COM/CXW/mnt **Mailed 12/20/04**

Decision 04-12-056 December 16, 2004

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's own motion for the purpose of considering policies and rules governing utility construction contracting processes.	Rulemaking 03-09-006 (Filed September 4, 2003)

ORDER ADOPTING RULES FOR UTILITY CONSTRUCTION CONTRACTING

1. Summary

This order adopts certain policies and practices for utility construction contracting procedures. Specifically, this order prohibits the use of "reverse auctions" in energy utility construction contract bidding procedures, a practice in which bidders compete for contracts by lowering their bids until the lowest bid is accepted. The order also requires respondent utilities to ensure the payment of prevailing wages by their construction contractors in all construction. We do not at this time address the use of "Project Labor Agreements" (PLAs) by the jurisdictional utilities.

2. Procedural Background

The Commission opened this rulemaking to investigate utility contracting processes. Rulemaking (R.) 03-09-006 included two types of contracting procedures that may be problematic. One, called "reverse auctions," solicits bids over the internet and permits bidders to continue to bid until the lowest bid is made. The other, called "bid shopping," occurs where a prime contractor solicits

subcontractor bids after bids are opened and subcontractors have been designated. Large utilities filed reports regarding their contracting procedures on December 1, 2003. Parties filed initial comments in response to rulemaking questions on December 5, 2003.

At a prehearing conference held in this proceeding and on the basis of the utilities' reports, the parties agreed that "bid shopping" does not appear to be a practice among large California jurisdictional utilities. Some utilities do use reverse auctions for construction contracts. The scoping memo, issued December 29, 2003, affirms that no utility appears to use "bid shopping" procedures but that some use "reverse auctions" over the internet.

The International Brotherhood of Electrical Workers Local 1245, California State Pipe Trades Council, Northern California Mechanical Contractors Association, and the California Plumbing and Mechanical Contractors Association (together, "Labor-Management Parties", or LMPs) jointly filed comments in this proceeding recommending that the Commission adopt a rule limiting the practice of reverse auctions. The LMPs submitted testimony addressing the alleged harms caused by of reverse auctions. SBC California (SBC), Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), Wild Goose Storage, Inc. (Wild Goose), and Lodi Gas Storage (Lodi) submitted testimony or declarations in response to LMP's testimony.

R.03-06-009 made all jurisdictional utilities respondents to this proceeding. Several parties to this proceeding filed motions to be excused as respondents to the rulemaking. The Commission subsequently issued D. 04-04-038, which excused as respondents to this proceeding all water utilities designated as Class B, C, or D and all utilities except independent storage providers with annual California revenues less than $500 million.

On October 5, 2004, another group representing unionized labor, the Southern California District Council of Laborers (SCDCL), filed a proposal that would require jurisdictional utilities to incorporate in their construction contracting procedures the use of Project Labor Agreements (PLAs) and/or the payment of prevailing wages. According to SCDCL, PLAs would establish uniform terms and conditions of employment for employees of contractors that bid on and obtain construction work from the utilities. In addition or in the alternative SCDCL proposes to require utilities to make prevailing wages a condition of a contract for construction work.

Several utilities filed reply comments to the SCDCL's proposals, all of them in opposition. Reply comments generally allege that the proposals are untimely, outside the scope of the proceeding, poor public policy and possibly contrary to state and federal labor laws. Some of the parties' reply comments also complained that the parties had only a limited time to address SCDCL's proposals. Following notice by the Assigned ALJ, numerous parties filed supplemental reply comments on SCDCL's October 5 proposals.

Comments to the draft alternate decision were filed on December 10th. Reply comments were filed on December 14th. The Commission modified its order to clarify its reasoning in response to comments.

3. Scope of Rulemaking

R.03-09-006, which initiated this proceeding, stated the Commission's broad interest in this rulemaking. The Commission stated its interest in "understanding of the construction contracting processes of the electric, natural gas, telecommunication and water utilities – the criteria by which utilities' contract awards are based, the overall magnitude of the utilities' annual construction contracts granted, the processes used by utilities to solicit and award construction contracts, and their policies regarding the execution of

primary contracts and subcontractor agreements." The Commission also stated it would consider whether to adopt rules "to ensure that utility construction contracting practices are consistent with rules governing state and federal public works contracting practices."

The Commission currently does not impose specific requirements on jurisdictional utilities regarding their solicitation and awarding of bids for construction of utility facilities. However, state law imposes certain requirements on state entities bidding out public works projects, as well as on the prime and subcontractor bidders of such projects. The purpose of these requirements is to avoid the practice known as "bid shopping" or "bid peddling", which occurs when prime contractors ask, require or otherwise influence subcontractors to lower bids for subcontract work after the low bidder becomes known or the prime contract is awarded. In such situations, the government entity is, essentially, not getting what it paid for. To prevent such actions, California Public Contract Code Section 4100 requires that prime contractors provide detailed information to the public contracting entity, subject to a specific threshold subcontracting amount, about "any subcontractor who will perform work or labor or render service to the prime contractor" in connection with a public improvement project. It also prohibits successful prime contractors from substituting a person as a subcontractor in place of the subcontractor listed in the original bid, with certain exceptions. The Legislature noted in adopting these requirements that

> "…the practices of bid shopping and bid peddling in connection with the construction, alteration, and repair of public improvements often results in poor quality of material and workmanship to the detriment of the public, deprive the public of the full benefits of fair competition among prime contractors and subcontractors, and lead to insolvencies, loss of wages to employees, and other evils." (California Public Contract Code Section 4101.)

