQUIRED?*
Under \$5,000	No	No
\$5,000–\$50,000	Yes, but some contracts are exempt†	No
\$50,001 or higher	Yes, but some contracts are exempt†	Yes, but some contracts are exempt‡

Source: California State Auditor’s analysis of the *State Contracting Manual*, Volume 1.

\* If an amendment increases a contract’s funding to more than the \$50,000 threshold, the amendment is subject to General Services’ approval.

† Contracts for legal services or expert witness services for litigation, interagency agreements, and emergency contracts are exempt by statute from competitive bidding requirements regardless of their dollar value.

‡ Some contracts are exempt from General Services’ approval. For example, some contracts are exempt from approval because of statute or because of exemption letters issued by General Services.

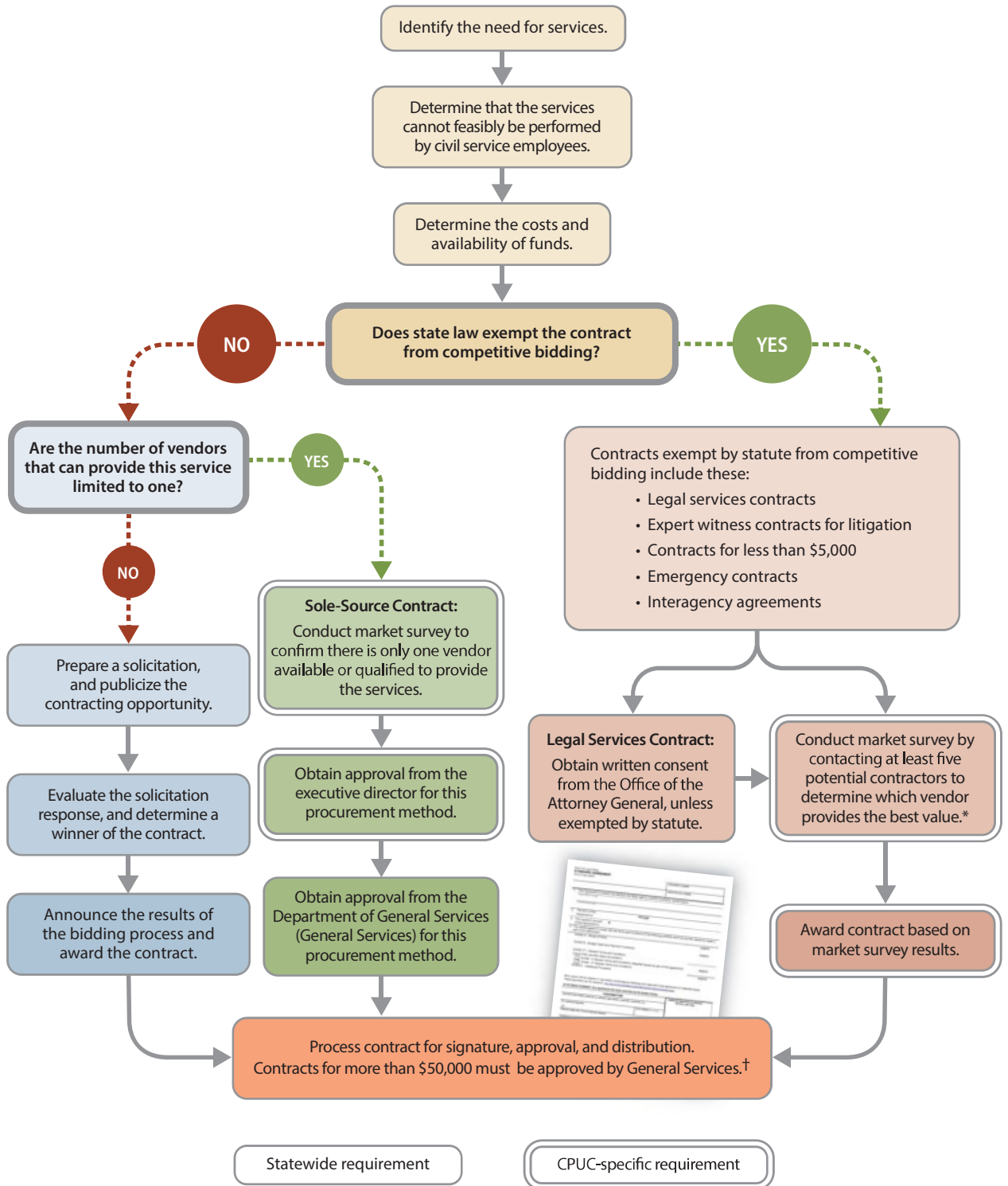
<sup>1</sup> Consistent with our audit objectives, our review focused on contracts for services not specifically related to information technology, and this report refers to those agreements as *CPUC contracts*. We did not review contracts for goods or for information technology services.

State law and the *State Contracting Manual* establish baseline requirements for how agencies must contract for services, and the CPUC also has internal policies for how it will ensure that its contracts represent the best possible value. Figure 1 shows the general process required by state law, by the *State Contracting Manual*, and by the CPUC's policies for contracting for a service. State law generally requires a competitive bidding process for service contracts unless the law or General Services' policies make these contracts exempt from competition (exempt contracts). Examples of exempt contracts include contracts for legal services, expert witness contracts for litigation, interagency agreements, and emergency contracts; these types of contracts are all exempt from competitive bidding requirements regardless of their total dollar value. Although such contracts do not have to be competitively bid, for almost all types of exempt contracts CPUC policy requires that CPUC staff conduct a market survey so as to identify the contractor that will provide the best value.

A contract's dollar value is also a determining factor in whether the contract must be competitively bid and approved by General Services. Table 1 on the previous page shows the cumulative dollar thresholds at which requirements change for competitive bidding and General Services' approval. CPUC contracts valued at more than \$50,000, and any amendments to such contracts, generally must be approved by General Services before the contract or contract amendment is effective. If the CPUC enters into a contract for \$50,000 or less and subsequently amends that contract to an amount above that threshold, it must submit to General Services for approval the amendment that increased the value to more than \$50,000 and any subsequent amendments. Agencies may use *sole-source contracts* to obtain services that would have normally been obtained through a competitive bidding process if the agency has established that only one vendor can provide the service the agency needs.<sup>2</sup> The CPUC's policy requires staff to conduct the same type of market survey for sole-source contracts as staff does for exempt contracts. However, agencies must obtain approval from General Services in a two-step process for sole-source contracts that are more than \$50,000. Before an agency can execute a sole-source contract for more than \$50,000, it must first obtain General Services' approval of the sole-source procurement and then seek General Services' approval of the actual contract.

<sup>2</sup> This report refers to what the *State Contracting Manual* calls *noncompetitively bid contracts* as *sole-source contracts* in order to avoid confusion between noncompetitively bid contracts and contracts that are exempt from competitive bidding.

**Figure 1**  
Overview of the State’s and the California Public Utilities Commission’s Processes for Obtaining Services Contracts



Sources: California State Auditor’s analysis of the *State Contracting Manual* and the *California Public Utilities Commission Policies and Procedures Manual: Personal Services Consultant Contracts*.

\* Emergency contracts and interagency agreements do not require a market survey.

† Emergency contracts do not require General Services’ approval before taking effect. In addition, some service contracts are exempt from General Services’ approval, such as contracts that are specifically exempt by statute or by an exemption letter issued by General Services.

The CPUC is subject to all contracting requirements in state law and the *State Contracting Manual* with one exception: state law allows the CPUC to bypass approval from General Services for consultant or advisory service contracts if the CPUC makes a finding that extraordinary circumstances exist. State law does not define *extraordinary circumstances* or identify a time limit on this exemption, and we identified no information in state law that explains why the CPUC is allowed this exemption from contracting requirements. However, the history of the legislation that established the exemption indicates that the intent of the Legislature was to enable the CPUC to hire expert consultants in major ratesetting proceedings without missing deadlines.

To manage different components of its contracting process, the CPUC separates contract duties between project managers and contract analysts. A project manager is the program expert and overall manager for a CPUC contract. He or she identifies the need for the contract or for an amendment to an existing contract and determines, with the assistance of the contract analyst, the procurement method the CPUC will use to obtain the service. If the contract is competitively bid, a team of individuals at the CPUC collaborates to score bids and chooses a vendor.<sup>3</sup> In situations where the CPUC does not use a competitive bidding process for a contract, the project manager identifies and selects the vendor that will be awarded the contract. Regardless of procurement method, the project manager is responsible for monitoring the progress of the work that the contractor performs. The CPUC employs a contract manager and three contract analysts to ensure that contracts comply with and are administered according to state requirements from the time that a project manager proposes the contract through the conclusion of the contract's terms. The contract analyst advises the project manager on contracting options as well as policy and procedural requirements, and he or she serves as the CPUC liaison with General Services.

### **The CPUC's Oversight of Energy Utility Contracting**

The CPUC has broad authority under state law to oversee energy utilities, including the authority to direct those utilities to contract with other entities. Generally, the CPUC issues these directions through its decisions, which are the product of CPUC proceedings. The three categories of formal CPUC proceedings—adjudicatory, ratesetting, and quasi-legislative—are described in more detail

<sup>3</sup> For a certain type of competitively bid contract, the CPUC must award the contract to the vendor with the lowest bid.

in the text box. At the outset of certain proceedings, the CPUC issues a scoping memo that describes the scope of issues to be considered in the proceeding.

Interested persons and entities may formally participate in CPUC proceedings by becoming a *party* to the proceeding. Contractors interested in CPUC-directed contracts are not prohibited from becoming parties to CPUC proceedings. Parties must adhere to certain rules, such as those related to communications between parties and decision makers. As a party, a person or organization can present evidence and witnesses, obtain information from other parties, and submit relevant motions, petitions, objections, and briefs to the CPUC. This participation can affect the eventual decisions that the CPUC makes as a result of its proceedings. For example, parties can advance arguments either for or against contract awards. However, because the ultimate decision-making authority rests with the commissioners, no conflict of interest can be attributed to decision makers by having contractors participating and advocating for their own interests.

After a comment or hearing process, the CPUC issues a proposed decision based on the evidence presented. Parties and the public are given an opportunity to review and comment on the proposed decision and, after this comment period closes, the CPUC commissioners vote on whether to approve a final version of the proposed decision. CPUC decisions generally include a discussion of the arguments or comments the parties submitted to the proceeding. These decisions may include orders that direct energy utilities to contract with third parties or approve contracts that the utilities propose.

### Categories of California Public Utilities Commission Proceedings

*Adjudicatory proceedings:* Investigate possible violations of state law, a CPUC order or rule, or both—as well as complaints against regulated entities—except those that challenge the reasonableness of rates. Can be initiated by the CPUC for enforcement purposes or when a consumer or entity files a complaint.

*Ratesetting proceedings:* Set or investigate rates for utilities. Can be initiated by a regulated entity that files an application, by those challenging the reasonableness of rates or charges, or by the CPUC to establish a mechanism that in turn sets rates.

*Quasi-legislative proceedings:* Establish policy or rules affecting a class of regulated entities. Can be initiated by legislation, petition, or by the CPUC.

**Sources:** California State Auditor's analysis of California Code of Regulations, title 20, section 1.3 and a CPUC presentation regarding CPUC decision making dated March 23, 2016.

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# The CPUC Has Not Effectively Guarded Against the Appearance of Improper Influence in Its Public Decision Making

## Key Points:

- Although the CPUC can direct utilities to contract with specific vendors, it did not adequately support one decision to do so. As a result, it appears that the choice of that contractor was inappropriately influenced by the contractor’s participation in the CPUC proceeding.
- The standard that the CPUC applies to questions of bias in decision making makes it more difficult in California than it is in other states to disqualify a commissioner from participating in decision making. Because of this standard, the CPUC allowed one of its commissioners to participate in a decision when there was evidence that reasonably suggested he had been influenced by off-the-record conversations with utilities.

## The CPUC’s Direction of Sole-Source Contracts

The CPUC directs energy utilities to enter into contracts with third-party vendors, and this direction generally comes from CPUC decisions. In many cases, before the CPUC issues a decision, it holds related proceedings. We asked the energy utilities to report the number of contracts the CPUC directed them to enter into from 2010 through 2015 and the method the CPUC used to order each contract. Using the information the energy utilities reported to us, we determined that the CPUC ordered a total of 25 contracts. Table 2 shows the distribution of contracts among the different utilities. We reviewed 18 of these contracts and found that all but two were funded through ratepayer funds. For 12 of the 18 contracts, the CPUC named the specific entities with which the utilities were required to contract. We reviewed the CPUC decisions or other actions that led to all 18 contracts and found that for eight contracts, the entities that received contracts formally participated in the related proceedings.

**Table 2**  
**Total Number of Contracts the California Public Utilities Commission Directed Energy Utilities to Enter Into From 2010 Through 2015**

UTILITY	NUMBER OF CONTRACTS
Pacific Gas and Electric	8
San Diego Gas and Electric	6
Southern California Edison	4
Southern California Gas	7
<b>Total</b>	<b>25</b>

Sources: California State Auditor’s analysis of information provided by Pacific Gas and Electric, San Diego Gas and Electric, Southern California Edison, and Southern California Gas.

Note: In some instances, the CPUC directed multiple energy utilities to enter into a joint contract. For these cases, this table includes the contract under the name of the utility that we determined, through review of CPUC decisions and contract documents, was the lead entity in the contract.

In one of those eight instances, a participating entity offered to administer a program and appeared to influence the CPUC decision to award the contract to that entity despite opposition from other interested parties. In an October 2011 ruling, the CPUC asked parties how a statewide outreach program for energy efficiency should be administered. The four energy utilities commented that they should collectively administer the outreach program. In contrast, a San Diego-based nonprofit entity—the California Center for Sustainable Energy (Center)—commented that a network of local energy nonprofits should share ownership of the energy efficiency outreach program. The Center then suggested that because of its experience, it should act as the coordinating entity for that network.

