Considerations for Closing the Moral and Legal Gap in Public Utility Regulation

E. Nathan Cheung

Follow this and additional works at: https://digitalcommons.pepperdine.edu/naalj

Part of the Administrative Law Commons, and the Energy and Utilities Law Commons

Recommended Citation
Available at: https://digitalcommons.pepperdine.edu/naalj/vol40/iss1/3

This Comment is brought to you for free and open access by the Caruso School of Law at Pepperdine Digital Commons. It has been accepted for inclusion in Journal of the National Association of Administrative Law Judiciary by an authorized editor of Pepperdine Digital Commons. For more information, please contact Katrina.Gallardo@pepperdine.edu, anna.speth@pepperdine.edu, linhgavin.do@pepperdine.edu.
Considerations for Closing the Moral and Legal Gap in Public Utility Regulation

By E. Nathan Cheung

I. INTRODUCTION
II. THE MODERN PUBLIC UTILITY COMMISSION
   A. Public Utility Commissions
   B. The Broad Reach and Authority of Public Utility Commissions
III. PHILOSOPHICAL CONSIDERATIONS FOR REGULATION
   A. Akrasia: Wrong Action Without Knowledge
   B. Motivation: Causation for Moral Action
   C. Shame: An Imperfect Response to Wrong Action
   D. Incentive Reporting Morality Based on Economic Efficiency
IV. INCENTIVE REGULATION APPLIED
   A. California Public Utility Commission History
   B. Statutory Authority for Penalties and Fines
      1. Commission Distinction Between Reparation and Fine
      2. Commission’s Consideration for Determining Appropriate Fines
         a. Severity of the offense
         b. The conduct of the utility before, during, and after the offense
         c. Financial resources of the utility
         d. Totality of circumstances in furtherance of the public interest
         e. The role of precedent
      3. D. 98-12-075 Framework & Potential Development
V. CONCLUSION
I. INTRODUCTION

State public utility commissions play an enormous role in the regulation of different industries that have subtle but substantial effects on the daily lives of consumers—which includes citizens who use these services, that is to say nearly everyone in the United States. Regulated industries, generally referred to as investor owned utilities, include gas, electric, or water providers, regional telecommunication, and railroad companies. Some jurisdictions may also regulate regional light rail transportation, buses, automated vehicles, or ride hailing services.

Many public utility commissions were originally created to regulate railroad companies. However, during the transition to the modern era their reach was greatly expanded to encompass the host of now regulated public industries. In more recent times, the role of the

---

1 New Database Provides a Window into Public Utility Commissions in All 50 U.S. States, PR NEWSWIRE (Sept. 18, 2019), https://perma.cc/9HQV-RALK.
2 Also known as publicly owned utilities because they are owned by members of the public, namely investors. See generally Differences Between Publicly and Investor-Owned Utilities, CAL. ENERGY COMM’N, https://ww2.energy.ca.gov/pou_reporting/background/difference_pou_iou.html (last visited Apr. 10, 2020).
5 See PUB. UTIL. COMM’N OF TEX., supra note 3.
6 See PUB. UTIL. COMM’N OF TEX., supra note 3.
public utility commission has further expanded beyond regulation of specific industries to become tools to implement various policy goals and attitudes towards respective industries.7

Part II of this paper will seek to address different issues that may be encountered by the modern public utility commission.8 Part II provides a brief description of the regulatory framework that serves as an epistemic rationale for public utility commissions.9 Further, Part II provides a description of the broad statutory and implicit powers of public utility commissions.10

Part III of this paper seeks to present the concept of incentive regulation, which beyond its common support in economic theory, also has a basis in moral theory.11 Notable among these is the Aristotelian concept of akrasia,12 which serves both as a guiding principle for the tendencies of individual corporate behavior and a rationale for regulating behavior.13 Additionally, Part III introduces the Humean idea of motivation,14 which provides the principle for regulation based on incentivizing and rewarding behavior.15 Part III also considers a sociological approach of punishment based on disincentivizing certain behavior by placing public spotlight on actions deemed immoral.16

Lastly, Part IV seeks to analyze incentive regulation applied to the California Public Utilities Commission (CPUC).17 The purpose of the analysis is both to prescribe the applicability of incentive regulation, and also assign potential challenges with this approach. Part IV outlines the unique, specific authority of the CPUC as a

---

8 See infra Part II.
9 See infra id.
10 See infra id. Most of this authority stems from the state and may be independent from federal law. Id.
11 See infra Part III.
12 See Aristotle, infra note 46.
13 See id.; infra Part II.
14 See Smith, infra note 62.
15 See id.
16 See infra Part III.
17 See infra Part IV. This article discusses the California Public Utilities Commission because it is historically one of the largest and best staffed commissions, while overseeing one of the largest states in the nation. See, e.g., CPUC History & Organizational Structure, CAL. PUB. UTIL. COMM’N, https://www.cpuc.ca.gov/history/ (last visited Apr. 10, 2020).
constitutionally enabled regulatory body.\textsuperscript{18} It also identifies areas where incentive regulation is readily applicable at the CPUC, where it has already applied, and how it could supplement its current regulatory scheme.\textsuperscript{19} Part IV ends with a discussion of unique challenges the CPUC faces with incentive regulation.\textsuperscript{20}

II. THE MODERN PUBLIC UTILITY COMMISSION

In the nineteenth century, many states began forming their own respective precursor to the modern public utility commission to regulate railroads.\textsuperscript{21} Early on, the powers of these commissions were fairly limited.\textsuperscript{22} It was not until years later that legislation provided additional powers to regulate electricity and natural gas.\textsuperscript{23} It is within the authority of public utility commissions to regulate rates of those utilities that much of its modern authority stems.\textsuperscript{24}