R.03-09-006 also stated a concern with bidding processes known as "reverse auctions". Reverse auctions permit buying goods and services over the internet by contractors who submit continuing anonymous bids against one another in real time in an effort to win the contract by bidding the lowest price.

R.03-09-006, which initiated this proceeding, stated a concern that "bid shopping and reverse auction processes may create a disparity between a project's costs and its value if costs are cut below the cost to the contractor during the bidding process, or if the primary contractor reduces project materials, labor or quality after a contract is awarded. In such situations, bid shopping can result in increased change orders, higher maintenance costs, and lower overall value to the project beneficiary. On the other hand, a reverse auction process also may provide certain benefits in the form of driving down prices for certain types of commercial commodities, and providing owners or contracting entities with an innovative means of soliciting bids." The impacts of reverse auctions and bid shopping by a utility may be to keep costs low and thereby benefit the utility's ratepayers. R.03-09-006 stated our concern, however that the impacts on "worker safety, product safety, product quality and timeliness of project completion all must be considered as well."

We therefore initiated this rulemaking to better understand bid shopping practices and gather information about our jurisdictional utilities' construction contracting practices. We directed jurisdictional utilities to provide certain information with the objective of determining whether to adopt new rules to ensure utility construction contracting processes to provide the best outcome for California's utility customers. Specifically, we directed each utility respondent to file a report that answered the following questions.

1. What are the utility's construction contracting practices currently? Identify the processes used to solicit, consider and award construction contracts.

2. Do the utility's construction contracting practices include any form of bid shopping as described above? If so, please articulate the methods used.

3. Identify all construction contract awards by project and contract award amount for the last five years.

4. Explain the criteria by which the utility's contract awards are based.

5. Should the potential rules considered in this rulemaking apply to utilities that meet a certain threshold, such as utility size, or construction budget? If so, how should that threshold be defined, and at what level?

On the basis of these reports, the parties' comments and the testimony or declarations of several parties, we address each issue below[1].

As a threshold matter, we consider the argument of the utilities that SCDCL's proposals to adopt rules requiring PLAs and/or prevailing wages are outside the scope of the proceeding and untimely. We find the utilities' arguments unpersuasive for several reasons. First, the scope of this proceeding, as stated in R.03-09-006 is to "ensure that utility construction contracting practices are consistent with rules governing state and federal public works contracting practices." PLAs and prevailing wages are among those "state and federal public works contracting practices" that apply to construction projects. No party suggests otherwise. While the scoping memo in this proceeding

[1] The testimony submitted in this proceeding, and the responses to it, have not been the subject of hearings. In this case, however, the ALJ correctly determined that hearings were not necessary because the controversies in this proceeding mainly concern matters of policy and law rather than fact.

referred specifically to "reverse auctions" and "bid shopping," it did not exclude from the scope of the proceeding any other practices that might promote contracting safety and efficiency or counsel the adoption of state and federal contracting practices for public works projects. Indeed, the scoping memo issued in this proceeding affirms the scope of the proceeding as including the issues identified in R.03-09-006 and provides that the assigned Commissioner may "modify the scope of issues following receipt and evaluation of additional information and testimony."

Numerous utility parties in their comments raise the threshold question of whether the Commission has the authority to consider adopting new rules relating to utility contracting procedures. This Commission is endowed with broad authority under Public Utilities Code sec. 701 to "supervise and regulate every public utility in the State" which includes the authority to regulate utility contracting that can affect utility costs and rates. The Commission stands in a unique position because the California Constitution, Art. XII, sec. 3, subjects utilities to the plenary control of the Legislature which is directed to exercise its its control over utilities through the Commission. The Legislature in Public Utilities Code sec. 451 has specifically charged this Commission with ensuring the well-being, not only of ratepayers, but also of utility employees. Thus, this Commission's mandate is to ensure that every "public utility shall furnish and maintain such adequate, efficient, just and reasonable service, instrumentalities, equipment, and facilities as are necessary to promote the safety, health, comfort, and convenience of its patrons, *employees and the public*". (emphasis added). Thus, this Commission has broad authority as provided by the Legislature to enact these rules.

The parties in this proceeding filed opening comments in December 2003 and testimony thereafter in February 2004. In October 2004, SCDCL filed its

proposal for the Commission to require PLAs and prevailing wages. The parties had two opportunities following that filing to respond to it, and many parties took advantage of the opportunity. The case-based evidence in this proceeding involves the submission of data and arguments regarding the potential effect of PLAs and prevailing wages on utility costs and services, or project completion and integrity. The evidence presented includes those studies submitted by SCDCL concerning the impacts of PLAs and prevailing wages in public works projects and for private projects where the use of PLAs was voluntary. No party has questioned the relevance of those studies or their veracity as a foundation for policy-making.

We do not agree with the utilities that SCDCL's comments are untimely. Those comments were served with the permission of the ALJ, who has discretion to accept any pleadings as long as doing so does not compromise the rights of other parties or otherwise prejudice the proceeding. Neither circumstance is present here. The Commission has discretion to manage its proceedings as it sees fit and we concur with the ALJ that acceptance of the SCDCL comments was appropriate in this case.

For all of the foregoing reasons, we find that the scope of this proceeding does not preclude us from considering whether to adopt rules governing PLAs and prevailing wages. No party disputes that reverse auctions and bid shopping are within the scope of this proceeding.