The CPUC appeared to find the Center’s suggestion persuasive. In March 2012—four months after the Center’s comments—the CPUC released a proposed decision stating that it was intrigued by the suggestion and that the Center had the experience and vision to execute the statewide campaign. The proposed decision indicated that the CPUC planned to direct the energy utilities to enter into a contract with the Center to administer the program. In response to this proposed decision, the energy utilities all submitted comments stating that a competitive bidding process should be used to select the outreach program’s administrator. San Diego Gas and Electric and Southern California Gas jointly commented that there was no proof that the Center had the experience to execute the statewide campaign.

Despite the objections from all four energy utilities, the CPUC’s final decision directed the utilities to enter into a sole-source contract with the Center to administer the outreach program. This contract was budgeted at about \$3.8 million for 2012. The CPUC’s final decision explained that although it prefers to conduct competitive solicitations, competition was not required. The CPUC further specified that the Center would select any subcontractors through a competitive process, that time was of the essence, and that the CPUC was not aware of any organization similar to the Center in the State.

Nonetheless, the CPUC could have better justified its choice of the contractor and avoided the appearance of improper influence. As it did in this case, the CPUC has the authority to direct utilities to contract with a specific entity, and it is not required to choose that entity through a competitive process. However, when it does not select a vendor competitively, the CPUC is directing contracts that are similar in nature to the sole-source contracts that state agencies may choose to enter into. General Services requires agencies to justify a sole-source contract by explaining how they determined that no other vendor could meet the business need. In the case of



the contract for program administration, the CPUC decision to direct the contract to a specific entity would have been justified had the CPUC provided such an explanation. This is especially true given that the entity ultimately awarded the contract was the one that proposed the idea for establishing the contract in the first place. Without an explanation to support its decision, the CPUC risked appearing improperly influenced by the Center's participation in the proceeding. Further, it did not consider other vendors that may have provided better value before directing the energy utilities to contract with this vendor using ratepayer funds.

Although one commissioner concurred with the decision that directed the contract for the outreach program, he wrote that he was deeply troubled that the CPUC awarded the contract to the Center without competitive solicitation. In his view, awarding the contract in this way suggested that the CPUC considers itself above the rules it imposes on others. In this respect, the commissioner stated, the decision was crucially deficient. Subsequent CPUC decisions also demonstrate the prolonged effect of this sole-source selection: after the CPUC chose the Center for the \$3.8 million contract, it continued to direct the utilities to contract with the Center as the outreach program administrator.

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According to information provided to us by Pacific Gas and Electric, the lead utility responsible for contracting with the Center, the cumulative contract value the Center received because of the CPUC's sole-source selection was about \$74 million through 2016. In March 2016, the CPUC issued a decision that ordered its staff to lead a competitive solicitation to determine the entity that should administer the program beginning in October 2016.

In the remaining seven instances in which contractors formally participated in proceedings related to the decisions in which they received contracts, we found no evidence that the participation improperly influenced the CPUC. This absence of inappropriate influence was true even though contractors sometimes advocated or suggested outcomes that would financially benefit themselves. For example, in one instance, a contractor suggested that the contract it held to administer a solar energy program should not be reopened for bidding when it expired. Instead, the contractor

argued that it should be directly awarded the new contract for program administration. A significant number of other participants—including those with competing interests, such as other nonprofit entities and the energy utilities—supported the contractor’s position that it should remain as program administrator and that the CPUC should not reopen the contract for competitive bidding because they believed the contractor was administering the program well. The CPUC agreed and awarded the new contract directly to this entity.

### **Standard for Recusal of a Commissioner**

In addition to directing contracts, the CPUC also approves contracts that utilities propose. We found that the CPUC can improve its rules concerning when its commissioners can participate in those approval decisions. We reviewed a selection of 20 sole-source contracts that the energy utilities submitted to the CPUC for approval. One of those contracts was submitted in July 2011 by Pacific Gas and Electric, San Diego Gas and Electric, and Southern California Edison as a joint application for a \$152 million research and development agreement with Lawrence Livermore National Laboratory (Lawrence Livermore). In March 2012, The Utility Reform Network (TURN), a utility consumer advocacy organization, requested that the CPUC prohibit the then-president (former president) of the CPUC from participating in the CPUC decision about that application. TURN argued that the former president could not participate in the CPUC proceeding in an unbiased manner because he had engaged in discussions about the contract before the utilities submitted their application.

In an attachment to its request, TURN submitted emails that had been sent to and from the former president of the CPUC and representatives of Pacific Gas and Electric, Lawrence Livermore, and an energy sector consultant during the year before the utilities submitted their application. The content of these emails strongly suggests that the former president of the CPUC participated in early discussions regarding the research and development agreement, made multiple inquiries about the agreement’s status, and saw a draft version of the agreement before the utilities submitted it to the CPUC. Even after the utilities submitted the application, the former president of the CPUC continued to inquire about the status of the agreement. In its request, TURN noted that the emails showed that the former president played a significant role in the development of the application. It concluded that given the actions he took to initiate and foster the agreement, the only reasonable conclusion would be that the former president was unable to act in an unbiased manner towards TURN’s proposal that the CPUC reject the agreement.

However, the CPUC standard for recusal of a commissioner from a proceeding requires more than the appearance of bias. Instead of considering whether there is an appearance of bias, the CPUC considers whether the evidence clearly and convincingly shows that a commissioner has an unalterably closed state of mind regarding the matter the CPUC is considering. Accordingly, in the same decision in which it approved the proposed contract, the CPUC dismissed TURN's request to remove the former president from the proceeding. The former president participated in the CPUC decision, which held that TURN had not presented convincing evidence that he had an unalterable state of mind and that TURN's conclusions had no basis in fact.

The CPUC standard is a more difficult standard for parties to challenge than the standards used by other states' public utilities commissions, and it does not demonstrate a commitment by the CPUC to avoid apparent bias. For example, the standards of conduct for commissioners of the Public Utility Commission of Texas state that a commissioner must remove himself or herself from a proceeding if the commissioner's impartiality has been *reasonably questioned*.

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**The CPUC standard does not demonstrate  
a commitment by the CPUC to avoid  
apparent bias.**

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Additionally, the standard for CPUC commissioners is a more difficult standard for parties to challenge than the standard for disqualification of CPUC administrative law judges. According to the chief administrative law judge at the CPUC, when the CPUC determines whether an assigned administrative law judge has bias, it assesses whether a person who is aware of the facts may reasonably entertain doubt as to whether the judge would be able to act impartially. In the Lawrence Livermore proceeding, TURN submitted an argument and evidence that could lead a reasonable person to doubt the former president of the CPUC's ability to review TURN's position in an impartial manner. If standards similar to those of other agencies had been in place at the CPUC, TURN's argument would likely have resulted in the former president's having to recuse himself from the proceeding. Instead, by dismissing TURN's request, the CPUC allowed a commissioner—in this case, the former president—to participate in a decision when there was evidence that reasonably suggested he had been influenced by off-the-record conversations with utilities.

## Recommendations

### *Legislature*

The Legislature should amend state law to direct the CPUC to adopt a standard that requires commissioners to recuse themselves from proceedings if a person who is aware of the facts may reasonably question whether a commissioner is able to act impartially.

### *CPUC*

To ensure that the choice of a vendor is sufficiently justified and that the vendor represents the best value, the CPUC should explain in its final decision how the vendor was the most qualified in all cases when the CPUC does not competitively select the vendor it directs utilities to contract with.

## The CPUC Has Failed to Fully Disclose Important Communications Between Commissioners and External Parties

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### Key Points:

- CPUC rules do not require commissioners to report private communications with parties to CPUC proceedings. These rules do not align with best practices and have resulted in conversations concerning a critical CPUC proceeding to go unreported.
- The former president of the CPUC participated in private conversations related to the San Onofre Nuclear Generating Station (SONGS) decommissioning settlement but was not required to make those conversations a matter of public record. After the CPUC approved the settlement agreement, others disclosed that these conversations had occurred, which led to questions about the integrity of the settlement.
- Commissioners received 19 international trips funded by nonprofit organizations from 2010 through 2015. Six of these trips were paid for by a nonprofit with strong ties to entities that the CPUC regulates or financially affects through its decisions.

### Ex Parte Communications

The former president of the CPUC engaged in private discussions that were not disclosed in a timely manner and that have cast doubt on a key CPUC decision. These occurrences demonstrate a need for changes in the way such conversations are disclosed to the public. As discussed earlier, the energy utilities reported that the CPUC directed them to enter into 25 contracts from 2010 through 2015. One of those was a \$25 million joint contract between Southern California Edison, San Diego Gas and Electric, and the University of California as part of a multibillion-dollar settlement agreement regarding the closing of SONGS. The settlement provided consumer refunds and credits because of the premature shutdown of SONGS, and it directed the development of a research program with the University of California to reduce emissions at current and future power plants. The CPUC approved this settlement agreement in 2014, but the agreement has been the subject of widespread media attention because of undisclosed negotiations between the former president of the CPUC and an executive from Southern California Edison that occurred during a trip they both took to Poland in 2013.

#### Rules for Ex Parte Communications For Each Category of California Public Utilities Commission Proceeding

*Adjudicatory proceedings:* Ex parte communications are prohibited.

*Ratesetting proceedings:* Ex parte communications are permitted with restrictions, and interested persons must disclose the contents of their communications but not those of the CPUC decision maker.

*Quasi-legislative proceedings:* Ex parte communications are allowed without restriction or reporting requirement.

Sources: California State Auditor's analysis of Public Utilities Code, sections 1701.2, 1701.3, and 1701.4 as well as California Code of Regulations, title 20, sections 8.3 and 8.4.

Multiple news outlets later reported that while on the trip, the former president and the executive from Southern California Edison privately discussed the details of the agreement, which was active business before the CPUC at the time of the trip.

CPUC rules govern under what circumstances such communications, known as *ex parte communications*, are allowed and who is responsible for disclosing them. CPUC regulations define *ex parte communication* as a written or oral communication between an interested person and a CPUC decision maker concerning any substantive issue in a formal proceeding before the CPUC that does not occur in a public forum or on the record of the proceeding. As discussed in the Introduction, there are three different categories of CPUC proceedings. Each of these categories of proceedings has different rules regarding ex parte communications, which are shown in the text box on the previous page. Interested parties in a ratesetting proceeding are required to report ex parte communications regardless of who initiated the communication, and these reports must describe the communications the interested party makes and their content but not those made by the CPUC decision maker.

Because the SONGS settlement resulted from a ratesetting proceeding, under CPUC disclosure rules Southern California Edison, not the former president of the CPUC, was required to disclose within three working days the communication its executive had in Poland with the former president.

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**Interested parties in a ratesetting proceeding are required to report some ex parte communications regardless of who initiated the communication.**

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However, the utility did not file a timely disclosure of the conversation; instead, Southern California Edison filed its notice of ex parte communication almost two years after the conversation took place and three months after the CPUC approved the SONGS settlement agreement. In its notice of ex parte communication, Southern California Edison indicated that it was the former CPUC president who had initiated the conversation about SONGS while on the trip to Poland.

This conversation was not the only private discussion the former president had that went undisclosed until after the CPUC had already approved the SONGS settlement. According to a disclosure that the University of California filed more than a year late, the former president of the CPUC also engaged in several communications with representatives of the University of California about the \$25 million contract that, with later modifications, became part of the settlement agreement. The University of California submitted email records showing that the former president reviewed a proposal for the contract arrangement and relayed comments he had received from Southern California Edison on the proposal. The disclosure also mentions that the former president and a University of California representative had discussed the proposal during a trip to Spain in May 2014.

The fact that these conversations were not disclosed before the CPUC issued its decision on the SONGS settlement also casts doubt on how well the settlement protects ratepayers and on the selection of the University of California as the recipient of the \$25 million contract as part of the settlement. After the ex parte communication from the trip to Poland was disclosed, the CPUC's independent consumer advocate questioned the integrity of the SONGS settlement, stating that the Poland conversation may have impaired the advocate's ability to negotiate on behalf of ratepayers. One news outlet reported that a lawyer who analyzed notes from the Poland meeting believed that the private discussions allowed Southern California Edison to strengthen its negotiating stance, which may have cost customers as much as \$1.3 billion. In May 2016, the CPUC reopened the record of the proceeding to reassess the settlement. The California State University filed a motion to become a party to the reopened proceeding and stated that it will contend that the University of California should not be the sole recipient of the \$25 million contract.

These criticisms of the SONGS decision might have been avoided if the former president of the CPUC had ensured that the public was promptly made aware of his conversations with Southern California Edison and the University of California. Although Southern California Edison and the University of California disclosed these ex parte communications months after the settlement was approved, the former president of the CPUC was an integral participant in these conversations and could have made them a matter of public record before the CPUC approved the settlement agreement. Instead, he voted to approve the SONGS settlement without disclosing the conversations.

CPUC disclosure rules are not aligned with best practices because they do not require CPUC decision makers to take responsibility for disclosing ex parte communications. In 2014 the CPUC contracted with a consultant to recommend ways the CPUC could guard against future inappropriate contact between CPUC employees and entities that are parties to CPUC proceedings. In its resulting report issued in June 2015, the consultant observed that it is common practice among agencies similar to the CPUC to require the agency decision maker or both the agency decision maker and the interested party to disclose ex parte communications. The consultant's report also noted that unlike the CPUC, most agencies it reviewed require disclosure of the agency decision maker's statements, or at least disclosure of any response to the ex parte communication, and that only the CPUC specifically exempts decision makers' statements from disclosure.