A. Public Utility Commissions

State statutes organize many types of public utility commission.\textsuperscript{25} Often, either public citizens or a state governor appoints the commissioners who comprise a commission.\textsuperscript{26} Depending on the state’s resources, a public utility commission may be quite large and include several specialized departments staffed by experts in each specific industry.\textsuperscript{27}

The precursor to public utility commissions were commissions that regulated the railroad industry.\textsuperscript{28} Later, as electricity and gas power became prominent aspects of modern life, states enacted legislation expanding the regulatory authority of these industries to

\textsuperscript{18} CAL. CONST. art. XII, § 2. Contra MASS. GEN. LAWS ch. 25 § 1 (2020); TEX. UTIL. CODE § 11.002(c) (2017).
\textsuperscript{19} See infra Part IV.
\textsuperscript{20} See id.
\textsuperscript{21} I. Leo Sharfman, Commission Regulation of Public Utilities: A Survey of Legislation, 53 THE ANNALS OF THE AM. ACAD. OF POL. & SOC. SCI., 1, 1-18 (1914); see also Scott, infra note 29, at 378.
\textsuperscript{22} Id.; see also Scott, infra note 29, at 378.
\textsuperscript{23} Sharfman, supra note 21, at 1.
\textsuperscript{24} Id.
\textsuperscript{25} Id.
\textsuperscript{26} Id.
\textsuperscript{27} For links to department organization charts, see About the California Public Utilities Commission (CPUC), CAL. PUB. UTIL. COMM’N, https://www.cpuc.ca.gov/aboutus/ (last visited Feb. 4, 2020); Department of Public Utilities (DPU), MASS. DEP’T OF PUB. UTIL., https://www.mass.gov/ (last visited Feb. 4, 2020); see also ICC Offices and Bureaus, ILL. COMM. COMM’N, https://www.illinois.gov/about/offices (last visited Feb. 4, 2020).
\textsuperscript{28} Supra note 3.
Since that time, the original power of railroads has declined and public utility commissions have shifted greater focus towards energy regulation.  

B. The Broad Reach and Authority of Public Utility Commissions

While the respective authority of public utility commissions may vary based on state legislation, most public utility commissions are endowed with authority to regulate rates that are “just and reasonable.” This provides each state commission discretion to determine the rates of each state utility within its jurisdiction. Additionally, each commission is typically granted authority to generate its own procedural rules. This regulation of utilities has often been referred to as a regulatory compact between state commissions and regulated industries. Because many of these regulated industries had monopolies over their service areas, government regulation substituted for the absence of general competition. Under this scheme, public utility commissions serve “a multi-faceted purpose: (1) to ensure that customers ha[ve] access to safe, reliable service; (2) to prevent discrimination against certain classes of customers; and (3) to ensure that the cost for service rendered under monopoly conditions remain[s] reasonable.”

By setting rates, the commissions have the authority to determine the profits of a regulated utility. Conversely, rate setting also affects the service cost and citizen’s living standards within the state. Traditionally, ratemaking has focused on the balance between investor and consumer interests. “The return to the equity owner should be commensurate with returns on investments in other

---

30 Id.
31 See, e.g., CAL. PUB. UTIL. CODE § 451 (2019); FLA. STAT. § 366.041(1) (2019).
32 Sharfman, supra note 21, at 7.
33 Id. at 9.
35 Scott, supra note 29, at 385.
36 Id.
37 Monast & Adair, supra note 34, at 1356.
38 Id.
39 Scott, supra note 29, at 381; see also Monast & Adair, supra note 34, at 135.
enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.”

However, in recent years, rate setting has expanded to encompass approval of utility projects by its state’s public utility commission. Under the authority of ratemaking, a commission has authority over a utility’s ability to make significant new investments. While a commission generally does not have independent power to mandate utility construction of new sites, the state legislature may delegate the power to the public utility commission. Thus, through its delegated authority, a commission may regulate various qualities of site construction and the subsequent rate effect of those projects.

II. PHILOSOPHICAL CONSIDERATIONS FOR REGULATION

With the advent of greater tools, a commission may consider adopting new policies and different concepts to regulate industries. This section will consider several different philosophical concepts for guidance in assessing the behavior of a utility.

A. Akrasia: Wrong Action Without Knowledge

Concerns about the actual motivation may arise when attempting to discern a utility’s moral judgments about their action. It might be simplistic to assume that every action is based on the utility’s moral judgment. Thus, when an actor act badly, it may be an instance where although she arrived through moral reasoning to a correct moral judgment, she nonetheless volitionally decided not to act upon it. Thus, she may decide to act contrary to what she reasoned to be good, and instead act otherwise. This then is contrary to the Plato’s idea in Protagoras, more like the opposite view of what Aristotle calls akrasia, or weakness of the will. In this way, the akratic individual

---

40 Scott, supra note 29, at 381.
41 Id. at 394.
43 Scott, supra note 29, at 393; see also Monast & Adair, supra note 34, at 1356.
44 Scott, supra note 29, at 394.
47 Id.
is more akin to someone who reasoned poorly and came to a conclusion that was wrong or immoral. Rather the akratic individual is someone who reasoned well and knows better, but acted contrary to what they have reasoned well or good. Thus, arises the problem of what should be done to resolve this to act well despite moral reasoning otherwise.

Inversely, it is not unimaginable that regulators occasionally fail to act well through their regulation. This may stem from deficiencies in information or resources. Such deficiencies could severely limit a commission to only identify especially bad utility action, while unknowingly permitting numerous other to persist.

B. Motivation: Causation for Moral Action

Hume’s theory of motivation (Humean theory) seeks to the effect of moral judgments on actions. One of the principles behind the Humean theory is that moral judgments connect to motivation. Moral judgments refer to conclusions based on all the information the actor possesses, which is translated into a decision as the best or worst action that the actor might take. Although moral judgments may be considered subjective, the resulting actions are not because the tangible real-world consequences always exist. The premise behind the Humean theory is a nexus between the cognitive state of belief and motivation. Thus, where one’s moral judgments affect and enlighten their actions, and what one adjudges to be moral or right should motivate them to action.

