OUTLOOK AND INSIGHTS  by Alex Radin

"An all-out effort of unprecedented magnitude will be required if the preference principle and cost-based pricing are to be maintained."

LOAD MANAGEMENT—THERE'S MORE TO CONSIDER  by Lori Woehrle

"There are other benefits to load management besides reducing power costs."

ACHIEVEMENT RECOGNIZED
Outstanding service won awards for individuals and two systems.

SIX ENERGY INNOVATORS HONORED
Palo Alto and Sacramento, Cal.; Fort Collins, Colo.; Livingston, Mont.; Nashville, Tenn.; and Austin, Texas, won this year's competition.

PREFERENCE ISSUE DOMINATES ANNUAL CONFERENCE
by Jeanne Wickline LaBella
Speakers and resolutions focus on relicensing and power marketing.

NATURAL GAS VS. HEAT PUMPS
by Arie M. Verrips and Walter A. Canney
Two public electric and gas officials debate a heating controversy.

SHOULD STATE COMMISSIONS REGULATE MUNICIPAL RATES?
Yes, says Douglas N. Jones—No, argues David W. Penn

FLY ASH MARKET GROWS
Waste produces revenue for Basin Electric Power Cooperative.

WANTED: PICTURES OF PUBLIC POWER PROJECTS AND PEOPLE

INSIDE APPA  by Priscilla Knight
APPA mounts preference campaign; membership year sets record; Association committees reorganized; APPA staff expands; new publications offered.

THE OTHER SIDE  by Vic Reinemer
Competition for hydroelectric licenses, which private utilities seek to avoid through H.R. 4402, leads to environmental and energy benefits.

Municipal electric utilities have come under increasing regulation during recent years, either individually or as part of joint-action agencies. Much of this regulation deals with power generation and its effect on land use, air and water. The regulations and applicable laws come from federal, state and local authority.

One area in which there has been little regulatory change is the establishment of retail rates. State commissions often regulate individual municipals' service, siting and safety. However, in a majority of the states the state public utility commissions do not regulate municipal retail rates. They are established locally, by city councils or governing boards.

Public Power asked two economists with divergent views on municipal rate regulation by state commissions—Douglas N. Jones and David W. Penn—to present their arguments. They follow the summary below of existing rate regulatory authority of state commissions, based upon their annual reports to the National Association of Regulatory Utility Commissioners and conversations with state commission and municipal utility officials in several states.

Municipal electric rates are fully regulated by state commissions in five states—Maine, Maryland, Rhode Island, Vermont and Wisconsin. Together these five states include 111 public power systems, including 84 in Wisconsin.

There is no state authority over municipal rates in 30 states. The authority in the 15 other states is limited or inconsequential:

- Seven commissions—in Arkansas, Kansas, Mississippi, New Hampshire, New Jersey, Pennsylvania and Wyoming—regulate municipal rates outside city boundaries.
- The Texas commission has appellate rate jurisdiction over municipals in areas outside city limits.
- Indiana has a home rule provision under which communities with municipal systems may opt for local rate regulation.
- New York law excludes from state commission rate regulation the 44 municipals which receive all their wholesale power from—and are regulated by—the New York Power Authority. The state commission regulates the authority’s three partial-requirements municipal customers—Freeport, Jamestown and Rockville Centre. The two New York municipals regulated by neither state agency are Gouverneur and Watertown, which provide hydropower for municipal buildings.
- The Florida commission can regulate rate structure, but not the rates themselves.
- The Massachusetts commission can prevent municipal rate changes more often than every three months.
- The Alaska commission regulates rates where utilities compete, as in Anchorage, which is served by a municipal utility and a rural electric cooperative.
- The West Virginia commission has limited review authority over rates and charges of the two municipals in that state.
- The Montana commission has only one municipal over which to exercise jurisdiction and that city—Livingston—which develops wind generation, does not sell electricity at the retail level.
- There are no municipal electric systems in Hawaii.

VIC REINEMER

Photo by Eugene Fischer, Helena (Mont.) Independent-Record
REGULATE MUNICIPAL RATES?

COLUMBUS, OHIO

VILLAGE OR MUNICIPAL OWNERSHIP no longer describes the inventive elaboration of non-federal public power. Countywide or multicounty public utility districts, special service districts and joint-action agencies are important additions to the conventional public power scene. These larger entities were occasioned primarily by the need to participate in scale economies and to alleviate financial restraints imposed by indebtedness limits and cash flow inadequacies.

Since the city of Colton, Cal., case of the early 1960s, which confirmed federal jurisdiction over wholesale electric transactions, to 1981 the public power sector has preferred Federal Energy Regulatory Commission (FERC) jurisdiction over wholesale electric transactions to that of state commissions. At the retail level, fending off state commission regulatory advances over the past 20 years has been only partly successful for public systems and co-ops. Rulings such as the Utah Supreme Court’s in 1940

‘Both public and private power have become less doctrinaire and less ideological.’

(Garkane Power vs. Public Service Commission of Utah) that a co-op is not a public utility, and opinions such as the Tennessee Public Service Commission’s in 1941, that a “natural bias against publicly owned power distributors . . . characterizes most public utility commissions,” are rare nowadays. More common may be the view of Larry J. Wallace, former president of NARUC and former chairman of the Indiana Public Service Commission, that government rate regulation over the longer term will grow to encompass more municipal electric utilities and rural electric cooperatives.