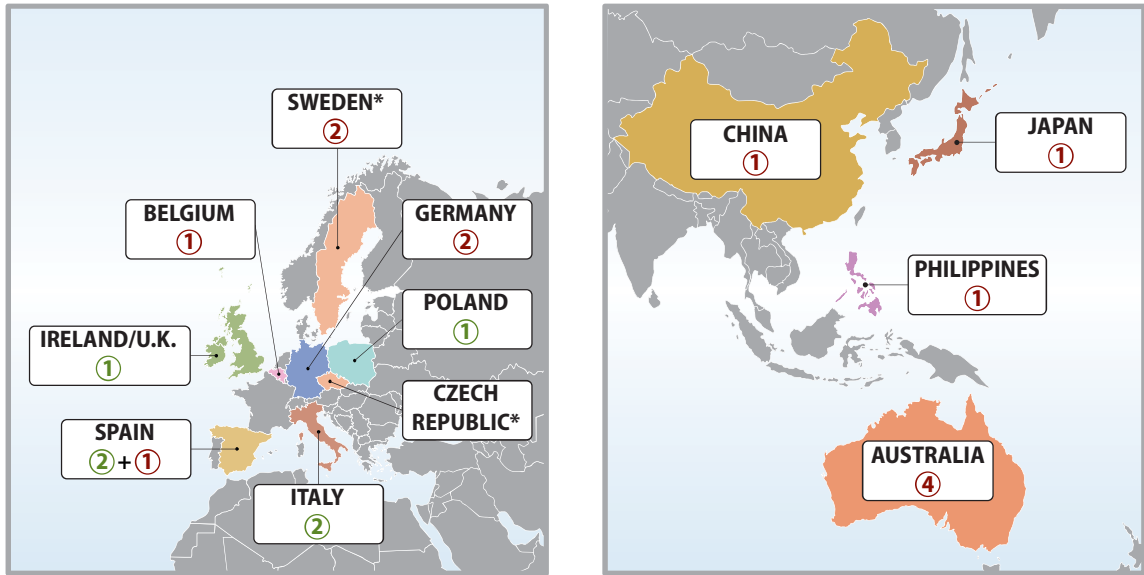
If the CPUC had disclosure requirements similar to those of other agencies, ex parte communications would be disclosed comprehensively, and the CPUC's decision-making process would be more transparent and its decision makers would be more accountable. For example, the disclosure of the ex parte communications with the University of California would have provided crucial context on how the university was chosen to receive the \$25 million contract as part of the SONGS settlement.

### **Gifts of International Travel**

The two examples of ex parte communications discussed in this section both took place while the former president of the CPUC was on international trips. Such travel is not uncommon among CPUC commissioners. We reviewed the economic interest disclosures for commissioners who served from 2010 through 2015, and of the 11 commissioners who served during this period, seven disclosed that they went on international trips that were gifts from nonprofit organizations. These seven commissioners participated in 19 international trips from 2010 through 2015 that totaled more than \$150,000 in value. Figure 2 shows the destinations of these trips. The Political Reform Act of 1974, which is a foundational component of the State's conflict-of-interest requirements, allows for reimbursements for travel expenses reasonably related to a governmental purpose that certain nonprofits provide to state officials. According to information the commissioners reported, all of the trips they took were allowed under these rules because they were gifts from qualified nonprofits.



**Figure 2**  
The Number of Times Nonprofits Funded International Trips for Commissioners From 2010 Through 2015



Sources: California State Auditor's analysis of commissioners' 2010 through 2015 economic interest disclosures and the membership roster of the California Foundation on the Environment and the Economy (CFEE).

① = Number of trips funded by CFEE, a nonprofit with a significant number of board members who are employees of entities that are regulated by, or have financial interest in, CPUC proceedings.

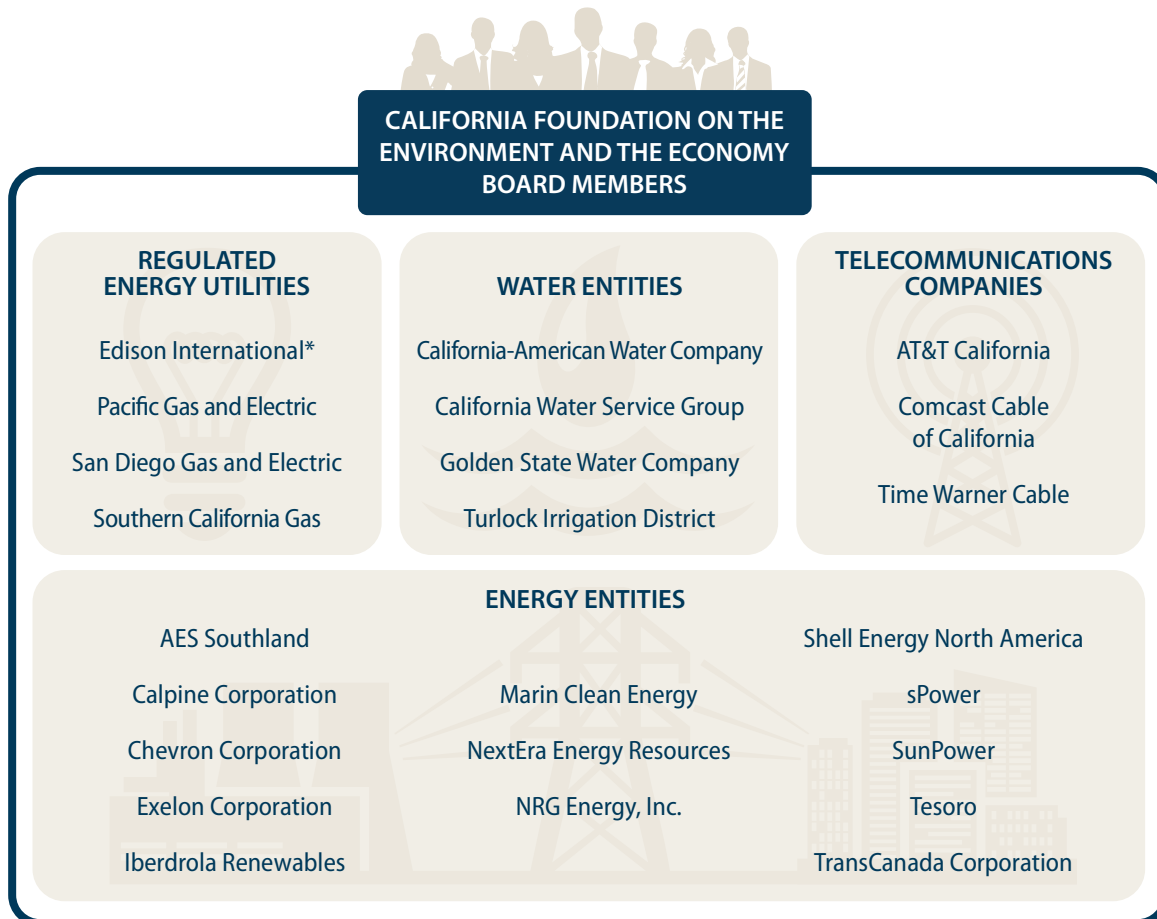
② = Number of trips funded by other nonprofits.

\* One trip to Sweden also involved the commissioner's traveling to the Czech Republic.

However, one of these nonprofits, the California Foundation on the Environment and the Economy, which paid for six of the 19 trips, including the Poland trip mentioned previously, has a significant number of board members who are employees of entities that had a financial interest in CPUC proceedings, including some individuals who represent energy utilities the CPUC regulates. Figure 3 on the following page shows some of the entities with employees who are board members of this nonprofit and how they are connected to the CPUC. Information about the board membership for the nonprofits that paid for the other trips was unavailable online, or the nonprofits' websites did not list any board members who were employees of regulated entities or entities with a financial interest in CPUC proceedings. However, it is possible that nonpublic information about these nonprofits would show a close tie to utilities or to other entities with a financial interest in CPUC proceedings.

**Figure 3**

Members of the California Foundation on the Environment and the Economy That Have Had a Financial Interest in California Public Utilities Commission Proceedings



Sources: California State Auditor's analysis of California Foundation on the Environment and the Economy's membership roster, websites of entities listed on the membership roster, the CPUC website, and various CPUC decisions and resolutions.

\* Edison International is the parent of Southern California Edison.

Advisors to the commissioners who went on these nonprofit-funded trips had differing opinions about their usefulness. For example, according to one advisor, international travel helps educate commissioners about new projects and cutting-edge technologies, and the office of the Governor would likely not approve of such trips if they were funded solely by the CPUC. We also noted that commissioners reported that they made speeches or participated in panel discussions on some of these trips. However, another advisor stated that he believed that international travel was not essential to the duties of a commissioner and that there may be increased opportunity for discussion about CPUC business on these trips. In the consultant report mentioned previously, the consultant advised the CPUC to consider

prohibiting commissioners from receiving free travel, lodging, and meals from organizations affiliated with regulated utilities and from other parties to proceedings before the CPUC.

When we discussed these trips with the CPUC, it acknowledged the appearance of inappropriate relationships that could come from these gifts. According to the assistant general counsel who supervises the CPUC's conflict-of-interest legal team, the advice her team gives to staff and commissioners is not limited to a review of the *legality* of accepting a gift, but the advice also focuses on the *appearance* of accepting a gift. For example, a commissioner can legally receive a gift of a meal from a regulated utility so long as the total value of all gifts from that utility does not exceed a specific dollar amount in a calendar year; however, such meals can still carry the appearance of inappropriate influence. Our review of commissioners' economic interest disclosures shows that from 2010 through 2015, five commissioners also received gifts, unrelated to the trips mentioned previously, from regulated utilities or other energy companies with a combined total value of about \$1,600.

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**Our review of commissioners' economic interest disclosures shows that from 2010 through 2015, five commissioners also received gifts from regulated utilities or other energy companies.**

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Although some gifts are allowed legally, such gifts as travel that come from entities with close ties to those with a financial stake in the outcomes of CPUC proceedings create the appearance of inappropriate relationships between the CPUC and those it regulates. In its report, the CPUC consultant referred to allegations of improper private meetings between commissioners and regulated utilities and discussed the public's interest in whether utility-related organizations sponsor travel for CPUC decision makers in exchange for greater opportunities for direct contact. Widespread media reports also describe the public's distrust of the CPUC because of accounts of a culture of improper access and influence granted to utilities. To help restore its image as a trustworthy, unbiased regulatory agency, the CPUC would benefit from establishing a prohibition against accepting travel, meals, or other gifts from individuals or entities that have a strong or direct connection to the utilities it regulates.

## Recommendations

### *Legislature*

The Legislature should amend state law to direct the CPUC to adopt rules for ex parte communications between CPUC commissioners and interested parties that include the following:

- A requirement for CPUC commissioners to disclose any ex parte communications in which they participate, in addition to the existing requirement for interested party disclosure. This disclosure should occur within the same time frame as the interested party disclosure.
- A requirement that commissioners' disclosures include a description of the commissioners' communications and their contents.

### *CPUC*







To avoid the appearance of inappropriate relationships, the CPUC should adopt a policy to prohibit commissioners from accepting gifts from regulated utilities and energy companies and free travel from organizations with significant ties to regulated utilities and other parties with financial interests in CPUC proceedings.

# The CPUC’s Contracting Activity Has Not Been Consistent With State Requirements or Best Practices

## Key Points:

- In many of the 60 contracts for services that we reviewed, the CPUC failed to meet state requirements and did not align its actions with good business practices. Table 3 shows a summary of the deficiencies we observed in the contracts we reviewed.
- The shortcomings we noted in CPUC contracting practices resulted from a lax control environment that the CPUC has allowed to persist. This lax environment is characterized by outdated guidance to staff, the absence of supervisory review, and a lack of training for key staff members.

**Table 3**  
Summary of the Results of the State Auditor’s Review of the California Public Utilities Commission’s Contracts for Services

CONTRACT ASPECTS REVIEWED	SUMMARY OF RESULTS
 <p>Civil service exemption</p>	<p>For personal service contracts, regulations require the CPUC to include with a request for contract approval detailed and specific information explaining why services cannot be obtained through the civil service.</p> <p><b>Of the 40 contracts we reviewed that were sent to General Services for approval, 23 did not contain this specific and detailed information.</b></p>
 <p>Market survey</p>	<p>CPUC policy requires staff to complete a market survey for some contracts that are exempt from competitive bidding.*</p> <p><b>We reviewed 35 contracts subject to this policy and found no evidence that the CPUC conducted complete market surveys for 24 of these contracts.</b></p>
 <p>Adding dollar value</p>	<p>To follow best practices, the CPUC should explain its rationale for adding funds to contracts when the scope of work for those contracts does not change.</p> <p><b>The CPUC did not document the reasons additional funds were necessary for 12 of 24 contracts we reviewed in which it increased contract funding but did not change the scope of work.</b></p>
 <p>Changes to scope of work</p>	<p>We expected, as a best practice, that any amendments to the scope of work for a contract would include additional work that is closely related to the original scope.</p> <p><b>For 3 of 14 contracts in which the CPUC significantly changed the scope of work through an amendment, the CPUC did not justify why the existing contracts were the optimal way to obtain the new services.</b></p>
 <p>Monitoring performance</p>	<p>The <i>State Contracting Manual</i> states that a contract manager’s responsibilities typically include monitoring the progress of contracted work. Also, state law requires that agencies complete contractor evaluations at the expiration of all consultant services contracts of \$5,000 or more.</p> <p><b>For 19 of the 60 contracts we reviewed, the CPUC did not maintain evidence that the contract manager monitored the contractor’s progress during the life of the contract. Further, in the 38 contracts valued at \$5,000 or more, although end-of-contract performance evaluations were required, the CPUC did not complete any evaluations.</b></p>
 <p>Performance criteria</p>	<p>The <i>State Contracting Manual</i> requires consultant services contracts of \$5,000 or more to contain detailed performance criteria.</p> <p><b>However, 9 of the 56 contracts we reviewed for an amount more than \$5,000 did not contain detailed performance criteria.</b></p>

Sources: California State Auditor’s analysis of selected CPUC contract files, state regulations, the *State Contracting Manual*, and the CPUC’s *Policies and Procedures Manual: Personal Services Consultant Contracts*.

\* The CPUC does not require market surveys for contracts with other government entities or emergency contracts. These types of contracts are not included in our count of 35.

### Exemptions From Using Civil Service

The CPUC has consistently failed to explain in a sufficient manner why it contracted outside the state civil service for a majority of the contracts we tested. The state constitution generally requires that services conducted on behalf of state government be performed by civil service employees, although state law does provide specific exemptions that agencies can use to bypass this requirement appropriately. For each contract that requires General Services' approval—generally most services contracts for more than \$50,000—state regulations require agencies to submit a written justification to General Services that includes specific and detailed information demonstrating how the contract meets one or more of the exemptions from civil service requirements. The CPUC sent 40 of the 60 contracts we reviewed to General Services for approval, but more than half—23 of these contracts—did not contain specific and detailed information to support the civil service exemption the CPUC claimed. When we asked why the CPUC was not adequately supporting the civil service exemptions, the chief of the management services branch (management services branch chief), who oversees the contracts office, stated that the CPUC has never had any issue with General Services' approving the contracts because of inadequately supported civil service exemptions; therefore, she did not believe its exemptions were unsupported.