Here, the Humean theory seems to echo the Platonic idea that no man acts contrary to what they believe is good, even if his

---

48 Id.
51 Id.
52 Moral Motivation, STAN. ENCYCLOPEDIA OF PHIL. (Sep. 18, 2019), https://perma.cc/PSA7-4Q98.
53 Id.
55 See, e.g., id. at 1-19.
56 Moral Motivation, supra note 52.
57 Id.
good is considered wrong by all others.\textsuperscript{58} In this way, no individual deliberately acts wrongly while at the same time maintaining the understanding he is acting wrongly.\textsuperscript{59} An individual that, \textit{in fact}, is acting wrongly will always do so with the belief his wrong action is good. Thus, in the context of Hume’s theory, one’s moral judgment (i.e. what the individual believes to be morally right) always translates and motivates their actions.\textsuperscript{60}

In the context of a regulated utility’s behavior, there is often a break between correct behavior and the bad behavior. Thus, one must presume that no regulated utility deliberately acts in a way that violates the regulator’s rules. Under the premise that no utility can deliberately act wrongfully while in fact acting wrongly, the error must lie in the utility’s actions. Thus, there must be some error in the utility’s judgment in determining its actions, such as where an action that is actually wrong, the actor believes it is good.

If the argument is that the utility’s error is the result of its own poor moral behavior, something like a monetary fine would be unsuccessful in remediating that error. Even if an actor is punished for an action, the actor cannot reasonably change an action that it intrinsically believes to be correct because this is what motivates the action.

Thus, applied to the context of fines, there must be a better way to correct the utility’s behavior besides merely fining them. A fine only indicates to the utility that an action was contrary to the regulator’s standard of good action. However, an indicator neither necessarily, nor sufficiently corrects poor judgment leading to the bad behavior.\textsuperscript{61} Rather there must be some sort of re-education to repair the defective moral judgments of the actor, i.e., a regulated utility.

Initially, it seems easy to reduce this to an assumption that regulated utilities (or anything in the Humean theory) are based on what some have called a “strong phenomenological conception” of desires.\textsuperscript{62} Here, phenomenological conception refers to motivations and desires like feelings—sequences that occur as a result of some

\textsuperscript{58} See PLATO, PROTAGORAS (Benjamin Jowett trans.) (c. 380 B.C.E), http://classics.mit.edu/Plato/protagoras.html (last visited Apr. 11, 2020).

\textsuperscript{59} Id.

\textsuperscript{60} Moral Motivation, supra note 52.

\textsuperscript{61} See H.A. Prichard, \textit{Does Moral Philosophy Rest on a Mistake?}, 21 MIND 21, 21-37 (1912) (noting that signifiers provide a description of a value, but provide no insight toward the value itself).

\textsuperscript{62} Michael Smith, \textit{The Humean Theory of Motivation}, 96 MIND 35, 45 (Jan. 1987) (defining that desires are, like sensations, simply and essentially states that have a certain phenomenological content).
random stimulus or desire for something.\textsuperscript{63} However, although motivations or desires may initially seem phenomenological, that result for a subject’s fallibility in understanding one’s own Rather, these desires are propositional and based on a series of contributing factors or reasons.\textsuperscript{65} Thus, they are not the result of spontaneous appearance of ideas despite however much an actor might feel or believe their motivations are spontaneous.

C. \textit{Shame: An Imperfect Response to Wrong Action}

One difficulty with the Humean theory is the possibility that despite efforts to correct moral behavior, the actor still acts Here, a regulated party might rather choose to take its chances and risk greater penalties than to make additional strides toward self-reporting and self-auditing of compliance. Thus, the actor’s moral judgment may remain unaltered despite attempts at reeducation or conditioning to mend his behavior.

Nonetheless, if the utility deliberately acts wrongfully, there conceivably must be another way to enforce correct moral behavior. Thus, there exists the sociological approach of somehow shining the spotlight on an agency or even shaming the infringing utility for its bad behavior.

Throughout history, shaming a wrongdoer has been a staple of human punishment.\textsuperscript{67} Shaming has ranged from public hangings to criminals in the stocks.\textsuperscript{68} Applied to the context of a utility, it stretches the imagination to find ways to shame a utility. Beyond ostracizing the leadership of a utility for their poor decision-making, the apparent ways to shame a utility into correct behavior are limited.\textsuperscript{69}

However, taken in conjunction with other approaches mentioned above, perhaps a form of hybrid shaming may be appropriate. Regulators may seek to shame the utility by making public: (1) the monetary fine inflicted on the utility public, (2) past attempts of reeducating and fixing the utility’s poor moral

\textsuperscript{63} Id. at 46.
\textsuperscript{64} Id. at 47.
\textsuperscript{65} Id.
\textsuperscript{66} See, e.g., id. at 35-37.
\textsuperscript{69} See, e.g., Skeel, \textit{supra} note 67.
judgment public,\textsuperscript{70} (3) and the attempts and steps taken to condition the utility to act better public.\textsuperscript{71} While traditional forms of shaming done for the sake of shaming (e.g., hanging or putting in the stocks)\textsuperscript{72} may be unsuccessful, shaming that affects the utility’s reputation by highlighting its indignation may be more successful in deterring poor behavior.\textsuperscript{73}

It may be presumed that when the utility’s continued bad behavior behavior is “aired out,” it would change.\textsuperscript{74} When the utility’s bad behavior is made public, it becomes a public image problem that the utility is more inclined to repair.\textsuperscript{75}