4. Procedural Issues

The utility parties in their comments raise numerous procedural issues with regard to due process and statutory compliance. Some utilities argue that the Commission has identified no problem that requires new policy or rules. PG&E is correct that we did not adduce evidence in the traditional format, that is, with testimony, hearings and briefs. We did, however, hear from dozens of

parties, some of whom presented studies, reports and written expert opinion. The law requires the Commission to provide notice and an opportunity to be heard before it resolves a matter of controversy or changes existing regulation or policy. We accomplished that here and we find that there is enough evidence to suggest that more explicit oversight of utility contracting procedures may produce benefits for utility ratepayers, utility employees and the public generally. The Commission does not need to identify immediate problems before adopting rules and regulations designed to forestall a problem or make improvements to existing circumstances. We wonder whether the utilities would apply the standard they propose in this proceeding to the proposals they bring before us and thereby require them to present evidence of a factual problem before we change policies or rules on their behalf.

We have changed our regulation many times without evidence of a specific problem at the request of the utilities and to their benefit. For example, we instituted performance-based ratemaking for energy utilities and the New Regulatory Framework for telephone utilities under the theory that these new policies would improve utility productivity and service. We recently changed utility reserve margins without hearings and have adopted hundreds of settlements signed by the utilities without explicit findings of an identifiable problem. Several years ago, we adopted maintenance standards for electric utility distribution systems on the basis that such standards would mitigate the safety risks and promote system reliability, and we did so without specific evidence of a problem. In all of these cases and others, we implicitly or explicitly found that a change in policy or rules – and in some cases rates -- would improve circumstances for utilities and their customers.

Moreover, this Commission has established new rules or requirements in numerous proceedings without including those changes in the initial rulemaking

or scoping memo, but incorporating those changes along the way pursuant to an ALJ or Assigned Commissioner Ruling as was accomplished here. In some cases the Commission establishes new requirements without even reopening the evidentiary record, as was provided for in this proceeding. To take only one example, R.04-04-003 was initiated to consider six specific issues: 1) review and adoption of long-term procurement plans for the three utilities; 2) resource adequacy issues not otherwise addressed in workshops; 3) treatment of confidential information; 4) the development of procurement incentives for each utility; 5) development of a long-term policy for expiring QF contracts; and 6) review of the management audits of SDG&E's and PG&E's electric procurement transactions with affiliates. The Proposed Decision on the Commission's 12/16/04 agenda addressing issue #1, the utilities' long-term procurement plans, makes major policy changes covering at least two issues not identified in the original rulemaking or scoping memo in R.04-04-003: affiliate rules and greenhouse gas costs. In neither case was the scope of the rulemaking changed from the original June 4, 2004 scoping memo, although in the case of the greenhouse gas cost adder, the assigned commissioner solicited answers from IOUs to several greenhouse-related questions. In that case, as here, parties had full ability to comment on that ruling.

Some utilities also argue that the reopening of the record provided them with too short a period to provide meaningful comment. SDG&E cites *California Trucking Assoc. v. PUC, (*1977*) 19* Cal.3d 240, concerning the opportunity to be heard. However, that case dealt with a rescission and amendment of a previously promulgated order and the notice and opportunity to be heard necessary under Public Utilities Code sec. 1708, which the Court ruled required a hearing. Here this rulemaking is a quasi-legislative proceeding pursuant to sec. 1701.4. In a quasi-legislative proceeding, the Commission can determine that a

hearing is not necessary. The ALJ did allow other parties an opportunity to comment and submit new record evidence once SCDCL provided additional evidence, an opportunity not always afforded parties in Commission proceedings. All parties have had a full opportunity to comment on the Draft Decision and the Alternate Decision, as provided in Commission rules. Additionally, many utility parties argue that this rulemaking does not comport with Public Utilities Code sec. 321.1. The utilities' argument is misplaced. Section 321.1 does not require an economic *analysis* of the proposed impact of the rule. Rather, Section 321.1 requires only an assessment of the economic effects or consequences, not an analysis that would require additional staff resources and new Commission structures and procedures. Indeed, the Legislature specifically directed the Commission to conduct such an assessment "using existing resources and within existing Commission structures." This statute does not require any particular analysis, evidentiary hearing or other process.

Here the record in this case is sufficient to provide the basis for an assessment. Our findings regarding reverse auction bidding and the payment of prevailing wages constitutes an economic assessment sufficient to satisfy sec. 321.1 as we are using existing Commission structures and resources. The discussion in this decision regarding the merits of prevailing wages and their ultimate benefits to ratepayers and the problems raised by reverse auction bidding itself constitutes the assessment contemplated by the statute. Moreover, since the enactment of sec. 321.1, the Commission has acted many times pursuant to its existing structures and resources and has not specifically identified a separate economic analysis. The Commission routinely conducts the kind of assessment that is contained in this decision. To be crystal clear, we clarify in our findings that the requirement of paying prevailing wages is in the public interest and is consistent with Public Utilities Code Section 451.

The telecommunications utilities argue that imposing prevailing wage requirements and prohibitions on reverse auction bidding impermissibly interfere with New Regulatory Framework requirements. Although we are clearly within our authority to set these rules for all jurisdictional utilities, we will further consider the application of these rules to the telecommunications utilities in Phase II of this proceeding. Thus, we need not reach the utilities' arguments regarding potential recovery under the limited exogenous factor established in D.98-10-026.

Finally, some utility parties raise Public Utilities Code Section 8281 in asserting that any requirement of prevailing wages will run afoul of its provisions. The utilities provide no support for their assertions. Section 8281 is a declaration of policy which does not conflict with the rules developed here. The rules promulgated in this decision are race and gender neutral and comport fully with Section 8281. The utilities provide no basis or cognizable argument how these rules conflict and thus we do not accept their suppositions.