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**The CPUC sent 40 of the 60 contracts we reviewed to General Services for approval, but more than half—23 of these contracts—did not contain specific and detailed information to support the civil service exemption.**

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Nonetheless, for 12 of the 23 contracts, the only information the CPUC included to support its exemptions was text taken verbatim from state law without additional explanations to support its claims to the exemptions for those specific contracts. This citation of state law is clearly not the type of detailed information the regulation requires. In the remaining 11 cases, the CPUC provided explanations that went beyond merely quoting state law, but the content still fell short of specific and detailed justifications. Further, we note that the requirement to include specific and detailed factual information is a requirement that state regulations place on

the contracting agency, not on General Services. We expected the CPUC to be aware of and meet this requirement independent of whether General Services eventually approved its contracts.

In addition, we believe that it is reasonable to expect the CPUC to sufficiently justify its need to contract outside the civil service regardless of whether the contract requires General Services' approval. We reviewed the remaining 20 contracts that did not require such approval and found that the CPUC did not adequately support the civil service exemption for 13 of those contracts. In each of these cases, the CPUC could not demonstrate that it was complying with state law because it did not prepare detailed and specific information for its decision to contract for the service. Fully supported civil service exemptions serve as evidence that the CPUC considered whether it needed to contract for services. When it does not fully document its rationale when contracting for outside assistance, the CPUC leaves itself open to challenges that its contracts are not necessary and that the State may incur unwarranted costs as a result.

### Market Surveys

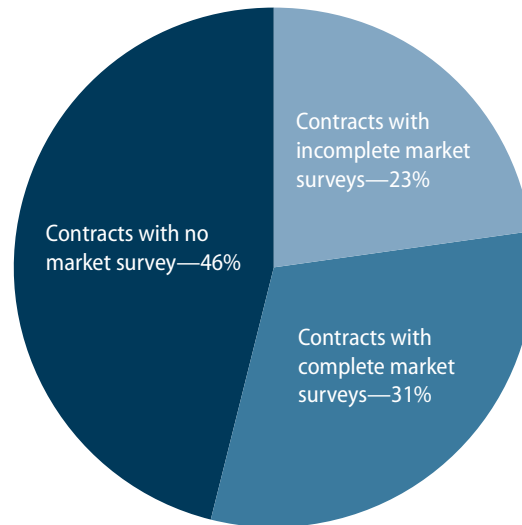
The CPUC did not consistently conduct market research to ensure that it obtained the best value when contracts it issued were exempt from competitive bidding requirements. The CPUC contracting manual requires its staff to conduct a market survey for some exempt contracts to help the CPUC choose the most qualified contractor for the service. As shown in the text box, the CPUC highlighted this policy in a legislative hearing in August 2015. However, Figure 4 on the following page shows that for nearly 70 percent of the contracts we reviewed that required such a survey, the CPUC could not provide documentation that a market survey took place or that it conducted a complete survey by contacting the minimum number of potential contractors its contracting manual requires. For example, in one \$75,000 contract for expert witness services, contract documents state that the contractor was selected because he was known by CPUC staff members and because he offered to provide his services at a reduced rate. According to the former deputy executive director of administrative services (deputy director), the CPUC is not legally required to conduct a market survey for exempt contracts. However, since 2007 the CPUC has had a policy requiring market surveys, including in cases where the CPUC was seeking expert witness services. Without conducting market research, the CPUC cannot ensure that it is obtaining the best value for services it acquires outside of competitive bidding.

#### Testimony by California Public Utilities Commission at an August 2015 Legislative Hearing

"... the CPUC, as part of its internal business process, requires the project manager that requests the contract to conduct some level of market analysis—we call it a market survey—of potential vendors in order to *assure ourselves that the rates for the requested services are fair for the ratepayers to pay.*" (Emphasis added.).

Source: Testimony by the former deputy executive director of administrative services for the CPUC at an August 17, 2015, Assembly Utilities and Commerce committee hearing.

**Figure 4**  
Percentage of Contracts for Which the California Public Utilities Commission Required but Did Not Perform a Market Survey to Assess Best Value



Source: California State Auditor's analysis of selected CPUC contract files and the CPUC's *Policies and Procedures Manual: Personal Services Consultant Contracts*.

We identified another instance in which the CPUC did not conduct a market survey and in which it has continued to rely on that selected contractor for years without knowing whether the State is truly receiving the best value. In June 2009, the CPUC entered into a contract to obtain legal advice and counsel for various bankruptcy and bond securitization questions. Although legal services contracts are exempt from competitive bidding requirements, the CPUC requires its staff to conduct a market survey before it awards a legal services contract. However, the CPUC did not document that it conducted a market survey for this contract. Therefore, it is unable to demonstrate how it knew that it obtained the best value for these services. Further, as of August 2016, the CPUC continued to use the same contractor's services under the same contract. Therefore, for more than seven years, the CPUC has used the same contractor without originally establishing that the contractor offered the best value for the service. When we asked why the CPUC did not conduct a market survey for this contract, the former project manager stated that the contractor already had a positive working relationship with the CPUC and was very experienced with bankruptcy proceedings and bond financing issues.



### Funds Added to Contracts

The CPUC did not always clearly document why it needed to add funds to some of its contracts. For the contracts we reviewed, the CPUC amended 24 of them to add funding without changing the scope of work for the contracts. To follow best practices, the CPUC should have explained the rationale for adding funds to contracts when the scope of work for those contracts had not changed. However, in 12 of these cases, we did not find adequate explanations within the contract documents to describe why additional funding was necessary. These cases included five contracts with amendments that more than doubled the original contract value. The CPUC did not document why it needed a total of about \$2.4 million in additional funding for these 12 contracts. According to the management services branch chief, the contracts office staff was not consistently ensuring that the amendments contained sufficient explanations for why the amendments were necessary.

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**The CPUC did not document why it needed a total of about \$2.4 million in additional funding for these 12 contracts.**

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One of these 12 contracts was an agreement for legal representation that the CPUC amended to add \$460,000 in unsupported additional funding. In March 2010, the CPUC entered into a \$500,000 agreement for representation in employment-related litigation. In January 2013, the CPUC added another \$200,000 to this contract. A contract request document in the CPUC's contract file indicates the reason the funds were necessary was that the CPUC had expected that the employment case would settle, but the case instead went to trial. However, four months later, the CPUC amended this contract again to add another \$460,000 to the contract value. The CPUC provided no explanation in contract documents it sent to General Services for why these additional funds were necessary, and its contract request document merely repeated the statement from the previous amendment about the case going to trial.

In addition to these 12 cases, we noted another contract the CPUC amended without initially providing an adequate explanation for why it needed \$5.1 million in additional funding. In November 2014, the CPUC entered into a \$49,000 contract for legal representation. The scope of this contract stated that the contractor would represent the CPUC in all criminal, civil, and administrative

proceedings and investigations undertaken by any federal, state, or local agency involving any allegations of inappropriate interactions by CPUC personnel with any utility from 2009 through 2014. According to the project manager at the time it entered into this contract, the CPUC anticipated that the contract would require additional funding, but it needed immediate assistance in responding to investigations. Therefore, by entering into a contract for \$49,000, the CPUC was able to obtain legal services without waiting for General Services' approval. As explained in the Introduction, contracts for legal services do not require competitive bidding regardless of dollar value, and contracts valued at \$50,000 or less do not need General Services' approval.

However, within five months of entering into this \$49,000 contract, the CPUC amended the contract to extend the contract's term by one year and to add \$5.1 million in funds. The CPUC sent the contract amendment to General Services for approval, but the contract documents that it submitted to General Services did not explain the need for additional funding. Instead, those contract documents repeated the exact scope of work contained in the original \$49,000 contract. According to the attorney at General Services who reviews CPUC contracts, it was highly unusual to see a contract amendment raise the total value of the contract by this magnitude.

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**Within five months of entering into this \$49,000 contract, the CPUC amended the contract to extend the contract's term by one year and to add \$5.1 million in funds.**

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After receiving additional information from the CPUC, General Services' deputy director of legal services approved the amendment. That additional information for this contract included a separate letter from the CPUC project manager in which the CPUC explained that the contract amendment was necessary because the scope of investigations at the CPUC was expanding and the number of witnesses to be interviewed and the documents the CPUC needed to provide were growing. Further, the letter acknowledged that the original contract dollar amount was insufficient.

Although the letter that the CPUC's project manager sent to General Services explains why the CPUC needed additional funding for this contract, the CPUC did not provide us with a copy of this letter when we discussed this contract. We obtained the letter by asking General Services for any additional documentation

that the CPUC submitted to support the need for the additional funds. However, the information contained in the letter could have easily been included in the contract documents that the CPUC sent to General Services, and this inclusion would have eliminated the need to send subsequent additional information. As shown by this contract and the other 12 contracts for which we did not find adequate support for additional funds, the CPUC can improve in the area of explaining adequately its need for additional funds.

### Changes to Contracts' Scope of Work

The CPUC amended some of the contracts we reviewed to add activities that significantly differed from those in the contracts' original scope of work. The CPUC's initial determination that a particular vendor provided the best possible value was based on a specific service that the vendor could provide; therefore, we expected as a best practice, that any amendments to the scope of work for a contract would include additional work that was related closely to the contract's original scope. We reviewed 14 contracts that the CPUC amended to add services and determined that three were amended to add services that were unrelated to the original scope of work. For example, the CPUC contracted with a vendor to provide training to its supervisory staff but later amended the contract to add additional training courses for other staff levels. The CPUC allocated about \$34,000 to provide training for its supervisory staff and added about \$193,600 for the additional training courses.

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**We reviewed 14 contracts that the CPUC amended to add services and determined that three were amended to add services that were unrelated to the original scope of work.**  
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According to the project manager for this contract, the contract was amended because of the contractor's expertise and the quality of training courses as well as staff satisfaction with the contractor's initial performance. However, the training courses the CPUC added, which included a course on strategy for analyzing data and research methods, differed from the basic supervision course it originally solicited. Therefore, the CPUC did not justify that the contractor it chose for the supervision training still represented the best choice for providing the additional training courses.

In another example, the CPUC entered into a contract for legal representation to defend itself against a lawsuit related to its compliance with the California Public Records Act (Public Records Act). After it settled the lawsuit, the CPUC amended this contract so that the contractor could assist the CPUC in responding to Public Records Act requests. To obtain legal representation, the CPUC allocated \$99,000 and then added approximately \$1 million to the contract for responding to Public Records Act requests. According to the former project manager for this contract, this contractor was the best choice for the additional service because the contractor had experience with Public Records Act requests and was familiar with CPUC staff. However, responding to Public Records Act requests and providing defense in a court proceeding are two significantly different services. The factors an agency should consider when choosing a contractor likely vary based on the type of service it needs. For example, when contracting for legal representation in civil litigation, the CPUC might want someone with experience in similar court cases, which would not be a necessary prerequisite for responding to Public Records Act requests. Because it did not conduct a new procurement for these services, the CPUC cannot demonstrate that the contractor it selected for the original contract represents the best value for responding to Public Records Act requests.

According to the management services branch chief, contract analysts were not monitoring whether contract amendments related to the original scope of work. However, such monitoring is crucial to ensuring that the CPUC obtains the best value for new services it contracts to obtain. Moreover, the CPUC contracting manual does not provide guidance regarding contract amendments. It is important that the CPUC provide such guidance to its project managers and contract analysts so that they can implement prudent business practices when contracting for services.

### **Monitoring and Evaluating Contractors' Performance**

Despite a requirement in the *State Contracting Manual*, the CPUC has not been consistently monitoring the progress of its contractors' performance. The manual states that a contract manager's responsibilities typically include monitoring the progress of contracted work to ensure that services are performed according to the quality, quantity, objectives, time frames, and manner specified in the contract and ensuring that all work is completed and accepted before the contract expires. To monitor the progress of work, the CPUC requires project managers to complete an invoice review form before issuing a payment to the contractor. To verify that the project managers completed invoice review forms, we first checked the contract files. In instances where the contract

files did not contain any completed invoice review forms, we searched records maintained by the CPUC fiscal unit. At the fiscal unit, we selected up to five payments per contract and determined whether the CPUC completed invoice review forms. However, for nearly one-third—19 of the 60 contracts we reviewed—we were unable to find invoice review forms in either the contract file or in the records kept by the CPUC fiscal unit. As a result, the CPUC cannot demonstrate that its contract or fiscal offices were aware of whether project managers were monitoring the progress of work or ensuring that the services met the quality and needs specified in these contracts. It is critical that the contract and fiscal offices, as the two offices responsible for ensuring that invoices are correct before issuing payment, are aware of whether project managers are adequately monitoring contractor performance. Without this knowledge, the CPUC risks paying a contractor for services that it did not perform or that did not meet minimum standards.

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**For nearly one-third of the contracts we reviewed, we were unable to find invoice review forms in either the contract file or in the records kept by the CPUC fiscal unit.**

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Further, we identified three instances in which the CPUC completed invoice review forms but the contractors appeared to be working beyond the scope or dollar limit of the contract. The CPUC subsequently amended these contracts to account for work that had already been performed. For example, for one of these contracts, a contractor submitted an invoice for about \$88,600 more than the balance of funding remaining on the contract. When the CPUC received the invoice, the project manager advised the assigned contract analyst to postpone its processing until the CPUC could amend the contract to cover these additional charges. According to that project manager, the contractor had completed work at the request of another staff member at the CPUC without the project manager's knowledge, and this new work, although within the scope of the original contract, was not accounted for in the contract budget. In all three of these cases, although the project managers completed the invoice review forms, the project managers did not appear to have been actively monitoring the contracts. The CPUC's practice of allowing contractors to perform additional work before approving contract amendments places it at greater risk for disputes with contractors over payment or delivery of work products.