However, the problem with shaming utilities and their leadership is that those liable are seldom held accountable.\textsuperscript{76} Corporate leadership frequently shifts, and decisionmakers responsible for bad actions may be gone by the time the negative effects are realized as severe violations.\textsuperscript{77} Thus, shaming runs the risk of punishing the wrong actors, indeed, those who are not even the actors responsible for the violations may be punished.\textsuperscript{78} Furthermore, with corporate reshuffling, there is the possibility that those who were responsible for establishing a culture of non-compliance might be completely gone and liability may be difficult to trace to the originators.\textsuperscript{79}

Thus, if agency bad behavior is characterized as a public image problem, an alternative would be to shine the spotlight on regulated parties and presenting them to the public for accountability.\textsuperscript{80} Indeed, shaming would only aggravate and serve a certain sort of “justice” without any promise of true societal benefit.\textsuperscript{81} However, by seeking to transfer some of the regulation to public opinion, the agency may be caused to change their attitudes and policies.\textsuperscript{82}

\textsuperscript{70} Id.
\textsuperscript{71} Id.
\textsuperscript{72} See Hood, supra note 68; Hirsh, supra note 68.
\textsuperscript{73} See, e.g., Skeel, supra note 67.
\textsuperscript{74} Id.
\textsuperscript{75} Id.
\textsuperscript{76} Id.
\textsuperscript{78} See, e.g., Skeel, supra note 67.
\textsuperscript{79} Id.
\textsuperscript{80} Id.
\textsuperscript{81} Id.
\textsuperscript{82} Id.
One method is deterrence-based enforcement. Under this method, the first strategy is a performance-based approach where “[w]hat is being spotlighted is the performance of government institutions—and such an approach ties in perfectly with the mantra of accountability.”

Second, similar to the first suggestion, increasing transparency government by “promoting transparency, because it is a useful policy tool to influence [compliance] related behavior for the and because it is the ‘right thing to do’ in an open society, has strong support in recent years.” Similar to the Humean idea that there are correct moral judgments, this approach furthers the that if the regulator is unable to fully hold the regulated party accountable, and the regulated party is unwilling to hold itself accountable, then the public might hold the regulated party accountable.

This may be manifest through the agency reporting on the accomplishments of respective regulated parties. For example, a report on the industry leaders in compliance among a subset of utilities or providing statistics of fulfilled incentive goals. Furthermore, such a report may contain information about a regulated party’s statistics of self-reporting and subsequent compliance. Thus, this would provide transparency on how the utility is regulated and how they have been interacting with the respective agency. Furthermore, this would provide the public with insight into how commissions function and how they regulate utilities. Thus, when the regulator is transparent about the progress—or lack of progress through omission or deficiency in reporting—of industries, it may inspire change among similar actors in the same regulated industry.

Notably, the commission may include a policy of granting interested third parties standing to represent consumer interests in its proceedings. These intervenors, notable in energy, are

---

84 Id.
85 Id.
86 Smith, *supra* note 62.
87 Id. Forms of this might include self-reporting or demonstrated good faith efforts towards compliance. See Markell, *supra* note 83.
88 Markell, *supra* note 83.
usually fully staffed organizations comprised of specialists in the field such as attorneys and experts capable of representing consumer interests.\textsuperscript{91}

However, this is not to presume that the intervenors alone would be sufficient. Although these groups are organized, they fit within a very specific category and are not systematically available and participatory in every realm that a public utility commission regulates.\textsuperscript{92} Furthermore, these groups are not always always focused on compliance, but generally only on certain policy goals like the bottom-line and the effect of ratepayers.\textsuperscript{93} Thus, their advocacy may include a specific bias to specific types of administrative proceedings, with a specific intent for specific outcomes.

Lastly, Professor Markell suggests using the internet as a vehicle for disseminating information.\textsuperscript{94} The internet “continue[s] to to refine and enhance its . . . for public disclosure and dialogue in the future.”\textsuperscript{95} Since Professor Markell published his article in 2000, the internet capabilities have expanded.\textsuperscript{96} The turn of the second millennium was the time of dial-up, where a landline phone connection was needed to connect to the internet.\textsuperscript{97} Now, a mobile phone is the medium for accessing the internet.\textsuperscript{98} Certainly, since 2000 the internet has become a powerful and influential vehicle for influencing public interest and disseminating information.\textsuperscript{99}


\textsuperscript{91} Intervenor Compensation Program, supra note 89.

\textsuperscript{92} See, e.g., Understanding Third Party Ownership Financing, supra note 90.


\textsuperscript{94} Markell, supra note 83, at 101.

\textsuperscript{95} Id.

\textsuperscript{96} See, e.g., Grichawat Lowatcharin & Charles E. Menifield, Determinants of Internet-enabled Transparency at the Local Level: A Study of Midwestern County Web Sites, 47 ST. & LOCAL GOV. REV., 102, 102-15 (2015).


\textsuperscript{98} See, e.g., id.

\textsuperscript{99} See Lowatcharin & Menifield, supra note 96.
Thus, applied here, the internet provides a powerful and untapped resource for regulating industries. Many public utility commission websites publish proceedings, including pending decisions, recent filings, and an archive of past decisions agency rules. Furthermore, there are online forms that provide a practitioner or complainant with access to administrative remedies; these electronic filing systems allow potential complainants to file complaints and initiate proceedings against violating utilities. This plethora of access provides greater access to the public to monitor and report violations. The internet provides parties from across state jurisdiction to participate in hearings and to have their voices and comments heard at agency meetings. The internet allows interested parties to live stream agency meetings and other hearings that are open to the public. Thus, compared to the internet two decades ago, there are more resources available for greater transparency.

However, public utility commission websites are not without shortcomings. Many websites are difficult to navigate, with redundant links and pages that are out of date. Although a may find the required information to successfully launch against a utility, the difficulty is finding and navigating the reach the relevant information to ensure a successful complaint. Furthermore, litigant access may be hindered because of confusion about proper administrative procedures. Whether a litigant has standing to file a complaint or whether they know the type of proceeding are to search for. These hindrances likely affect the public’s ability to keep these industries accountable.