5. Reverse Auctions

"Reverse auction bidding" or "reverse auctions" is the practice of using the Internet to solicit bids from contractors for a specific project or service. Bids are normally posted anonymously so other potential bidders may view them before making a bid. The entity soliciting the bids accepts the lowest bid made over a specified period of time.

Many utilities and the LMP filed comments on reverse auction bidding. Each utility opposes any rules regulating reverse auctions. The LMP support it. The LMP submitted testimony in support of regulation of reverse auctions, to which several utilities responded. SDG&E, SoCalGas, and PG&E state that they occasionally use reverse auctions. SBC reported developing a pilot program to implement reverse auctions. No other party reported using the practice of

reverse auctions although some suggested they may use the procedure in the future.

The LMP oppose the use of reverse auctions by California utilities. They argue that reverse auctions actually increase costs rather than reducing them, largely because bidders start high and only reduce their bids in response to a lower one. In contrast, bidders start with their lowest bid in a more traditional sealed bidding process. The LMP also believe reverse auctions promote adversarial relationship among participants because of the pressure to bid low, sometimes without any cushion for profit or contingencies.

The LMP believe that reverse auctions compromise quality workmanship because of the emphasis on price and because reverse auctions do not typically pre-qualify bidders to screen out poor-quality contractors. The process also puts pressure on bidders to make hurried bids and cut corners by using cheaper materials that may be of an inferior quality. Finally, LMP believe that reverse auctions compromise safety as bidders cut costs by reducing project supervision or the amount of labor to finish a project. LMP's pleading includes copies of several studies and articles that Unions believe affirm their concerns.

Most utilities that filed comments argued that the Commission has before it no evidence that utility practices have or would compromise consumer interests, safety or other public concerns. Some state that existing laws and regulations directly and adequately address safety, service quality and system reliability. Most assert that the Commission has before it no evidence to suggest that reverse auctions have created any problems in California.

SCE states that its contracting procedures have resulted in construction work that meets its expectations or exceeds them. SCE states that it pursues its legal remedies in the instances where problems arise. SCE believes adopting more elaborate contracting procedures would add time and expense to its

construction projects without offsetting benefits. SDG&E/SoCalGas state that their reverse auction procedures accommodate rapidly changing market conditions. PG&E observes that the studies to which the LMP refer in making their case suggest that reverse auctions have saved consumers substantial sums.

Cox adds that government contracting rules are in place to assure the public gets good value from a government contract. In contrast, public utilities have an incentive that government does not automatically have to conduct low cost operational practices and provide reliable service.

SBC and Verizon argue that they are subject to the principles of the New Regulatory Framework (NRF), which provides incentives for each to conduct its business in the most cost-effective manner. They believe that reverse auctions are neither unlawful nor unethical but that to require them would compromise NRF principles and increase utility costs. SBC and PG&E suggest that bid shopping may be conducted with a variety of safeguards to promote safety and high quality work.

Wild Goose and Lodi Storage comment that while the Commission may feel compelled to regulate the construction contracting procedures of companies offering monopoly services, the Commission need not concern itself with regulating companies that do not enjoy the benefits of government-sanctioned monopoly power. Sprint similarly argues that competitive companies pursue high quality projects at the least cost because they assume the risk for their operations.

San Gabriel Valley Water Company observes that Commission-regulated water companies are small and have contracting procedures tailored to their individual needs and should not be subject to regulations of large utilities with expansive territories.

Discussion

In considering whether to adopt a rule prohibiting the use of reverse auctions, we are aware of the claims that doing so would establish a form of micromanaging utility operations, that the use of the Internet for real-time auctions may promote more competitive bidding processes, and that such prohibitions may lead to costlier utility projects. These arguments are not trivial; we do not wish to micromanage utility operations, we support more competitive utility operations and we endeavor to support lower project costs to keep utility rates low. We agree with the utilities that both reverse auctions and sealed bids may be conducted in ways that promote bidding by qualified bidders and a diverse population of bidders. We are therefore not concerned at this time that one or the other practice is more likely to reduce the number of responsive bids received or compromise project quality.

On the other hand, we are convinced that reverse auctions may not satisfy the utilities' and our own objectives to keep costs down while promoting quality, safety and fair construction practices. On the issue of costs, reverse auctions may not consistently result in lower prices than sealed bids. Reverse auctions permit bidders to start the bidding high in order to maximize the opportunity for profits. They need only reduce their bids in response to the bids of others. The potential for a utility accepting an artificially high bid in a reverse auction would be especially pronounced where a market for labor, services or supplies is not highly competitive. The prospect of such a circumstance would be higher for construction projects than, for example, in a solicitation for building maintenance. We would also expect limited price competition where a construction project has very specialized elements, for example, using new techniques or technologies. Sealed bid procedures, in contrast, provide bidders a single opportunity to present their best estimate of a project's costs and are

therefore less likely to lead to the type of gaming that is possible with reverse auctions. Because bidders do not know the estimates of other bidders, they are more likely to provide their own best estimates of actual costs plus a reasonable profit.

Reverse auctions may also motivate bidders to oversimplify the elements of a complex project and to emphasize price at the expense of other project criteria, such as long term integrity, safety or quality. Construction projects typically have many complex elements, and contracts for their construction cannot be judged on the basis of price alone.

For all of these reasons, we herein prohibit the use of reverse auctions for utility construction contracts. This prohibition shall apply only to those utilities that are respondents to this proceeding. We also direct each respondent utility to submit a report on July 1, 2006 describing how this prohibition has affected their construction contracting procedures, costs and population of bidders. If any party proposes to change the rule after the receipt of these reports, it should file a petition to modify this order. The Commission may reconsider the rule at that time.