In addition to not monitoring the progress of work during the contract term, the CPUC also has not evaluated contractor performance at the end of a contract. State law requires that agencies complete contractor evaluations at the expiration of all consultant services contracts of \$5,000 or more. However, the CPUC did not conduct these evaluations for any of the 38 contracts from our selection that were valued at \$5,000 or more and that were completed at the time of our review in April 2016. The management services branch chief confirmed that project managers were not completing the contractor evaluations at the end of contracts; she explained that the contracts office is understaffed and that its contract analysts do not have time to ensure that project managers are completing this task. Nevertheless, if the CPUC is not evaluating contractor performance at the end of a contract, it cannot determine whether it received the quality of work that it expected and may unknowingly enter into subsequent contracts with poorly performing vendors.

However, the CPUC may find it difficult to monitor contractor performance without improving the level of detail in its contracts. Although the *State Contracting Manual* requires consultant services contracts of \$5,000 or more to contain detailed performance criteria and a schedule of performance, nine of the 56 applicable contracts we reviewed did not contain such detailed criteria.

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**The CPUC may find it difficult to monitor contractor performance without improving the level of detail in its contracts.**

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For example, in one case we reviewed, the CPUC entered into a contract with some portions of the scope of work written in an open-ended format that allowed the contractor to perform special projects for the CPUC as needed. It is unclear how the CPUC would be able to monitor the contractor's performance and progress in fulfilling his duties in these contract areas. In addition, we found that 17 of the contracts we reviewed did not contain a schedule of performance.<sup>4</sup> For example, one contract to provide training services did not contain a description of the period when the CPUC wanted the training to occur. Without providing a

<sup>4</sup> In reviewing the 56 consultant services contracts of \$5,000 or more, we determined that it was reasonable that 13 of the contracts did not contain schedules of performance because the nature of the services provided under these contracts, such as representation in pending litigation, made it difficult to establish set schedules of performance.

timeline for provision of the services, the CPUC could find it difficult to hold the contractor accountable for meeting the CPUC's needs in a timely manner.

### Lax Control Environment

We observed a few key deficiencies indicative of a lax control environment over CPUC contracting activity, and that lax control environment likely contributed to many of the issues we noted with CPUC service contracts. One of these deficiencies is the outdated contracting manual, which was last updated in 2007. We compared the CPUC manual to state contracting requirements and found that it does not provide staff with any guidance about contract amendments and does not include direction about a specific conflict-of-interest rule from the *State Contracting Manual*. Specifically, the CPUC manual does not specify that a consultant under contract should not be awarded any subsequent contract that the consultant recommends in its previous consulting contract. According to the management services branch chief, contract analysts do not consult the manual for guidance because it is outdated. She also said that the task of updating the contracting manual is time-consuming, and staff has prioritized processing contracts and amendments over spending time on the manual. However, she stated that the staff is currently working on revising the manual and is expected to complete it in December 2016. Having an up-to-date contracting manual that describes CPUC contracting policies and procedures will provide staff with the needed guidance to properly process contracts that comply with state requirements and best practices.

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### **Contract analysts do not consult the manual for guidance because it is outdated.**

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Furthermore, the contracts office manager (manager) has not been reviewing contracts before they are sent for signature. According to the management services branch chief, in 2011 the manager no longer reviewed contracts before the contract analysts sent them for executive director approval. She stated that the manager's review was officially discontinued when a former deputy director instructed the office that the manager should stop conducting this review. When we spoke with the deputy director who succeeded the deputy director who ordered the manager's review discontinued, she informed us that although there was no longer any formal review of the contracts

before they were sent to her for approval, she believed that it was adequate that the contract analysts worked together with the manager when they faced more complicated tasks. Although the manager and contract analysts may be working together on a case-by-case basis when dealing with difficult contracts, formalizing a review of *all* contracts would be beneficial to the CPUC because—based on the variety of issues we found—it is clear that the contract analysts' work alone does not ensure that the CPUC complies with state requirements and best practices. Additionally, when we asked the management services branch chief about many of the deficiencies we identified, her response was that staff was simply not performing work that would prevent the problems we identified. Nonetheless, we expected the supervisory personnel at the CPUC to be actively overseeing the work its staff performs and thus preventing the frequency of the issues we found.

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**We expected the supervisory personnel at the CPUC to be actively overseeing the work its staff performs and thus preventing the frequency of the issues we found.**

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Another deficiency that contributes to the lax control environment at the CPUC is the lack of training for contract analysts and project managers. According to the management services branch chief, contract analysts are certified by General Services at the intermediate level in contract procurement, which is the highest level of procurement training that General Services offers. However, the management services branch chief stated that the contract analysts have not attended trainings routinely to refresh their knowledge because the staff's priority is to process contracts and amendments. Although she hopes to establish a policy for routine training, she believes that the workload of the contract analysts does not provide time to attend trainings. Also, she and the project managers we spoke with confirmed that project managers do not receive formal training on their contract-related responsibilities. Specifically, the management services branch chief stated that the project managers do not receive such training because the contracts office does not have the staff to provide it. We also noted that the CPUC does not have any parameters limiting the number of project managers assigned within divisions. Establishing a maximum number of project managers could help the CPUC ensure that it trains all project managers, particularly when individuals are newly appointed to do that work.



Because training is an essential part of ensuring that staff members are equipped to perform well at their jobs, it is important for the CPUC to provide regular training to those who oversee contracts. Without this training, contract analysts may not be consistent in conducting their reviews, and project managers may be unaware of their duties to conduct market surveys or to monitor contractor performance.

### **Sole-Source Contracts**

Most of the CPUC sole-source contracts we reviewed—13 out of 15—complied with key criteria related to sole-source contracting. For the first of the two noncompliant contracts, the CPUC did not follow the *State Contracting Manual* requirements for amending such contracts. The manual requires agencies to obtain new sole-source contract approval from General Services when they amend sole-source contracts to expand beyond the originally approved amount, term, and scope of work. In February 2013, the CPUC amended a sole-source contract for court reporting services and increased the contract funding by \$12,000 but did not seek new sole-source approval from General Services to add this funding. Because it added funding that was not included under the original approval, the CPUC should have obtained General Services' approval to use sole source as the method for obtaining the additional services. This was the only sole-source contract we reviewed that the CPUC amended to add additional funding.

For the second contract, which was related to the first, the CPUC did not plan effectively to avoid sole-source contracting. One month before the contract for court reporting services was set to expire, the CPUC entered into a new sole-source contract with the same vendor for the same services. In the request for sole-source approval that the CPUC submitted to General Services, it stated that it had planned to solicit bids for these services but was requesting a sole-source contract because time and staff availability were constrained. Although General Services gave the CPUC authority to procure these services through a sole-source contract, it is unclear why the CPUC did not solicit competitive bids for these services, given that these were services the CPUC had a predictable need to acquire and had at least one year's notice that it would need to execute a new contract. The CPUC's chief hearing reporter stated that she was not involved with the contract, but because her unit is extremely busy, she can understand why her predecessor may not have had time to solicit bids. She explained that her unit has not received much guidance on the contracting process. However, the chief hearing reporter agreed that the CPUC knew in advance that the services were needed and could have solicited

bids for the services during a less busy period. She stated that she anticipates using a bid process when the CPUC contracts for these services in the future.

### Attorney General Approval

To enhance the overall efficiency and economy of state government, state law generally requires agencies to employ the Office of the Attorney General (Attorney General) as legal counsel or to obtain the Attorney General's written consent to employ other legal counsel. However, the CPUC has not consistently contacted the Attorney General before it has contracted for outside legal assistance. Of the 12 legal services contracts we reviewed, only one documented that the CPUC had requested assistance from the Attorney General. In this case, the Attorney General declined to represent the CPUC because of a potential conflict of interest, and the CPUC therefore contracted for the service. In the other 11 cases in which the CPUC did not contact the Attorney General, the CPUC may have obtained legal services that the Attorney General could have provided at a lesser cost.

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**Of the 12 legal services contracts we reviewed, only one documented that the CPUC had requested assistance from the Attorney General.**

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The CPUC did not contact the Attorney General in most cases we reviewed because it believes that state law exempts it from the requirement to use the Attorney General. An assistant general counsel at the CPUC claimed that the CPUC has often asked the Attorney General to represent it in matters that involve expertise and resources that the CPUC does not possess; however, this did not appear to be the case among the contracts we reviewed. In addition, the assistant general counsel explained that the CPUC believes that state law, specifically section 11041 of the Government Code, exempts it from having to use the Attorney General for all legal needs. This section of law does list selected agencies, including the CPUC, and states that they are exempt from the requirement to employ the Attorney General as legal counsel.

However, section 632 of the Public Utilities Code states that the requirement to use the Attorney General applies to the CPUC for consultant or advisory services contracts, which include contracts

for legal services, *except* when the CPUC makes a finding that extraordinary circumstances justify expedited contracting. In response to our questions about these two statutes, the general counsel at the CPUC stated that the CPUC believes that section 11041 of the Government Code clearly exempts the CPUC from obtaining legal services from the Attorney General. However, after reviewing the legislative history of section 632 of the Public Utilities Code, including legislative committee analyses, we concluded that the Legislature intended to limit the CPUC's exemption from using the Attorney General in cases where the CPUC decides to contract for legal services. Further, the general counsel stated that Public Utilities Code section 307 gives the CPUC the authority to represent the people of California in all matters relating to the Public Utilities Code and to any act or order of the CPUC. Although we acknowledge the authority that state law grants the CPUC under this additional section, we believe section 632 requires the CPUC to use the Attorney General or obtain its written consent before contracting for legal services without making a finding that extraordinary circumstances exist. To ensure the CPUC acts as the Legislature intends, a change to state law is needed.

## Recommendations

### *Legislature*

The Legislature should amend Public Utilities Code section 632 to clarify that its provisions related to the Attorney General apply to the CPUC regardless of Government Code section 11041 and Public Utilities Code section 307.

### *CPUC*

To ensure that its contracting practices align with state requirements and best practices, the CPUC should take the following actions:

- Update, distribute, and follow its contracting procedures manual. The manual should identify specific responsibilities for both contracts office staff and project managers, and it should provide specific guidance about the processes the CPUC will employ to do the following:
  - Fully justify civil service exemptions.
  - Conduct market research for exempt contracts.
  - Fully support the need for additional funding.

- Ensure that it does not change the scope of work too significantly from the original.
- Monitor contractor performance against criteria included in its contracts.
- Avoid sole-source contracts when it is able to solicit competitive bids for services.
- Provide immediate refresher training to its contract analysts and contracts office manager, and establish a regular schedule of annual training for them to attend.
- Designate a limited number of project managers for each division at the CPUC, and provide those individuals with training on the CPUC's processes related to contracting, including how to monitor progress of a contractor's work.
- Implement a supervisory review by the contracts office manager of proposed contracts and contract amendments to occur before contracts and amendments go to vendors for signature.

## OTHER AREAS WE REVIEWED

To address the audit objectives that the Joint Legislative Audit Committee approved, we reviewed the subject areas shown in Table 4. In the table, we indicate the results of our review and any associated recommendations we made that are not discussed in other sections of this report.

**Table 4**  
**Other Areas Reviewed as Part of This Audit**

CPUC Responses to Public Records Act Requests
<ul style="list-style-type: none"> <li>• The CPUC has publicly stated that its general policy related to Public Records Act requests (record requests), which was last updated in 1982, is outdated and not aligned with current law. For example, the policy cites a specific Public Utilities Code section as an authority for exempting records even though the CPUC believes that the law neither creates a privilege of nondisclosure for utilities nor designates any specific types of documents as confidential.</li> <li>• We reviewed 20 record requests related to contracts. The CPUC did not meet the statutory deadline for responding with its determination of whether it possessed the requested records and whether those records were disclosable for five of these record requests. However, it was late by only about three days on average.</li> <li>• We found that the CPUC did not always clearly communicate whether it had the records that a member of the public requested and its reasons for withholding certain public records. However, the CPUC has recently developed templates to address these issues.</li> <li>• In one record request we reviewed, the CPUC should have provided records to the requester earlier than it did. In this case, nearly four months elapsed between the time the CPUC identified the requested documents and when it began sending those documents to the requester. According to the head of the CPUC's legal division's public records office, the CPUC did not closely oversee the staff member assigned to respond to the request. Further, our review of the CPUC's process for tracking the status of unresolved records requests indicated that the CPUC tracks the status of record requests inconsistently.</li> </ul> <p><b>Recommendations</b></p> <p><i>The CPUC should update its general policy on responding to record requests so that the policy aligns with state law.</i></p> <p><i>The CPUC should develop and follow procedures to regularly track and review record requests it has not fully responded to and determine whether it can provide information.</i></p>

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### Tracking of Sole-Source Contracts

- We determined that the CPUC entered into or amended at least 15 sole-source contracts from 2010 through 2015. However, our conclusion is based on information we obtained from a hand count of contracts we found at General Services. According to the management services branch chief, the CPUC does not use its contract database to track its method of procurement. The CPUC is generally not required to submit contracts of less than \$50,000 to General Services for approval and, according to General Services, it does not maintain records for contracts that expired before 2011; therefore, our total may not reflect all CPUC sole-source contracts from this period.
- If the CPUC used its contract database to track the procurement methods it uses, it would be able to more accurately and efficiently complete required reports. General Services requires the CPUC to report on contract activity every fiscal year so that General Services can accumulate and report information on statewide contracting activity. Included in the CPUC's report is a count of the number of sole-source contracts that the CPUC entered into or amended in the fiscal year.
- The management services branch chief stated that the CPUC reports to General Services by querying its database in several different ways and through manually reviewing contract files. However, we reviewed the reports that the CPUC submitted to General Services for fiscal years 2010–11 through 2014–15 and found the reports did not always accurately identify contracts as sole source and it did not identify all the sole-source contracts the CPUC entered into.