102 Id.
103 See, e.g., id.
104 Id.
108 See, e.g., Filing a Complaint, supra note 101.
Thus, the problem is not a lack of resources and opportunity, but an excess of them.\footnote{But see Guide to Handling Complaints about Your Regulated Utility Service, N.Y. DEP’T OF PUB. SERV., https://www3.dps.ny.gov/W/PSCWeb.nsf/ArticlesByTitle/E14FA4E4025783248525782C006979E8?OpenDocument (last accessed Apr. 13, 2020).} Perhaps the next step in increasing the public’s ability to help regulate utilities is to present and reform commission websites and other data accessible on the internet.

D. Incentive Reporting: Morality Based on Economic Efficiency

Instead of relying on utilities to altruistically act well based on their moral judgment, an alternative may be to “provide positive incentives for the regulated community to examine what it’s doing, doing, see if there are problems, and correct them.”\footnote{Markell, supra note 83, at 15.} This policy first implemented by the Environmental Protection Agency (EPA), allows regulated parties to self-report any violations.\footnote{Id. at 16.} By self-reporting any violation, the potential fine for that violation would be reduced based on the agency’s discretion.\footnote{Id.} Similarly, a commission may attempt to adopt a similar methodology for self-reporting where regulated industries could directly report its own violation to the commission to enjoy a reduction on potential fines for those violations.

This self-reporting serves two benefits. First, this alleviates some of the burden on the agency to review every detail of the industry’s compliance status—something that is infeasible due to the administrative limits of a commission and the vastness of data to review.\footnote{Id. at 104.} Second, this would hopefully create a culture of self-regulation among utilities.

While the EPA program only provides a reduction of fines for self-reporting,\footnote{Id. at 16.} self-reporting among regulated utilities would affect the utility’s record in the case of severe issues of non-compliance.\footnote{See, e.g., Compliance Record Review Document, KY. DEP’T OF EDUC., 3-4 (June 2018), https://education.ky.gov/specialed/excep/forms/Documents/Compliance_Record_Review_Document_2018.pdf.} Such a policy would not require a complete elimination of fines, rather it would complement fines by providing an opportunity for regulated parties to take steps as insurance against more severe fines.
in the future. Indeed, such a system carries risks that parties will attempt to “game” the system by building enough credit to avert catastrophic fines during extraordinary events. Such a risk may arguably outweigh the significant benefit of better compliance and reporting.

However, this reporting system may still fail if the incentives insufficiently encourage self-reporting. Where the benefits from reporting do not outweigh the sanctions from the bad action, there no reason for a utility to expend resources to self-report and existing violations. Furthermore, it may be significantly disadvantageous for the bad actor to self-report when the for the issue are worse than any benefit derived from reporting a problem; had they rolled the dice and let it remain undetected, may have been better off still.

With this framework, one is in a position to assess and analyze what a commission can seek to do to encourage utilities to act rightly. What can be done to resolve the discord in akatic behavior of the utilities to encourage the utility to act according to what they have deliberated and concluded to be the morally right action. In a sense, how can the regulator promote virtuous behavior by the regulated industry?

What immediately seems best is an incentive program. Similar to an incentive system, it seems that one of the best ways to encourage good behavior is to make that behavior more desirable. Indeed, there is a framework for creating incentives for self-reporting, for creating benefits for those who self-report, and stricter penalties for those who do not catch errors. While this approach might seem attractive, it is probably not the best approach.

There is the initial problem of administrating such a program. There are numerous concerns of line drawing, of placing a benefit possibly in the form of reduced penalty for any given standard for

---

117 See, e.g., id.
118 Skeel, supra note 67.
119 See supra Part II.A.
120 Markell, supra note 83.
121 See infra Part IV.
reporting.\textsuperscript{123} In this way, any benefit ascribed to a certain reported violation would create a currency of discounts for bad action and the reporting of that action.\textsuperscript{124} A discount system, while laced with good intentions, is at risk of being gamed by regulated industries.\textsuperscript{125} They may choose to report only certain infractions to curry favor, while even generating fabricated situations to gain a specific benefit.\textsuperscript{126} In this way, infraction and reporting would be factored and integrated into a corporate structure of what the regulated industry does and how business is performed.

A more immediate concern also arises when the incentive system fails to actually encourage good behavior.\textsuperscript{127} Indeed, while it may be well-intentioned to attempt an innovative, alternative framework for encouraging good behavior, it would be foolish and inefficient to move directly into a new regulation when it would clearly not work. Thus, it would be pointless to even attempt to integrate an unproven incentive system if the benefits are clearly not beneficial or enticing enough to dissuade a regulated industry’s bad behavior.

Furthermore, an incentives system may be likened to some kind of rewards system. Rewards are generally helpful to encourage certain behavior.\textsuperscript{128} In a way this is the carrot and stick problem, where sometime holding a carrot (encouragement) is more helpful to getting the benefit.\textsuperscript{129} However, that is not the case here.\textsuperscript{130} It seems superfluous for the regulator to create its own rewards system on top of the existing corporate, capitalistic rewards system where the regulated industry exists.\textsuperscript{131} It would further seem superfluous for creating a rewards system for obeying the law.\textsuperscript{132}

\textsuperscript{123} See, e.g., NATIONAL BUREAU OF ECONOMIC RESEARCH, supra note 122, at 306-09.
\textsuperscript{124} See supra Part II.A.
\textsuperscript{125} See, e.g., Designed to Fail: Why Regulatory Agencies Don’t Work, supra note 116.
\textsuperscript{126} See, e.g., id.
\textsuperscript{127} Markell, supra note 83.
\textsuperscript{128} See, e.g., Robert Bruce, Regulation: Carrot or Stick?, FIN. TIMES, https://www.ft.com/content/3dae4b96-77eb-11dc-8e4c-0000779fd2ac (last visited Feb. 4, 2020).
\textsuperscript{129} Id.
In another sense, a rewards system for obeying the law would be like giving every automobile driver a dollar every time they drove without exceeding the speed limit. While at the same time, creating an incentive system for drivers to report bad driving and speeding fails to make reasonable sense in any subjective calculus. Beyond the surface problem that rewarding behavior that an actor is already obliged to perform, there is a problem of cost and funding. It seems unreasonable to affect certain treatment to others while withholding it from others. There are questions like who would be more deserving? How will resources be divided or shared? Thus, an approach based purely on incentivizing good behavior likely seems doomed to fail.