5. Bid Shopping

"Bid shopping" or "contractor swapping" commonly refers to the practice of changing subcontractors after an overlying contract is won and signed, in this case between a utility and a prime contractor. The practice permits the prime contractor to make extraordinary profits by offering the substitute subcontractor less than the contract commits to the original subcontractor. However the question is not only whether utilities shop for bids, but also whether their bidders do so after bid opening. Such bidder practices allow the bidder to lower their own cost - and to motivate their subcontractors to cut corners – without passing the savings on to the utilities or to the utility ratepayers.

In response to the Commission's directive for each utility to describe construction contracting procedures, no utility reported using bid shopping. No party proposes a rule to address bid shopping at this time. We therefore do not adopt one.

Because no utility appears to use this procedure and no party proposes we address it, we decline to state any policy or rule on bid shopping at this time. We may reconsider this practice at a later date if circumstances change.

6. Prevailing Wages

SCDCL proposes that the Commission require jurisdictional utilities to include in construction contracts a requirement that project employees be paid at prevailing wage rates. SCDCL does not define "prevailing wage" but materials accompanying its pleading show that the prevailing wage is generally that level of pay that would be paid on public works projects subject to Labor Code sections 1720-1815. Currently, California Labor Code Section §1771 requires that contractors pay prevailing wages to employees working on public works projects. In most instances, prevailing wage determinations reflect collectively bargained wage rates.

SBC, SCE, SDG&E/SoCalGas and PG&E object to the proposal, arguing that it is untimely and outside the scope of the proceeding. Verizon makes similar comments and opposes the adoption of a prevailing wage requirement using some of the same legal argument it offers to oppose the use of PLAs, namely, that the NLRA does not permit the state to influence or dictate the substantive terms and conditions of employment. Verizon argues that even the requirement that prevailing wages be paid to employees assigned to public works projects is the subject of a statute, providing an explicit authority the Commission does not have with regard to the provisions of the Labor Code. The wireless carriers object to the proposals. The parties in their comments on the

Alternate Decision raise these same arguments and cite additional legal authority to support these arguments.

Discussion

In this decision, we consider imposing new contracting rules on the respondent energy utilities, with the exception of Lodi and Wild Goose. In a later phase, we will consider the implications of these policies as they related to all other respondent utilities, some of whom claim that special circumstances apply to their companies. We note that in D.04-04-038, the list of respondent utilities was reduced to eliminate, among others, all of the smaller regulated energy utilities. This order does not apply to them.

It is long established that this Commission has broad authority to oversee California jurisdictional utilities. This authority extends to our duty to prevent utilities from passing on unreasonable costs for materials and services to ratepayers. *General Telephone Co. v. PUC* (1983) 34 Cal.3d 817, 824. Our regulatory authority extends to the manner in which the utility provides services to the ratepayers. *Id.* At 827. Thus in *General Telephone*, the Commission's authority to regulate competitive bidding requirements was upheld, recognizing the Commission's broad grant of authority to regulate utility practices in order to guarantee adequate service and benefit to the ratepayer. We agree with SCDCL that the utilities' reliance on *Pacific Telephone & Telegraph Co. v. PUC* (1950) 34 Cal.2d 822 is misplaced. As the California Supreme Court found in *General Telephone*, the continuing validity of *Pacific Telephone & Telegraph* is much in doubt and it certainly does not control in this case given the broad sweep of this Commission's authority confirmed by *General Telephone* and its progeny.

Similarly, *Gay Law Students Assoc. v. Pacific Telephone & Telegraph Co.* (1979) 24 Cal.3d 458 provides no basis for preventing the exercise of this Commission's regulatory authority over the payment of prevailing wages or the use of PLAs by

jurisdictional utilities. In *Gay Law Students* the California Supreme Court allowed regulation of the utility's managerial conduct at issue and further limited the reach of *Pacific Telephone* by refusing to read *Pacific Telephone* to remove utility labor and employment policies from PUC authority. 24 Cal.3d at 477 (fn.11). Similarly, the court in *General Telephone* narrowed the reach of *Gay Law Students*, discussing it in the context of cases limiting intervention in utility management to much narrower circumstances. *General Telephone*, 34 Cal.3d at 825-26. Verizon itself notes that *Pacific Telephone's* primary holding has been eroded (Reply comments, page 6, fn. 20) as indeed it has been narrowed virtually into extinction.

As discussed in section 4, above, this Commission's broad statutory authority under Public Utilities Code Section 701 and its specific statutory authority to ensure the well-being of utility *employees* as well as ratepayers and the general public pursuant to Public utilities Code Section 451 provides additional authority for the adoption of utility contracting rules.

Moreover, the California Supreme Court has repeatedly recognized the benefits to the public, as well as to the specific employees, conferred by the use of prevailing wage laws in California. In *Lusardi Construction Co. v. Aubry* (1992) 1 Cal.4th 976, the Court detailed the benefits resulting from the use of prevailing wages. In that analysis the Court not only focused on the benefits obtained by employees covered by prevailing wages and communities benefiting from such covered employees. The Court noted also that the overall purpose of the prevailing wage laws is "to benefit the public through the superior efficiency of well-paid employees." *Lusardi Construction*, 1 Cal.4th at 987. Thus, *General Telephone* and *Lusardi Construction* combine to instruct us that the Commission's broad authority to ensure adequate service and protect the ratepayer and the public interest are consistent with California labor law goals that also benefit the

public. This regulatory authority does not fall within the increasingly narrow band of "invasion of management" prerogatives as contemplated in the older case law cited by utility respondents.