#### **Recommendation**

*The CPUC should use its contract database to track the procurement method for each contract.*

### Contracts Below Competitive Bidding and Delegated Purchasing Authority Thresholds

- We reviewed four contracts the CPUC entered into that were less than the competitive bidding threshold of \$5,000 and found that the CPUC did not amend these contracts to increase funding.
- We also reviewed 15 additional contracts the CPUC entered into that were \$50,000 or less, which is the threshold for General Services' approval. The CPUC later amended nine of these 15 contracts to exceed the \$50,000 threshold, and it obtained General Services' approval in all nine cases. However, as noted earlier in this report, the CPUC did not always document the reason why it needed to add funding to contracts we reviewed.

#### **Recommendation**

*Refer to our recommendation regarding adding contract funding on page 37.*

### General Business Practices at the CPUC

- At the start of our audit, we observed that the CPUC contract office had poorly organized the contracts it stored on-site. As a result, it took the CPUC about 1.5 months to locate one contract we reviewed and about four months to locate another we had selected for review. Since we raised this as an issue with the contracts office manager, the CPUC has reorganized the filing system and has issued sufficient guidance to contract analysts about how to maintain this organization.

### Parties Disclosing Interests in Proceedings

- In the rules it has adopted related to party status in proceedings, the CPUC requires some entities who are parties to a CPUC proceeding to disclose their interest in the proceeding as a condition of becoming a party.
- One way to become a party to a proceeding without being required to disclose interests is by filing an application, petition, or complaint with the CPUC. This path to party status is for regulated entities and other persons or interested organizations that request CPUC action on an issue. These entities would all have explicit stakes in the proceeding that could be inherent in their applications, petitions, or complaints to the CPUC, and thus additional disclosure would likely be redundant.
- However, entities can also become parties to a proceeding by filing a protest or response to an application or petition or by filing comments in response to a rulemaking. Entities who become a party through this method are not subject to any requirement to disclose their interest in the proceeding.
- Our review found that parties who were not required to disclose their interests generally volunteered their interests in the proceeding. However, we believe that it would be prudent for the CPUC to ensure that all parties disclose their interests by amending its rules for becoming a party to a proceeding.

#### **Recommendation**

*The CPUC should update its regulations to require parties joining a proceeding by filing a protest or response to an application or petition, or by filing comments in response to a rulemaking proceeding to fully disclose their interests in the proceeding.*

### Contracts That Utilities Proposed

- The CPUC reviews and approves contracts that energy utilities propose, including sole-source contracts, which are not selected through a competitive bidding process. According to the information the energy utilities provided to us, the CPUC approved 138 sole-source contracts that those utilities proposed from 2010 through 2015. We present further information about the way the CPUC oversees these contracts in the Appendix of this report.
- We reviewed 20 of those contracts, 16 of which were sole-source power purchase agreements. We determined that the information the energy utilities submitted to the CPUC shows those 16 contracts complied with key sole-source contracting requirements, including a requirement that the cost of the energy procured in these agreements be comparable to the cost of energy utilities obtained through competitively bid contracts.
- One of the four remaining sole-source contracts we reviewed was a research and development proposal that three energy utilities filed jointly and that the CPUC approved. Although two entities that advocate for ratepayer interests objected to the proposal—primarily because it lacked specific and clearly defined projects—our review determined that the CPUC met the requirements in state law for how it should review and assess research and development proposals when it considered this contract. Beginning on page 12, we discuss our concerns about the former president of the CPUC's participation in approving this contract.
- The three other sole-source contracts we reviewed consisted of two gas pipeline capacity agreements and a resource adequacy agreement between a utility and an outside entity. The information that the utilities submitted to the CPUC when seeking approval of these contracts shows that the contracts met all applicable requirements for contracts of these types.
- In response to concerns raised in the audit request letter, we also reviewed four competitively bid contracts that one utility proposed. We found that the utility submitted evidence to the CPUC that demonstrated the utility had complied with the applicable requirements for competitively bid contracts.

#### **Recommendation**

*Refer to our recommendation regarding a recusal standard for commissioners on page 14.*

#### Contracts That the CPUC Directed Utilities to Enter Into

- The CPUC did not monitor individual contractor performance in 12 of the 18 CPUC-directed contracts we reviewed. However, 11 of these contractors performed work under the CPUC's energy efficiency initiatives, and the CPUC performs analyses on its energy efficiency efforts to know whether energy efficiency program goals are being met and if the programs are cost-effective for ratepayers. Additionally, the CPUC's Utility Audit, Finance, and Compliance Branch annually audits the utility energy efficiency expenditures, which can include expenditures under these contracts, to help ensure that expenditures are accurately reported, reasonable, and in compliance with CPUC objectives. In the case of the other contract, which was not related to energy efficiency, the CPUC reviewed the usefulness and management of the program that the contractor was hired to implement. As a result of that review, the CPUC recommended that the program continue under the direction of a third-party contractor.
- In the remaining six cases we reviewed, the CPUC monitored contractor performance by performing tasks such as reviewing contractor invoices or deliverables.

#### Conflicts of Interest Related to CPUC Contracts and Utilities' Contracts

- We compared the interests that commissioners and contract decision makers disclosed on their statements of economic interests to the names of selected vendors that received contracts from the CPUC or energy utilities. Using the statements of economic interests we were able to review, we identified no conflicts of interest related to these contracts.
- In examining one case, we initially believed that a commissioner had a conflict of interest when participating in a CPUC decision because of the commissioner's disclosure of economic interests and documentation related to the project that was approved in that CPUC decision. However, we conducted follow-up work and concluded that he had erroneously reported ownership of stock on his economic interest disclosure, that he did not own the stock at the time of the decision, and that there was no conflict of interest.
- We were unable to determine whether decision makers had conflicts of interest related to some contracts because the CPUC could not locate 23 statements of economic interests. The CPUC was not able to determine if these statements were misplaced, if the employees did not file the required statements, or if the CPUC conflict-of-interest code did not require these employees to file statements of economic interests.
- According to the CPUC's former filing officer, the database she relied on to identify all employees who needed to file disclosures was not always accurate because of employees' changing positions or classifications.
- In addition, according to the CPUC's former filing officer, the CPUC retains staff statements of economic interests for only four years. However, state law requires original statements to be retained for seven years.

#### **Recommendation**

*The CPUC should ensure that it has accurate information about who is required to file statements of economic interests and then verify that all such persons file those statements when required.*

*The CPUC should update and follow its retention policy for economic interest disclosures so that it is aligned with state law.*

Sources: California State Auditor's analysis of CPUC records and interviews with key CPUC staff members about the subject areas identified in the table.



## SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (Audit Committee) directed the California State Auditor to review the CPUC’s contracting practices and procedures. Specifically, we were directed to review the practices related to the CPUC’s own contracts and the regulated utilities’ contracts that it directs or approves to determine how it ensures best value, meets competitive bidding requirements, avoids conflicts of interest, and monitors contractor performance. Table 5 lists the objectives that the Audit Committee approved and the methods used to address those objectives.

**Table 5**  
**Audit Objectives and the Methods Used to Address Them**

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed relevant laws, rules, regulations, CPUC decisions, and resolutions.
2 Determine the extent to which state contracting requirements, including those in state statute and the <i>State Contracting Manual</i> , apply to the CPUC. Note any areas in which the CPUC is exempt from state requirements, the reasons, and any time limits for the exemptions.	<ul style="list-style-type: none"> <li>• Reviewed the contracting requirements in the Public Contract Code and the <i>State Contracting Manual</i>.</li> <li>• Reviewed the legislative history of the CPUC’s exemptions from specific contracting requirements under certain circumstances to determine the reason for the exemptions.</li> </ul>
3 Review the CPUC’s contracting policies, procedures, and practices to determine whether and how they ensure best value, address competitive bidding, avoid conflicts of interest, and ensure that deliverables and costs meet requirements. Note any ways these policies differ from state contracting requirements.	<ul style="list-style-type: none"> <li>• Reviewed the CPUC contracting manual and other contracting-related documents the CPUC makes available to its staff on its intranet.</li> <li>• Compared the key state contracting requirements identified under Objectives 1 and 2 in the areas of requirements for ensuring best value, addressing competitive bidding, avoiding conflicts of interest, and ensuring that deliverables and costs meet requirements to the CPUC manual and guidance documents and noted any areas where the requirements differ from the manual and guidance.</li> <li>• For all areas in which we identified discrepancies, interviewed CPUC staff and asked why the differences existed.</li> </ul>
4 For a selection of contracts for services, including but not limited to legal and other consulting services that the CPUC entered into or amended between 2010 and 2014, determine the following:	<ul style="list-style-type: none"> <li>• For all objectives where the Audit Committee asked us to review information from 2010 through 2014, we also included information from 2015 in our review because information from 2015 was available when we began this audit, and it provided us with the opportunity to review more recent CPUC contracting activity.</li> <li>• Used data from the CPUC contract database to identify all contracts the CPUC entered into or amended between 2010 and 2015. From that population, judgmentally selected 60 service contracts from various points throughout the period and with varied initial dollar values.</li> <li>• As described in Table 4 on page 40, neither we nor the CPUC could locate for about four months one contract we initially selected for review. As a result, we selected another contract for review. Once the CPUC located the contract, we reviewed the contract and found no additional types of deficiencies beyond the ones we identify in the section of the report addressing CPUC contracting activity.</li> </ul>

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<p>a. Whether the CPUC solicited and awarded the contracts in accordance with applicable laws, rules, policies, and best practices, including those relating to contract approval, bidding, competition, justification for noncompetition, and cost/price reasonableness, and whether they contained appropriate requirements, such as detailed performance criteria and adequate controls for monitoring and ensuring contractor performance.</p>	<ul style="list-style-type: none"> <li>• Compared the CPUC's activity on the 60 selected contracts to the relevant criteria in state law, the <i>State Contracting Manual</i>, and best business practices, including criteria related to contract approval, bidding, competition, justification for noncompetition, and cost/price reasonableness. Determined whether the contracts contained detailed performance criteria and schedules of performance and whether the CPUC had effectively monitored the contractors' performance.</li> <li>• Interviewed staff to determine the reasons why contracting activity did not align with key criteria.</li> </ul>
<p>b. Whether the CPUC complied with applicable contracting laws, rules, and policies intended to avoid conflicts of interest, such as the participation of outside contractors or other individuals with financial interests in the contract.</p>	<ul style="list-style-type: none"> <li>• Identified individuals who were in decision-making roles related to the 60 contracts we selected. We also identified the individuals who served as commissioners at any time from 2010 through 2015.</li> <li>• Reviewed the statements of economic interests that each decision maker and commissioner filed and identified all interests related to investments, income, loans, and business positions.</li> <li>• Used the Lexis Total Research System, whenever information was available, to identify the parent company of the vendors awarded the contracts we selected.</li> <li>• Compared the names of the vendors that were awarded each of the contracts we selected and all of their identified parent companies to the economic interests that commissioners and decision makers disclosed to determine whether any commissioner or decision maker had a financial interest in the contracts we selected for review.</li> </ul>
<p>c. Whether the CPUC awarded the contract for an amount beneath the competitive bidding threshold or within its delegated purchasing authority but then amended the contract to exceed the initially authorized amount.</p>	<ul style="list-style-type: none"> <li>• Reviewed four contracts with initial values below the competitive bidding threshold and determined whether the CPUC amended the contracts to exceed the initially authorized amount.</li> <li>• Reviewed 15 additional contracts that the CPUC entered into within its delegated purchasing authority and determined whether it later amended the contracts to exceed the initially authorized amount.</li> <li>• Determined whether the CPUC obtained appropriate approval from General Services for the contracts it amended to exceed its delegated purchasing authority.</li> </ul>
<p>5 Determine the number of sole-source contracts for services the CPUC entered into or amended between 2010 and 2014. For a selection of those sole-source contracts, determine the following:</p>	<ul style="list-style-type: none"> <li>• As discussed in Table 4 on page 40, the CPUC has not used its contract database to track the procurement method for each of its contracts. As a result, we could not use the CPUC data to determine the number of sole-source contracts the CPUC entered into or amended between 2010 and 2015.</li> <li>• Determined that the next best sources of information were records kept by General Services. Refer to the <i>Tracking of Sole-Source Contracts</i> section in Table 4 on page 40 for a discussion of the limitations of this approach.</li> <li>• Conducted a manual count of the CPUC sole-source contracts that General Services had on record and corroborated that count with information from General Services' Office of Legal Services contract database.</li> <li>• Selected for review all 15 sole-source contracts we identified.</li> </ul>
<p>a. Assess whether sole-source contracts were sufficiently justified and complied with state law and contracting policies. Determine whether any of those sole-source contracts were subsequently amended to increase their amount without any changes in scope, and whether such actions complied with state law and contracting policies.</p>	<ul style="list-style-type: none"> <li>• Compared the 15 selected sole-source contracts to key criteria in state law and the <i>State Contracting Manual</i> related to sole-source contracts. We reviewed the contracts to determine whether they were sufficiently justified and whether the contract values changed without corresponding changes to scopes of work. We identified only one contract with such an increase in funding.</li> <li>• Interviewed staff to determine the reason contracting activity did not align with key criteria.</li> <li>• Performed the steps described under Objective 4(b) for the 15 sole-source contracts.</li> </ul>