IV. INCENTIVE REGULATION APPLIED

A. California Public Utility Commission History

The CPUC was originally established as the Railroad to regulate the powerful and influential railroad industries California. Uniquely, the CPUC established its San Francisco headquarters far away from Sacramento.

As diverse utility-related industries have grown in California, Commission has regulated more utility providers. Due to its large size and significant gas and oil deposits, several energy giants developed in California. Notable energy giants in California are Pacific Gas and Electric, Southern California

---

133 See, e.g., NATIONAL BUREAU OF ECONOMIC RESEARCH, supra note 122, at 306-07.
134 MAX THELEN, PUBLIC UTILITIES ACT OF CALIFORNIA (Eugene R. Hallett ed., 1st ed. 1912); see also CPUC History & Organizational Structure, supra note 17.
135 See CPUC History & Organizational Structure, supra note 17.
136 CPUC History & Organizational Structure, CAL. PUB. UTIL. COMM’N, https://www.cpuc.ca.gov/history/ (last visited Feb. 4, 2020); see also Utilities and Industries, supra note 3.
139 PETER ASMUS, INTRODUCTION TO ENERGY IN CALIFORNIA (CALIFORNIA NATURAL HISTORY GUIDES) (University of California Press, 1st ed. 2009).
140 Company profile, supra note 137.
Edison,¹⁴¹ and San Diego Gas and Electric.¹⁴² As telephone technology arose in the first half of the century, the Commission began regulating the many regional telephone networks across the state.¹⁴³ Recently, ride-hailing services and automated vehicles have also become part of the Commission’s purview.¹⁴⁴ As new technologies develop and present new challenges to the Commission’s regulation of disparate industries, it may be time to consider new rules for regulation of each of these industries.

B. Statutory Authority for Penalties and Fines

To reel in the powerful railroad industries, the California Constitution established the Commission as a constitutional agency.¹⁴⁵ Section two of the California Constitution broadly states that “[s]ubject to statute and due process, the commission may may establish its own procedures. Any commissioner as designated designated by the commission may hold a hearing or investigation or or issue an order subject to commission approval.”¹⁴⁶

The California constitution has provided the Commission with broad authority and power to regulate investor-owned utilities.¹⁴⁷ In In addition to regulating investor-owned utilities, the Commission has has used its administrative authority to establish its own rules and procedures and to further define its authority.¹⁴⁸

Relevant to this article, the legislature has limited the Commission's authority to issue monetary penalties in the Public Utilities Code (PUC) §§ 701, 734, 2102, 2107, and 2108.¹⁴⁹

Perhaps the broadest among these statutes is PUC § 701, which which grants the Commission the power to establish any orders that are “necessary and convenient” for the regulation of investor-owned utilities.¹⁵⁰ The Commission has broadly interpreted this section to provide statutory authority to issue fines or injunctions.¹⁵¹ Elsewhere, the Commission has interpreted this section to give it more extreme

¹⁴³ Otieno, supra note 137.
¹⁴⁴ Id.
¹⁴⁵ THELEN, supra note 134, at 17-20.
¹⁴⁶ CAL. CONST. art. XII, § 2.
¹⁴⁷ THELEN, supra note 134.
¹⁴⁸ Id.
¹⁴⁹ CAL. PUB. UTIL. CODE §§ 701, 734, 2102, 2107 (1951).
¹⁵⁰ CAL. PUB. UTIL. CODE § 701 (1951).
remedies, including divestiture. Where the legislature is silent, the constitution grants the Commission the power to regulate a utility in any justifiable way. Thus, when finding alternative ways to regulate and broaden the scope of the Commission’s regulation, PUC § 701 will probably provide statutory grounds.

Under PUC §§ 2107 and 2108, the Commission has statutory authority to calculate fines. Recently, the statutory maximum increased in PUC § 2107 from $50,000 to $100,000. Despite legislature altering PUC § 2107, it remains unclear whether the $100,000 fine is a maximum or a benchmark for Commission sanctions. Until the Commission fines a violator more than $100,000, the meaning of the new amount will stay unknown.

1. Commission Distinction Between a Reparation and Fine

Before discussing any penalty by the Commission, it is helpful to distinguish a reparation from a fine. The primary agency for issuing penalties is Decision (D.) 98-12-075. The decision developed from Rulemaking (R.) 97-12-088 and resulted from comments gathered from interested parties across the state.

In the final decision, the Commission specifically interpreted § 734 to mean that “[t]he purpose [of a reparation] is to return funds to the victim which were unlawfully collected by the public utility. Accordingly, the statute requires that all reparation amounts are paid to the victims.”

---

155 As the statutory maximum has been shifted for the first time since 2011, it remains uncertain whether this amount when compounded and applied to multiple utility violations of compliance will have a significant effect in deterring bad behavior.
159 D. 98-12-075, at *53.
By this interpretation, reparation acts solely to repay victims based on a calculated monetary assessment of the damages.\textsuperscript{160} The purpose of reparation is not to deter any bad action, nor is it deliberately meant to encourage the utility to correct its behavior.\textsuperscript{161} Reparation serves more like restitution, with deterrence deterrence or a sense of punishment incidental to the monetary amount.\textsuperscript{162}

Thus, monetary reparations alone fail to account for non-monetary harm committed by the utility. While the utility may pay reparation to the injured party, this amount may not make any holistic or systemic change to the utility’s behavior.