Here, the payment of prevailing wages and PLAs would affect utility customers by reducing the likelihood of project delays on key and critical energy, water and telecommunications infrastructure development. They would promote efficiency during the project construction and more certainty as to project completion, all of which promote system reliability and more certainty as to the costs assumed by utility ratepayers. The studies in our record also demonstrate that prevailing wage requirements increases the supply of well-trained and productive California workers available to work on utility projects. This is critical, as California faces significant infrastructure maintenance and development needs in our hybrid energy markets, our rapidly changing telecommunications markets and in our straining-at-the-seams water markets.

Moreover, SCDCL has made a showing that the payment of prevailing wages promotes a more efficient and skilled workforce, reducing cost overruns, construction delays and injuries and associated ratepayer liabilities on construction projects. No utility respondents have argued that the payment of prevailing wages will increase construction costs, or otherwise harm ratepayers. SCDCL has submitted studies showing that the opposite is true -- that the payment of prevailing wages does not increase construction costs and that in some instances the payment of prevailing wage to highly skilled and efficient workers have lowered construction costs compared to projects that have not used prevailing wages. (SCDCL Exhibits C, E and G).

The utilities argue that this Commission cannot develop new rules in the absence of evidence that a problem exists. To the contrary, this Commission has a continuing duty to protect the ratepayer and the public. Part of that duty

requires the provision of adequate utility service, which may require this Commission to take affirmative steps to improve the accrual of ratepayer benefits and not simply prevent harm to the ratepayer. The Commission in this quasi-legislative rulemaking has the authority to develop rules that will further the policies and goals of California utility and labor law without waiting for problems to manifest. Our discussion in section 4, above, refers to many of the proceedings in which the Commission has exercised its well-settled authority to adopt new rules without waiting for problems to fester and become wide-spread.

The California courts have consistently recognized governmental agencies' ability to promote statutory and policy goals without waiting for problems to develop. In *Domar* 9 Cal.4th at 174, 36 Cal.Rptr.2d 521, 885 the court upheld the discretion of the public agency to mandate minority / women outreach programs "despite the lack of empirical evidence" that in the absence of such mandated outreach problems would arise. The agency at issue was entitled to deference in its policymaking as long as that policy was otherwise consistent with its authority and with California law. Similarly, in *Assoc. Builders and Contractors, Inc. v. San Francisco Airports Comn.* (1999) 21 Cal. 4th 352 the California Supreme Court held that the local governmental agency "was not required to seek evidence of past labor strife at the airport, or await future labor unrest, before bargaining for a no-strike agreement designed to avoid costly delays in the completion of the project." *Id.* At 376. The utility parties proffer no rebuttal to SCDCL's studies and data as to the benefits of the payment of prevailing wage and the use of project labor agreements in utility construction. But even if the utilities had submitted evidence, this Commission can properly weigh the benefits and costs and take affirmative steps to enhance ratepayer benefits through the use of such mechanisms without waiting for problems to occur on

critically needed infrastructure projects within the jurisdiction of our regulatory authority.

Of course, those mechanisms must otherwise be lawful. Thus, the utility respondents' main challenge to SCDCL's request rests on a legal analysis that federal law preempts or bars this Commission from imposing a prevailing wage requirement as a state minimum labor standard. The utilities rely on *Chamber of Commerce v. Bragdon*, 64 F.3d 497 (9th Cir. 1995) to argue that the National Labor Relations Act preempts state requirements in this area and thus that this Commission may not require the payment of prevailing wages on utility construction and maintenance projects.

The reliance on *Bragdon* is misplaced, as *Bragdon* has almost entirely been superseded by later Ninth Circuit Decisions, including *Dillingham v. Sonoma County*,190 F. 3d 1034 (9th Cir.1999) ("*Dillingham II*"), where the Ninth Circuit held that the NRLA did not preempt a requirement that contractors on California Public Works Projects employ apprentices from state-approved apprenticeship programs. In *Dillingham II* the Ninth Circuit explained that "[m]inimum labor standards do not affect the collective bargaining process because minimum labor standards treat all workers – union and non-union—equally and neither encourage nor discourage the collective bargaining process." *Dillingham II*, 190 F.3d at 1040-1041. Thus, long after *Bragdon* the United State Supreme Court and the Ninth Circuit have settled that the imposition of California state minimum labor standards escape preemption by the only federal laws upon which the utilities have relied -- or can rely -- in this case.

The utilities in their comments argue that *Bragdon* is still good law and that the distinction between the rules promulgated here and those found valid in *Dillingham II* lies in the fact that there the Court was assessing apprenticeship standards and here the question is the requirement of minimum labor standards.

This distinction is without a difference. In *Dillingham II* the Court focused instead on whether Congress preserved state regulatory power in the arena – in that case in the regulation of apprenticeship standards. The utilities acknowledge this focus in their analysis of *Dillingham II*: "Congress has not intended to leave the area of apprenticeship standards unregulated because federal law unequivocally permits regulation of apprenticeship standards." Joint Comments of Verizon and Pacific Bell on Commissioner Lynch's Draft Decision at 10, quoting *Dillingham*, 190 F.3d at 1039. Thus, we must look to congressional intent in preserving a state role in utility regulation, as the *Dillingham II* court analyzed whether Congress preserved a state role in apprenticeship regulation.