<p>b. Determine whether the practice of including contractors as advocates in CPUC proceedings complies with state law and contracting policies, and whether it creates a conflict of interest or is in the best interest of ratepayers.</p>	<ul style="list-style-type: none"> <li>Reviewed state law and related criteria to determine whether contractor participation in CPUC proceedings violated any relevant criteria.</li> <li>Reviewed CPUC regulations that dictate how entities can become parties to proceedings.</li> <li>As described under Objective 5(c), reviewed the participation of contractors in proceedings to assess the potential harm to ratepayers.</li> </ul>
<p>c. To the extent possible, determine the number of times contractors have participated as advocates in CPUC proceedings and whether they had any influence on contract award decisions.</p>	<ul style="list-style-type: none"> <li>Because of the high volume of records, it was cost-prohibitive to determine the number of times that contractors had participated in CPUC proceedings.</li> <li>For the contracts reviewed under Objective 8, identified the related CPUC proceeding and reviewed the list of individuals and organizations that were parties to each proceeding to determine how often contractors participated in the proceedings that led to their contracts.</li> <li>For all cases where contractors participated in the proceedings related to their contracts, reviewed the CPUC decisions that resulted from the proceedings and the comments the contractors and other key parties submitted in the proceedings, and attempted to determine whether the contractors influenced contract award decisions.</li> <li>Reviewed interest disclosures that contractors made before participating in these proceedings to determine whether they sufficiently disclosed their interests in the proceeding.</li> <li>Reviewed CPUC's regulations related to participation in a proceeding and what those regulations require individuals or organizations to disclose.</li> </ul>
<p>6 Determine the extent, if any, to which private utility entities regulated by the CPUC are required to follow state requirements related to competitive bidding, avoiding conflicts of interest, and ensuring that contract deliverables and costs meet requirements.</p>	<p>Reviewed key sections of state law to determine whether the utilities regulated by the CPUC are required to follow any state contracting requirements related to competitive bidding, avoiding conflicts of interest, and ensuring that contract deliverables and costs meet requirements.</p>
<p>7 Identify any CPUC policies or procedures for overseeing the contracting processes of regulated utility entities.</p>	<ul style="list-style-type: none"> <li>Interviewed staff to determine what policies and procedures the CPUC has established for overseeing the contracting processes of utilities.</li> <li>Reviewed key CPUC decisions and portions of state law that relate to contract oversight requirements.</li> </ul>
<p>8 To the extent possible, determine how many contracts the CPUC directed regulated utility entities to enter into with other companies between 2010 and 2014. For a selection of those contracts, to the extent possible, determine the following:</p>	<p>The CPUC did not track the contracts it ordered the energy utilities—Pacific Gas and Electric, San Diego Gas and Electric, Southern California Edison, and Southern California Gas—to enter into in a manner that was cost-effective for us to review. Therefore, we asked the energy utilities for a listing of the contracts that the CPUC directed them to enter into from 2010 through 2015 and the related CPUC decisions or resolutions that directed the contracts. We reviewed the responses from the energy utilities, verified their accuracy, and identified additional contracts after following up with the utilities and with CPUC staff. We determined that the CPUC directed the utilities to enter into 25 contracts during our audit period. We selected 18 contracts for further review.</p>
<p>a. Whether the contracts were paid from ratepayer funds.</p>	<p>Reviewed the CPUC decisions or resolutions that directed the 18 contracts we selected to determine whether the CPUC authorized the utilities to use ratepayer funds for these contracts.</p>
<p>b. Whether the CPUC ensured that the contracts complied with applicable requirements related to competitive bidding, avoiding conflicts of interest, and ensuring that the contract deliverables and costs meet requirements.</p>	<ul style="list-style-type: none"> <li>Reviewed CPUC decisions and other related documents to determine whether the CPUC ensured that the contracts we selected complied with applicable requirements related to competitive bidding and ensured that contract deliverables and costs met requirements.</li> <li>For commissioners only, completed the steps indicated under Objective 4(b) for each of the selected contracts.</li> </ul>

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<p>9 Determine how many sole-source contracts proposed by regulated entities the CPUC approved between 2010 and 2014. For a selection of those contracts, determine the following:</p>	<p>The CPUC did not comprehensively track the sole-source contracts that the energy utilities requested that the CPUC approve. Therefore, we asked the energy utilities for a listing of the sole-source contracts that they proposed and the CPUC approved from 2010 through 2015 and the related CPUC decision or resolution that approved each contract. We reviewed the responses from the energy utilities, verified their accuracy, and selected 20 sole-source contracts for further review. We focused our review on sole-source contracts that the utilities proposed and that the CPUC approved as discrete contracts. We did not include in our review any contracts that were a component of a larger program the utilities proposed, such as an energy efficiency program.</p>
<p>a. Whether the contract complied with applicable requirements for sole-source contracts.</p>	<ul style="list-style-type: none"> <li>• Identified the sole-source contracting requirements energy utilities are required to follow.</li> <li>• Reviewed the 20 selected contracts and the contract information the energy utilities submitted to the CPUC and determined whether the contracts met the requirements for sole-source contracting.</li> </ul>
<p>b. Whether the contracts complied with applicable requirements or best practices related to achieving best value, avoiding conflicts of interest, and ensuring that the contract deliverables and costs meet requirements.</p>	<ul style="list-style-type: none"> <li>• For each of the selected contracts, determined the following: <ul style="list-style-type: none"> <li>- Whether the utility performed an assessment to determine if the contract was the best value and the results of that assessment.</li> <li>- Whether the contracts contained safeguards, such as performance requirements, default provisions, and remedies to ensure that contract deliverables and costs met requirements and noted no concerns.</li> </ul> </li> <li>• For commissioners only, completed the steps indicated under Objective 4(b) for each of the selected contracts.</li> </ul>
<p>10 Identify any CPUC policies and procedures for responding to requests for public records regarding its contracts and contracts between regulated entities and other parties and determine the following:</p>	<p>Reviewed CPUC policies and procedures related to record requests.</p>
<p>a. Whether the CPUC's policies and procedures for responding to these requests are consistent with state law.</p>	<ul style="list-style-type: none"> <li>• Reviewed a CPUC proceeding in which the CPUC considered updating its record request policy and noted the weaknesses that it identified in the policy.</li> <li>• Confirmed with CPUC staff members that they do not have a current desk procedure manual for responding to record requests.</li> </ul>
<p>b. To the extent possible, determine whether the CPUC complies with its policies and state law when receiving requests for public documents related to contracts and contract deliverables.</p>	<ul style="list-style-type: none"> <li>• Using the CPUC record request tracking system, we selected 20 contract-related record requests from 2012 through 2015 and reviewed the CPUC's response to those requests against key requirements in state law. We did not select record requests from 2010 and 2011 because the CPUC's record retention policy does not require it to keep requests after three years have elapsed.</li> <li>• Interviewed staff to inquire about any discrepancies between the CPUC's responses and the requirements in state law.</li> </ul>
<p>11 Review and assess any other issues that are significant to the audit.</p>	<ul style="list-style-type: none"> <li>• Reviewed economic interest disclosures for the commissioners who served from 2010 through 2015 to identify any gifts or interests that had the appearance of impropriety.</li> <li>• Reviewed the CPUC's rules and regulations for ex parte communications and an associated report related to a contract identified under Objective 8.</li> <li>• Reviewed the CPUC's rules for commissioner recusal related to a contract identified under Objective 9.</li> <li>• Reviewed disclosures to identify economic interests that had a higher likelihood of causing a conflict of interest. For each of these interests, we searched CPUC decisions to determine if the entity that a commissioner had an interest in was ever named in a CPUC decision.</li> <li>• Conducted follow-up research on the only economic interest and CPUC decision match we found within our audit period to determine whether a commissioner had a conflict of interest in CPUC decisions in which he participated.</li> </ul>

### Assessment of Data Reliability

The U.S. Government Accountability Office, whose standards we are statutorily required to follow, requires us to assess the sufficiency and appropriateness of the computer-processed information that we use to materially support our findings, conclusions, or recommendations. In performing this audit, we obtained contract data from the CPUC's Microsoft Dynamics Customer Relationship Management system (contract database) to determine the number of sole-source contracts that the CPUC entered into or amended from 2010 through 2015 and to make a selection of sole-source contracts and contracts that were not sole-source that the CPUC entered into or amended in the same period. We performed data-set verification procedures and electronic testing of key data elements and did not identify any significant issues. However, as discussed in greater detail in the *Other Areas We Reviewed* section of this report beginning on page 39, the CPUC's contract database does not identify the type of procurement method used for a contract, such as sole-source. Because we were only able to use the data to make a selection of active CPUC contracts from 2010 through 2015, a data reliability assessment was not required. Instead, we needed to gain assurance that the population was complete.

We also used data from the CPUC's Legal Information Request database to select requests for public documents related to contracts and contract deliverables from 2012 through 2015. Because we were only using the data to make a selection of requests, a data reliability assessment was not required. Instead, we needed to gain assurance that the population was complete.

We previously audited the CPUC and found pervasive weaknesses in the general controls it has implemented over its information systems. We noted in a report we issued in April 2015 that although the CPUC had certified to the California Department of Technology that it complied with all policy requirements in Chapter 5300 of the *State Administrative Manual* (security standards), we found that key information security documents were nonexistent or lacked critical components.<sup>5</sup> Specifically, the CPUC had yet to inventory all of its information assets, assess the risk to those assets, and develop an information security plan for mitigating those risks. Further, we reported that the CPUC did not have an incident response plan to ensure its timely response to and recovery from information security incidents such as malicious cyberattacks. Finally, although the CPUC had a current technology

<sup>5</sup> The April 2015 report is titled *California Public Utilities Commission: It Needs to Improve the Quality of Its Consumer Complaint Data and the Controls Over Its Information Systems, Report 2014-120*.

recovery plan, we questioned the plan's usefulness because it failed to consistently identify critical applications, establish acceptable outage time frames for these applications, and develop strategies for recovery. We concluded that the CPUC had poor general controls over its information systems, compromising the confidentiality, integrity, and availability of the information systems it uses to perform its day-to-day operations.

To rectify these control weaknesses, we recommended that the CPUC ensure compliance with all security standards no later than April 2016. When we initially followed up with the CPUC in April 2016 about the status of its general controls, it asserted that it had made progress toward implementing our recommendation and estimated that it would achieve full compliance with all security standards by the end of May 2016. When we again followed up with the CPUC to verify its compliance status, we expected, at a minimum, that it would have achieved full compliance with nearly all of the security standards. However, we found that the CPUC significantly overstated its progress toward addressing our recommendation. Although it submitted copies of various information security documents for our review, it was substantially out of compliance with the majority of the security standards. When we questioned the CPUC about the disconnect between its asserted level of compliance and its actual level of compliance, it explained that it did not fully understand the depth of the security standards when it provided the April 2016 status update. However, the CPUC explained that as a result of our follow-up work, it now believes it has a much clearer understanding of the requirements. The CPUC also cited limited staff resources as a barrier to its ability to achieve full compliance with the security standards. According to the CPUC, it recently received authorization to hire two more individuals for its information security team. As of August 2016, the CPUC asserted that it was actively trying to fill these two positions.

Nonetheless, the CPUC estimates it will not achieve full compliance with the security standards until December 2019. Until the CPUC improves the controls it has implemented over its information systems, the confidentiality, integrity, and availability of its information systems will continue to be at risk. Although we determined there is an unacceptably high risk that the population of contracts and the population of requests for public documents related to contracts and contract deliverables were not complete, there was sufficient evidence in total to support our audit findings, conclusions, and recommendations.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
State Auditor

Date: September 22, 2016

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For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

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## APPENDIX

### THE CPUC'S OVERSIGHT OF ENERGY UTILITY CONTRACTS

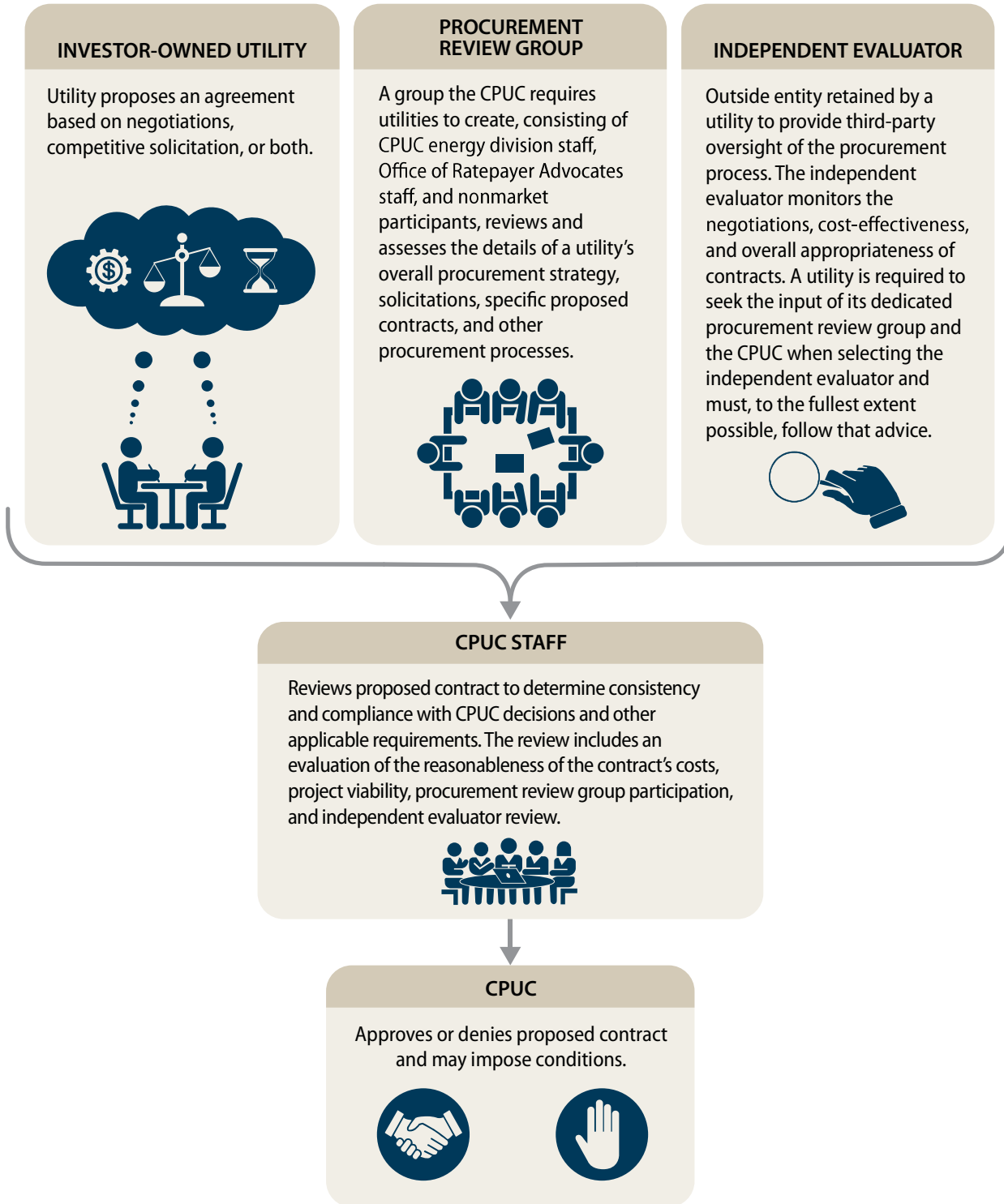
Privately owned energy utilities subject to the CPUC's authority are not state agencies and therefore are not subject to the requirements in the Public Contract Code and the *State Contracting Manual* when they contract with private third-parties. However, the CPUC has broad authority under state law to oversee energy utilities' agreements with third parties to help ensure that state policy goals are met and that utility ratepayer interests are protected. This oversight includes approving agreements that energy utilities propose and, in other instances, directing the utilities to contract with third parties.