In D. 98-12-075, the Commission stated that “[t]he purpose of a fine is to go beyond [reparations] to the victim and to effectively deter further violations by this perpetrator or others.”\textsuperscript{163} Where “[e]ffective deterrence creates an incentive for public utilities to avoid avoid violations. Deterrence is particularly important against violations which could result in public harm, and particularly against against those where severe consequences could result.”\textsuperscript{164}

Thus, a fine presumably should be sufficient to encourage good good behavior. Ideally, a fine should deter future bad action because because the risk or previous fines disincentivize bad action. Thus, fines may prevent bad actors from benefiting from their bad actions actions and discourage other actors from misbehaving.\textsuperscript{165}

2. The Commission’s considerations for determining appropriate fines

In D. 98-12-075, the Commission laid out five factors for determining an appropriate fine: (1) the severity of the offense; (2) the utility’s conduct; (3) the utility’s financial resources; (4) the totality of the circumstances in furtherance of the public interest; and (5) the role of precedent.\textsuperscript{166}

These factors closely match subsequent California case law. The California Supreme Court in People v. R.J. Reynolds Tobacco Company noted four factors for determining whether a fine is grossly

\textsuperscript{160} Id.
\textsuperscript{161} Id.
\textsuperscript{163} D. 98-12-075, at *54.
\textsuperscript{164} Id.
\textsuperscript{165} See Markell, supra note 83.
\textsuperscript{166} D. 98-12-075, at *54.
disproportional to the gravity of the offense. Those factors include: (1) the defendant’s culpability; (2) the relationship between the harm and the penalty; (3) the penalties imposed in similar statutes; and (4) the defendant’s ability to pay.

a. Severity of the offense

This factor takes into consideration any economic harm, of any statutory or Commission directive, and the number of violations.

For economic harm, the Commission considers the victims’ amount of expense and the public utility’s unlawful benefits, that “the greater of these two amounts will be used in establishing fine.” The Commission also may consider violations of or compliance requirements. Although these do not harm consumers, it harms the integrity of the regulatory processes. The legislature requires all California public utilities to comply with Commission directives. As noted in D. 98-12-075, “[s]uch compliance is absolutely necessary to the proper functioning of the regulatory process. For this reason, disregarding a statutory or Commission directive, regardless of the effects on the public, will be accorded a high level of severity.”

The Commission also considers re-offenses in determining the severity. The decision noted that “[a] series of temporally distinct violations can suggest an on-going compliance deficiency which the public utility should have addressed after the first instance. Similarly, a widespread violation which affects a large number of consumers is a more severe offense than one which is limited in scope.” For a continuing violation, PUC § 2108 counts each day as a separate offense.

Thus, when the Commission imposes fines on a noncompliant utility, the fines may add up. At the beginning of 2019, Assembly Bill 901 will set the upper statutory amount for fines at $100,000.

167 People v. R.J. Reynolds Tobacco Co., 37 Cal. 4th 707 (2005) [hereinafter R.J. Reynolds]; see also United States v. Bajakajian, 524 U.S. 321, 334 (1998) (where the Court used similar factors to determine that $350,000 for failure to report taking more than $10,000 cash out of the country was an excessive fine).
169 Id. 98-12-075, at *54.
170 Id.
171 Id.
172 See, e.g., CAL. PUB. UTIL. CODE § 702 (1951).
173 D. 98-12-075, at *55-56.
174 Id. at *54.
175 D. 98-12-075, at 56.
176 CAL. PUB. UTIL. CODE § 2108 (1951).
while leaving the lower statutory amount at $500. Because the legislature revised the statutory amount for the first time since 2011, 2011, it remains uncertain whether the change will significantly deter bad behavior.

b. The conduct of the utility before, during, and after the offense

The conduct factor considers the utility’s culpability and its compliance with applicable laws, regulations, and Commission directives. The Commission considers prudent practice, which requires that all public utilities take reasonable steps to ensure compliance with Commission directives. Reasonable steps include include the utility becoming familiar with applicable laws and regulations, and most critically, regularly reviewing its operations to ensure full compliance. In evaluating the utility’s compliance efforts, the Commission considers its past compliance with Commission directives.

In D. 98-12-075, the Commission considered the utility’s actions to detect a violation. This includes diligently monitoring their activities “where utilities have for whatever reason failed to meet this standard, the Commission will continue to hold the utility responsible for its actions. Deliberate, as opposed to inadvertent wrong-doing, will be considered an aggravating factor.”

The Commission considered a public utility’s steps to promptly and cooperatively report and correct violations. When a public utility is aware of a violation, the Commission expects the public utility to promptly bring it to the attention of the Commission. The definition of “prompt” will vary based on the nature of the violation. Thus, the Commission may need to oversee each industry’s safety requirements in addition to its industry-specific regulations.