In the arena of utility regulation, Congress affirmatively preserved all state power that could constitutionally be exercised under the Commerce Clause. Congress reserved to the states all of the authority that the states then enjoyed in the passage of the Federal Power Act. In fact, Congress explicitly and unequivocally included a savings clause to make clear the states' continuing regulatory authority. 16 U.S.C. 824(a). *See Connecticut Light & Power Co. v. Federal Power Com'n.*, 324 U.S. 515, 529-30 (1945). Moreover, Congress has explicitly preserved a role for state regulation of telecommunications companies in the Telecommunications Act of 1996. We need not analyze Congressional intent in that arena as we do not today apply these rules to telecommunications companies.

Thus, this Commission need only examine whether setting minimum wage requirements for use in utility construction contracts also constitutes a state minimum labor standard which would escape federal preemption under *Dillingham* and its progeny. The utilities attempt to conflate the issue of congressional intent to preempt, as discussed above, with the minimum labor standard analysis set forth by *Dillingham II*. As SCDCL sets forth in their

comments, two separate bases exist for this Commission's valid exercise of its authority and the rules promulgated today meet each basis. Whether a requirement to pay prevailing wages constitutes a minimum labor standard that the Ninth Circuit and California courts have found permissible and not preempted is a distinct and separate inquiry from whether Congress contemplated a state regulatory role in the arena regulated.

A review of relevant recent case law establishes that such wage requirements do constitute permissible state minimum labor standards. California courts are clear that prevailing wage laws constitute minimum labor standards that are not only beneficial but are also not subject to preemption under federal law. *People v. Hwang (1994) 25 Cal.App.4th 1168.* The Ninth Circuit has recently settled that setting minimum wages for state-registered apprentices, when working on private construction projects, constitutes a state minimum labor standard that is not preempted by the NLRA. *Assoc. Builders and Contractors of Southern California, Inc. v. Nunn*, 356 F.3d 979, 986-991 (9th Cir. 2004). *Nunn* and the Ninth Circuit caselaw on which *Nunn* is based show that *Bragdon* has little remaining vitality. If *Bragdon* were still good law, the Ninth Circuit would not have reached the decisions it did in *Dillingham II* and *Nunn.*

The utilities' reliance on the *Nunn* court's distinction that the regulation in *Bragdon* affected all private construction work while the regulation in *Dillingham II* did not is inapposite. Here the rules we promulgate affect only construction work performed for certain regulated utilities, an arena constitutionally within this Commission's mandate to regulate.

It is well-settled that a utility functions as a hybrid entity and not merely as any other private company. First, the California Constitution, Art. XII, sec. 3, provides broad regulatory authority over public utilities. The California Supreme Court has recognized the different status and treatment of public

utilities. "[T]he nature of the California regulatory scheme demonstrates that the state generally expects a public utility to conduct its affairs more like a governmental entity than like a private corporation." *Gay Law Students,* 24 Cal. 3d at 469-70. Moreover, public utilities enjoy special powers not available to private corporations, in part because of their inherently regulated status which treats them as operating more like a public entity than an exclusively private entity. *See Barham v. Southern California Edison Co.,* (1999) 74 Cal.App.4th 744, 753 (for purposes of inverse condemnation, the courts hold public utilities to the standards imposed on public entities.) Thus, even if *Bragdon* survives as good law, the utilities regulated by the Commission pursuant to its constitutional mandate are not "totally private" entities as those covered by the regulation at issue in *Bragdon*.

Our constitutional authority serves further to distinguish the actions we take today from the actions considered by the court in *Bragdon*. The constitutional authority of local governments is not in any way comparable to the powers of the Legislature under Art. XII, Section 3. The Commission has broad authority as provided by the Legislature to enact these rules, a power not as clearly within the pruview of the local government in *Bragdon.*

Setting minimum wage requirements neither attempts "to regulate conduct which is either arguably protected or prohibited by the NLRA [,]" *Dillingham II,* 190 F.3d at 1040 (which would trigger *Garmon* preemption) nor does it interfere "in activity which Congress intended to be unregulated [,]" *Contract Services Network, Inc. v. Aubry*, 62 F.3d 294, 298 (9th Cir. 1995) (which would trigger *Machinists* preemption). Here, prevailing wages would be paid to the employees of all utility contractors whether those workers were union members or not members of any union. *See Hwang, 25 Cal.App.4th at 1182* (prevailing wage laws "protect union and non-union employees alike"). Moreover, we have already

discussed the benefits that accrue from the use of prevailing wages on construction projects.

SCE argues that a prevailing wage requirement will force all utility companies to pay union wage rates. This is factually inaccurate. *See Nunn*, 356 F.3d at 989-90. Moreover, SCE's discussion of Labor Code sec. 1720(a)(1) is irrelevant because this statute does not prohibit the Commission's promulgation of new rules to regulate the actions of regulated utilities.

The utility parties argue that this Commission would somehow impermissibly interfere in the already-established Department of Industrial Relations prevailing wage determinations or, alternatively, that the process of setting prevailing wages would be unduly cumbersome. Both concerns are misplaced. By requiring the payment of prevailing wages on utility construction projects (a practice that Southern California Edison notes it already follows) the appropriate state standards setting and enforcement authorities would ensure compliance. Utilities merely would require the payment of prevailing wages in their construction bid packages and contract documents. Upon request, utilities would provide that information compliance data to the Commission. The normal and already - available enforcement mechanisms – and the utilities' obligations under Rule 1 of our rules of practice and procedure – would provide all the enforcement necessary without the creation of any additional processes or requirements. Thus, the development of this simple requirement, using existing and well-settled determination and enforcement mechanisms of our sister agencies and the legal process, will provide ratepayer access to the benefits described not only by the data submitted by SCDCL but also as detailed in California statutes and in California Supreme Court decisions concerning the use of prevailing wage requirements in California.