One key type of agreement that energy utilities propose for CPUC approval is a *power purchase agreement*. To submit power purchase agreements for approval, energy utilities submit an advice letter or an application to the CPUC describing the terms of the proposed agreement and how it complies with CPUC requirements. Although the CPUC allows its energy division to approve some agreements if they conform to an existing CPUC order, the CPUC contract review process for power purchase agreements involves participation by multiple entities as shown in Figure A on the following page. Each energy utility has its own procurement review group that reviews the utility's proposed agreements. These procurement review groups include CPUC energy division representatives, representatives from the Office of Ratepayer Advocates—an entity housed within the CPUC that represents the interests of public utility customers and subscribers with the goal of obtaining the lowest possible rates for service consistent with reliable and safe service levels—and parties that are not market participants. Additionally, an independent evaluator retained by the utility monitors some of the negotiations and reviews the cost-effectiveness and overall appropriateness of the agreements. Finally, CPUC staff reviews the proposed agreements for compliance with CPUC requirements before the agreements are approved or denied through a CPUC resolution.

The CPUC also has the authority to approve and oversee other agreements between energy utilities and third parties—such as agreements to establish research and development programs. State law establishes guidelines for the CPUC's review of energy utility research, development, and demonstration programs. These statutory guidelines require the CPUC to consider whether the projects provide a reasonable probability of providing benefits to ratepayers and whether the projects unnecessarily duplicate research that other entities are undertaking. State law also requires the CPUC to consider whether a project supports a specific objective, such as environmental improvement, public and employee safety, or development of new resources and processes.

**Figure A**

**The California Public Utilities Commission’s Process for Overseeing and Approving Power Purchase Agreements**



Sources: California State Auditor’s analysis of CPUC decisions D.15-11-041, D.06-05-039, D.02-08-071; Advice Letters AL 2273-E and AL 3449-E; CPUC resolutions E-4425 and E-4286; and independent evaluator reports.

September 2016

STATE OF CALIFORNIA

EDMUND G. BROWN JR., Governor

**PUBLIC UTILITIES COMMISSION**505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298

September 1, 2016

Elaine Howle, State Auditor\*  
 California State Auditor's Office  
 621 Capitol Mall, Suite 1200  
 Sacramento, CA 95814

**SUBJECT: Response to the State Auditor's Draft Report, "California Public Utilities Commission: It Should Reform its Rules to Increase Transparency and Accountability and Its Contracting Practices Do Not Align With Requirements or Best Practices"**

Dear Ms. Howle,

The California Public Utilities Commission (CPUC) provides the following response to the September 1<sup>st</sup>, 2016, draft audit report from the State Auditor entitled, "California Public Utilities Commission: It Should Reform its Rules to Increase Transparency and Accountability and its Contracting Practices Do Not Align With Requirements or Best Practices." We take the audit recommendations very seriously and intend to comply with the recommendations as outlined below:

Our goal is to make necessary changes to policies, process, practices and procedures to address all of the audit report recommendations and to bring our practices into conformity with state procedures, requirements, and norms.

Audit Recommendations (*in italics*) and CPUC Responses:

1. *To ensure that the choice of a vendor is sufficiently justified and that the vendor represents best value, the CPUC should explain in its final decision how the vendor was the most qualified in all cases when the CPUC does not competitively select the vendor it directs utilities to contract with.*

**Response:** The CPUC agrees with this recommendation. The CPUC will establish a process to include a justification in the formal Commission decision whenever the Commission is directing a utility to hire a specific vendor/contractor. Staff will recommend that the Commission adopt this as a formal policy through the Commission Policy and Governance Committee.

2. *To avoid the appearance of inappropriate relationships, the CPUC should adopt a policy to prohibit commissioners from accepting gifts from regulated utilities and energy companies and free travel from organizations with significant ties to regulated utilities and other parties with financial interests in CPUC proceedings.*

\* California State Auditor's comments begin on page 57.

## CALIFORNIA PUBLIC UTILITIES COMMISSION

### Findings and Recommendations, Cont'd

**Response:** The CPUC agrees that the appearance of inappropriate relations should be avoided. As the audit report recognizes, the Commissioners' acceptance of identified gifts is consistent with state law. The Commission's Legal Division will continue to analyze Commissioners' acceptance of gifts on a case-by-case basis, and such analysis will continue to examine whether any such gift raises appearance issues. We cannot, however, agree with the audit recommendation. Such a policy would need to be considered and adopted by the full Commission. This audit recommendation will be forwarded to the full Commission for discussion. The CPUC will inform the State Auditor of policies adopted.

3. *To ensure that its contracting practices align with state requirements and best practices, the CPUC should take the following actions:*

- *Update, distribute and follow its contracting procedures manual. The manual should identify specific responsibilities for both contracts office staff and project managers, and it should provide specific guidance about the processes the CPUC will employ to do the following:*
  - *Fully justify civil service exemptions*
  - *Conduct market research for exempt contracts*
  - *Fully support the need for additional funding*
  - *Ensure that it does not change the scope of work too significantly for the original*
  - *Monitor contractor performance against criteria included in its contracts*
  - *Avoid sole-source contracts when it is able to solicit competitive bids for services.*

**Response:** The CPUC agrees with the recommendation.

- The Contracts Office will update, distribute, and follow its contracting procedures manual by December 31, 2016. By December 31, 2016, the CPUC will also identify specific responsibilities for both contracts office staff and project managers, and provide specific guidance about the processes the CPUC will employ to do the following:
  - Fully justify civil service exemptions
  - Conduct market research for exempt contracts
  - Fully support the need for additional funding
  - Ensure that it does not change the scope of work too significantly for the original
  - Monitor contractor performance against criteria included in its contracts
  - Avoid sole-source contracts when it is able to solicit competitive bid for services

The CPUC has already initiated several activities as of mid-June 2016 to address the recommendations set forth in this audit report.

4. *Provide immediate refresher training to its contract analysts and contracts office manager and establish a regular schedule of annual training for them to attend.*

**Response:** The CPUC agrees with the recommendation. Due to the State-wide implementation of FISCAL, DGS deferred Procurement and Contracts Academy Training for

## CALIFORNIA PUBLIC UTILITIES COMMISSION Findings and Recommendations, Cont'd

approximately one year to utilize training resources for the new FISCAL program and the CPUC was therefore unable to provide the refresher training as we desired. A limited number of classes have been offered through 2016 but more classes are being offered beginning 9/2016. The CPUC will schedule contracts staff and management to attend "top 10" courses for certification and complete the required refreshers courses every three years.

5. *Designate a limited number of project managers for each division at the CPUC and provide those individuals with training on the CPUC's processes related to contracting, including how to monitor progress of a contractor's work.*

**Response:** The CPUC agrees with this recommendation. The Commission will develop a plan for limiting the number of project managers for each division by December 2016, and complete training for project managers.

6. *Implement a supervisory review by the contracts office manager of proposed contracts and contract amendments to occur before contracts and amendments go to vendor for signature.*

**Response:** The CPUC agrees with this recommendation. Supervisory review of contracts by the Contract Manager and Branch Chief prior to Deputy Executive Director review and approval has been in place since May 2016. The process continues to be reviewed, refined and clarified. ②

### OTHER AREAS REVIEWED

7. *The CPUC should update its general policy on responding to record requests so that the policy aligns with state law. The CPUC should develop and follow procedures to regularly track and review records requests it has not fully responded to and determine whether it can provide information.*

**Response:** The CPUC agrees with this recommendation. In Rulemaking (R.) 14-11-001, the Commission is currently examining its procedures for responding to requests pursuant to the California Public Records Acts and will adopt policies that align with state law. As the audit report notes, Commission staff assigned to the processing of the Public Records Act requests have taken steps to track and review open records requests. Staff will continue to do so to ensure that the Commission is in compliance with statutory guidelines. ③

8. *The CPUC should use its contract database to track the procurement method for each contract.*

**Response:** The CPUC agrees with this recommendation. The current contract database is not capable of tracking the procurement method for each contract. The Contracts Office will work with the Information Technology Services Branch to find a mechanism to capture the procurement method, add this information to the database, and develop a report capability. Estimated completion will be December 31, 2016.

CALIFORNIA PUBLIC UTILITIES COMMISSION  
Findings and Recommendations, Cont'd

9. *The CPUC should update its regulations to require parties joining a proceeding by filing a protest or response to an application, petition or CPUC rulemaking proceeding, or by filing comments in response to a rulemaking proceeding to fully disclose their interests.*

- ④ **Response:** The CPUC does not agree with this recommendation to update its regulations because our current rules and practices already achieve the desired result. The Commission's current Rules of Practice and Procedure already adequately address the issue of parties disclosing their interests in a Commission proceeding. The commission has several types of proceedings and our answer addresses each type. By definition, when a party files a protest of or a response to an application, petition, or CPUC-initiated rulemaking proceeding, or when a party files comments in the context of a rulemaking proceeding, the protest, response, or comments reveal the filer's position on issues in the proceeding, which make clear the party's interests in the matter. A new requirement for parties to independently disclose their interests would be redundant. Furthermore, when a Commission Order Instituting Rulemaking (OIR – a type of proceeding which often has no pre-hearing discovery process) calls for comments, the Commission is seeking policy opinion and legal argument, where the credibility of the witness (including motivation/financial interest/etc.) is generally immaterial. Thus, in a rulemaking proceeding, there is no need for such disclosure. Finally, changing the Commission's Rules of Practice and Procedure is a very lengthy process, which includes approval by the Office of Administrative Law. While the CPUC does update its Rules of Practice and Procedure periodically when necessary, this recommended change is both unnecessary and redundant.
- ④

10. *The CPUC should ensure that it has accurate information about who is required to file statements of economic interests and then verify that all such persons file those statements when required. The CPUC should update and follow its retention policy for economic interest disclosures so that it is aligned to state law.*

**Response:** The CPUC agrees with this recommendation. The Commission's Filing Officer will take appropriate steps to ensure that the Commission retains all Form 700s in compliance with State Law.

Sincerely,



Timothy J. Sullivan  
Executive Director

## COMMENTS

### CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE CPUC

To provide clarity and perspective, we are commenting on the CPUC's response to the audit. The numbers below correspond to the numbers we have placed in the margin of its response.

We find the CPUC's response to this recommendation confusing. The CPUC appears to state that it cannot agree with our recommendation because its commissioners need to consider and adopt a policy that would address our recommendation. The CPUC makes this assertion despite also stating that it agrees it should avoid the appearance of inappropriate relationships, which is precisely what our recommendation is meant to achieve. Further, the CPUC characterizes its ability to agree with and implement this recommendation much differently than it does for another recommendation that it addressed in its response letter. In response to our recommendation that it explain how it chose a vendor in all cases when it does not competitively select a vendor it directs utilities to contract with, the CPUC stated on page 53 that it agreed with our recommendation and stated that its staff would recommend that the commissioners adopt such a policy. We are puzzled that the CPUC is able to agree with this recommendation, and in turn recommend the CPUC adopt it, but take a contradictory position in not believing that it can agree with the recommendation pertaining to gifts.

①

Although the CPUC states that supervisory review has been in place since May 2016, it also indicates that this process is still being reviewed, refined, and clarified. Therefore, we look forward to hearing in the CPUC's 60-day response to the audit recommendations more about how it has formalized this process, including how it will incorporate it into its new contracting manual.

②

The CPUC overstates our conclusion about how it tracks and reviews unresolved Public Records Act requests. On page 39 of our report, we state that the CPUC *inconsistently* tracked the Public Records Act requests. As we note on that same page, this inconsistent tracking meant that the CPUC did not provide records as promptly as it could have in response to one of the requests we reviewed. The inconsistency of the CPUC's tracking and monitoring led us to make the recommendation on page 39 that it should *regularly* track and review its unresolved record requests.

③

④ Despite the CPUC's objections, we continue to believe it is important for the CPUC to implement our recommendation. Although the CPUC states that its current rules and practices already achieve the desired result of getting parties to adequately disclose their interests in CPUC proceedings, the rules do not explicitly require that parties disclose those interests when filing a protest or response to an application or petition, or comments in response to a rulemaking. Because those interests are potentially relevant to the CPUC's proceedings, we recommend on page 41 that the CPUC take the prudent step to ensure that in the future all those who become a party to the CPUC's proceedings through this method be required to disclose their interests.

Further, we find the CPUC's assertion that a party's interests are generally immaterial when the party responds to a CPUC Order Instituting Rulemaking to be unpersuasive. On pages 10 and 11 of our report, we discuss a CPUC proceeding in which the CPUC directed utilities to contract with a vendor that was a party to that proceeding. In that particular case, the CPUC proceeding was a rulemaking proceeding and the vendor became a party by commenting on an Order Instituting Rulemaking. As we discuss on page 10, despite the objections from all four energy utilities, the CPUC directed the utilities to contract with this vendor after the vendor volunteered to administer an outreach program—yet the CPUC did not provide an adequate justification as to how the CPUC knew the vendor represented the best possible value for ratepayers. We note on page 11 of our report that the cumulative result of this decision was that the vendor received contracts from the utilities totaling about \$74 million. Although in this instance the vendor voluntarily disclosed its interest in the proceeding, this example shows that parties who participate in this type of proceeding can financially benefit as a result of participating and therefore their interests are material to these types of proceedings.