---

177 CAL. PUB. UTIL. CODE § 2107 (1951).
178 See supra note 155 and accompanying text.
179 D. 98-12-075, at *57.
180 Id.
181 Id.
182 Id.
183 Id.
184 Id.
185 Id.
186 Id.
187 D. 98-12-075, at *58.
188 This includes interpreting the internal corporate requirements in addition to monitoring and inspecting that the utility is following procedures.
c. The financial resources of the utility

The financial resources factor considers the financial resources of the utility.\(^{189}\) The Commission must adjust the utility’s ability to deter misconduct, without excessively penalizing it, based on its financial resources.\(^{190}\)

In D. 15-04-024, the Commission evaluated the market value of Pacific Gas and Electric (PG&E) when calculating an appropriate penalty amount.\(^{191}\) The Commission considered various factors, including company share price, equity, and investor expectation.\(^{192}\) The Commission also considered relevant market factors to determine whether “PG&E should be able to pay a penalty of significant magnitude without harming ratepayers or its ability to raise the capital needed for revenue-producing investments required to provide adequate and safe service.”\(^{193}\)

However, this analysis may be problematic when extreme punishment of the utility might have far-reaching consequences for consumers.\(^{194}\) A financially troubled utility may be incapable of paying the Commission’s fine, causing it to declare bankruptcy.\(^{195}\)

There must be a balance between an adequate fine that would deter a utility’s misconduct, and a fine that would force a utility to declare bankruptcy. If a fine is too small, it would equate to payment for wrongdoing, or a license for violation. Alternatively, if a fine is too excessive, it could push the utility towards bankruptcy and harm the utility’s public users who the regulator seeks to protect.

d. The totality of the circumstances in furtherance of the public interest

This factor takes into consideration facts that may mitigate or exacerbate the degree of wrongdoing.\(^{196}\) This includes setting a fine at a level that effectively deters further unlawful conduct by the regulated utility and requiring that the Commission specifically tailor the package of sanctions, including any fine, to

---

\(^{189}\) D. 98-12-075, at *50.

\(^{190}\) Id.


\(^{192}\) Id. at *62-66.

\(^{193}\) Id. at *70.


\(^{195}\) Id.

\(^{196}\) D. 98-12-075, at *59.
the unique facts of the case. The Commission reviews facts that tend to mitigate the degree of wrongdoing as well as any facts which exacerbate the wrongdoing. In all cases, the harm is evaluated from the perspective of the public interest.

In D. 15-04-024, the Commission evaluated “PG&E’s statutory obligation to provide safe and reliable gas service, the pervasive nature of PG&E’s recordkeeping shortfalls, the impact of the San Bruno explosion on its residents, and the Commission’s and the public interest in ensuring safe and reliable natural gas service.”

Thus, in assessing this factor the Commission evaluates the effect that the fine will have on ratepayers and consumers who use the public utility. Corollary to the previous factor, this requires the Commission to be mindful that any decrease in the utility’s ability to provide reliable service will ultimately be of greater detriment to the public. Furthermore, legislation, and the Commission’s rules and policies are mindful of the economic effect of fines to the ratepayers and public consumers who use the utility. There is a network of cost-recovery procedures and allowances that affect the publicly owned utility’s ability to pass fines off as costs to ratepayers as opposed to shareholders.

e. The role of precedent

This factor takes into consideration the proposed outcome with “previously issued decisions which involve the most reasonably comparable factual circumstances and explain any substantial differences in outcome.” Yet, the Commission adjudicates a wide range of cases with sanctions, many cases of first impression, so the outcomes rarely comparable.

In D. 15-04-024, the Commission struggled to find any relevant comparison to prior its decisions to determine the appropriate penalties for a gas pipeline explosion. Furthermore, the diversity of regulated industries by the Commission presents additional problems for finding adequate comparisons between pending cases.

---

197 Id.
198 Id.
199 D. 15-04-024, at *73.
200 See id.
201 See id.
202 Id.
203 See D. 19-01-022.
204 D. 98-12-075, at *42.
205 Id. at *59-60.
206 D. 15-04-024, at *77.
and prior decisions. As described above, the Commission regulates industries ranging from ride-sharing services like Lyft and Uber to electric and gas utility companies. It may be difficult to find even a slightly comparable match of precedential decisions between any two industries. While for some industries there may be a large amount of precedential cases, for others there may be no prior precedent for reference or comparison.

3. Assessing the D. 98-12-075 Framework and Potential for Development

More than a decade since the Commission voted on R. 98-01-009, the problems facing the Commission have changed. many goals were considered theoretical and infeasible at the time, now advances in technology, reporting, and resources can further ensure industry compliance. At the same time, with the widening of the socioeconomic gaps in San Francisco, where the Commission is headquartered, immense competition for hiring poses unique personnel and hiring challenges.

Incidentally, while technology increases the regulator’s ability and tools to efficiently monitor industry action, the drivers of that technology make it increasingly difficult for the Commission to find operators with the ability to effectively apply those tools. With the reintroduction of agency decentralization and Commission offices stationed in different parts of the state, the Commission is seeking ways to broaden its access to different

---

207 See supra note 3 and accompanying text.
208 See, e.g., D. 98-12-075.
211 See CPUC History & Organizational Structure, supra note 17.
industries. Beyond the geographic and socioeconomic confines an expensive metropolitan area, the Commission now has the flexibility to establish offices elsewhere. While decentralization is still in its early stages, there is potential this early expansion can facilitate greater change in how the Commission regulates and fines industries to enforce compliance.

V. CONCLUSION

With the pervasiveness of electricity and the increased impetus by states for either cheaper or cleaner energy production, the role of the public utility commission should remain prominent for the foreseeable future. While diverse states may seek to advance varying energy projects based on the original ratemaking imperatives of most public utility commissions, much of future regulations will probably concern how utilities arrive at fair rates. While at times this may include misbehavior, the respective public utility commission must be ready to react and respond to these bad actions. At the same time, because of the size and scope of regulated industries, public utility commissions must be willing to respond to good behavior. Although there may be significant challenges ahead, many of these state commissions are presented with enormous statutory authority and tools for regulation. Thus, there remains significant confidence in the hope that those in charge of regulation have the ability to regulate well. It only remains for them to wisely and aptly operate those tools.

---

214 See, e.g., Stebbins, supra note 212.
215 See, e.g., id.
216 See, e.g., id.
219 See, e.g., CAL. PUB. UTIL. CODE § 451 (2019); Fla. STAT. § 366.041(1) (2019).