7. Project Labor Agreements

PLAs are agreements between contractors and their employees that establish employment terms and conditions for all persons and firms working on a project. PLAs are collective bargaining agreements negotiated between the owner of a construction project, the construction manager, and the labor unions who represent construction workers. PLAs typically include broad prohibitions on strikes and lockouts, requirements that hiring be conducted through union hiring halls, uniform work rules and hours, dispute resolution protocols, and the wages applicable to each craftsman. PLAs supersede inconsistent provisions in other collective bargaining agreements. They do not exclude nonunion contractors, although nonunion contractors and workers would be subject to the provisions of the PLA. State and federal agencies have used PLAs for large public works projects for more than 50 years and many states and local agencies require them. Private companies also use them, although state laws do not appear to compel private companies to use them.

SCDCL proposes that the Commission adopt a rule requiring that all utility construction projects be subject to PLAs. SCDCL states such agreements promote stable and cooperative relationships between labor and contractors by prohibiting strikes and lock-outs, and providing for mandatory grievance procedures. PLAs, according to SCDCL, supersede other bargaining agreements and may therefore simplify terms of employment by, for example, setting forth holidays and work periods. PLAs are usually limited to the duration of project construction.

PG&E, SCE, Verizon, SBC, and SDG&E/SoCalgas filed replies to SCDCL's proposals, strongly objecting to them[2]. SBC, SCE, SDG&E/SoCalGas and PG&E object to the proposal asserting that it is untimely and outside the scope of the proceeding. Verizon adds that state entities are preempted by the National Labor Relations Act (NLRA) from regulating the substantive terms and conditions of employment and any activities within the jurisdiction of the National Labor Relations Board (NLRB). Verizon argues that the NLRA permits PLAs but does not provide any authority for an employer to be compelled to enter into such agreements.

We are mindful of the comments of the utilities that the specific circumstances under which we might require PLAs are unclear on this record. We decline to adopt a requirement to use PLAs for utility construction projects at this time.

8. Category of Proceeding

R.03-06-009 preliminarily determined that this is a quasi-legislative proceeding as described in Rule 5(d). No party has expressed any objection to this categorization. This ruling confirms that the proceeding is quasi-legislative.

9. Proceeding Assignment

Loretta Lynch is the assigned Commissioner and Kim Malcolm is the assigned ALJ and principal hearing officer in this proceeding.

---

[2] Mountain Utilities also filed what it titled "comments" to the SCDCL proposal. Its pleading, however, does not address the substance of the proposals but the suggestion by PG&E that the Commission should reconsider making small utilities respondents again to this proceeding if it agrees to consider SCDCL's proposals. The Commission does not herein change D. 04-04-038, which specified that only certain large utilities are respondents to this proceeding.

Findings of Fact

1. Reverse auctions may not result in the lowest cost construction contracts, especially in cases where market competition is limited and where projects are complex and have specialized techniques or technologies.

2. Reverse auctions may motivate bidders to emphasize project price over other essential project elements, such as safety or quality of workmanship.

3. Ratepayers are likely to benefit from a prohibition on reverse auctions.

4. Prevailing wages promote a well-trained and stable workforce which in turn promote more reliable utility services and infrastructure, and more efficiently-managed utility construction projects.

5. There is no evidence to suggest that prevailing wages would necessarily increase project costs or utility rates.

6. Requiring respondent utilities to pay prevailing wages would not require any enforcement or compliance actions by the state that would be in addition to those already in place.

7. There is no evidence to suggest that requiring utilities and their contractors to pay prevailing wages for construction projects would harm ratepayers, although such a requirement may provide benefits to ratepayers.

8. The specific circumstances under which we might require PLAs are unclear on this record.

Conclusions of Law

1. The Commission should prohibit respondent energy utilities, with the exception of independent energy storage providers like Lodi and Wild Goose, to use reverse auctions for soliciting bids on utility construction contracts.

2. The California Supreme Court has determined that the Commission is within its authority to do all things necessary to promote reliable, safe and low

cost utility services. This determination extends to the regulation of utility contracts, labor practices, and managerial conduct.

3. The California Supreme court has recognized the benefits to employees and the public by the use of prevailing wages.

4. The California Supreme Court has found that a state agency is within its discretion to adopt regulations and take affirmative steps to forestall future problems even where there exists no evidence of a past problem.

5. The Ninth Circuit Court has determined that setting minimum wages for private companies constitutes a minimum labor standard that is not preempted by the National Labor Relations Act.

6. The Commission should require that prevailing wages be paid to employees working on energy utility construction projects, with the exception of independent gas storage providers like Lodi and Wild Goose.

7. It is in the public interest and consistent with Section 451 to require that prevailing wages be paid to employees working on energy utility projects.

IT IS ORDERED THAT:

With the exception of independent gas storage providers like Lodi and Wild Goose, energy utilities that are respondents to this proceeding shall not, when soliciting contract proposals for construction projects, engage in the practice of "reverse auctions" over the internet, which permit bidders to anonymously provide successively lower bids in response to the published bids of others. Each utility that is a respondent to this rulemaking shall submit a report no later than July 1, 2006 describing how the adopted prohibition on reverse auctions has affected its construction contracting procedures, costs and population of bidders. Each utility that is a respondent to this proceeding shall require the payment of prevailing wages to workers who are employed on

energy utility construction projects. Utilities that are respondents to this proceeding shall require that prevailing wages be paid out to employees working on energy utility construction projects.

This proceeding remains open to consider the issues described herein.

This order is effective today.

Dated December 16, 2004, at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
SUSAN KENNEDY
Commissioners

I dissent.

/s/ GEOFFREY F. BROWN
Commissioner