Historically, perhaps the most turbulent relationships for public systems have been those with the private power systems. During the ’60s and ’70s the relationship greatly improved on all fronts, to the benefit of both parties and surely for the larger social good.

To be sure, some quarrels continue, such as relicensing and preference arguments, now that hydroelectric power has become still more precious and coveted. Occasional struggles over territorial certification and wheeling and interconnects arise. Governmental studies of the feasibility of a national electric grid system invariably evoke fears of public power encroachments on the current balance between the parties. Ownership of local distribution systems may change—a few going from private to municipal and sometimes one going the other way. But if a lofty enough view is taken, all this can be seen as background noise compared to the very real advances that have been made in peaceful coexistence and substantial cooperation.

Dealings and discussions nowadays deal more with public power and private power; earlier the issues were public power vs. private power. Both sides have become less doctrinaire and less ideological.

The citizenry itself—ratepayer, taxpayer, stockholder—has become more pragmatic and eclectic on the provision of electric service. Perceptions are less polarized. Public ownership is neither uncritically equated with public interest behavior on the one hand nor pejoratively described as “political ownership” on the other. Private electrics are now seen as neither singlemindedly aversive nor uniformly efficient. Litigation between the two sectors is less frequent, less zealous.

What has brought the parties together more amicably, I believe, is the nature and depth of their common dealings. Here the forces of available technology, rational public policy, various financial adversities commonly felt, and just plain time have happily accomplished what controversy and coercion could not.

Power pooling, joint construction and financing, the need for further interties, and sensibleness of regionalism in transmission and distribution planning and operation have been helpful elements. So have sustained inflation, fuel shortages, high capital costs and increased risk. Bad times in an industry sharpen commonalities of interest and encourage imaginative joint solutions. The utilities’ wagons are circled to ward off the attackers—intrusive intervenors, assertive legislatures (including Congress), aggressive customers and vigorous regulators.

Regional demand forecasting, capacity expansion and electric power research increasingly call for public/private system coordination. Both municipal and cooperative power entities are represented in the North American Electric Reliability Council and Electric Power Research Institute. In electric industry relations between public systems and the IOUs, as in international affairs, the more frequent and thorough the dialogue, the better the outcome.

Joint Action Paid Off

Public utilities economists’ worries about allocative (resource) efficiency and the earlier failure to incorporate scale economies in local public power entities and co-ops have been ameliorated. Consolidation and joint-action agency arrangements have helped. Federal power marketing administrations encouraged area-wide systems.

Debate over non-comparability of costs for consumer- and investor-owned utilities continues, but in muted tones. Municipal utilities are exempt from federal tax, and can sell bonds yielding tax-exempt interest. Rural electric cooperatives are generally exempt from federal taxes and receive low-interest loans on about one-fifth of their financing. But the U.S. tax code, particularly within the Economic Recovery Tax Act of 1981, now contains so many concessions to investor-owned utilities, in the form of accel-

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erated depreciation and investment tax credits which reduce their federal income tax liability to or near zero, that the answer as to who gets the greater subsidy is not very clear. Legitimate analyses on this point can be cited with opposite outcomes, depending mostly on the period covered and the time value of money.

Pluralism Preferred
I believe an electric industry with a mixture of ownerships—something like the present case—is the best type of industry organization. In fact, there may now be a fairly settled equilibrium for the intermediate term among Ious, local publicly owned utilities and cooperatives. With luck there is just enough unease surrounding this circumstance to provide that quickening spur of competition, actual or potential, from alternative types of ownership, that lessens the lethargy and heightens the efficiency of the participants.

A remaining task is further coordination of systems among munis and between munis and co-ops on the one hand and neighboring private utilities on the other. The new development to be encouraged is the joint project approach to power supply that structurally combines private and public entities. And I would like to see more experimentation with another hybrid—public ownership with private operation on a lease basis.

Regulation Provides Discipline
State public utility commission regulation, in my opinion, should be further elaborated to embrace more of the publicly owned systems and cooperatives in their various forms. Professor Eli W. Clemens, the noted utility economist, was, I believe, correct in observing that “publicly owned utilities have much to gain from good regulation, and complete protection of the ratepayer requires it.”

Few persons dispute the evidence that public ownership does not ensure public interest behavior. Yet the contrary belief is, at bottom, the rationale of non-regulation of the municipals. Socialized electricity-making, for all its merits, works better with external prodding.

The co-ops’ argument against regulation—that the lack of conflict of interest between seller and buyer (since they are the same) makes it unnecessary—seems less than fully persuasive. While co-ops have a creditable history of doing well by their subscribers in the context in which they operate, their performance is probably a good deal short of optimal in terms of accountability for imprudence, bargaining power with the generation and transmission suppliers, adoption of new technology and productivity advances and innovativeness in rate design.

It may not be unfair to say that the current status of partial regulation of the consumer-owned power entities has more to do with habit and inertia, together with the strength and effectiveness of the lobbying effort against further state commission regulation, than with the merits of the argument. Commission regulation has a way of providing a healthy discipline to utility operations—whether private or public—with respect to equitable rates, earnings levels, cost control and investment decisions.

Where two of the three main classes of utilities (munis and co-ops) are not now regulated, state commissions are denied a truly statewide view of service needs and the ability to shape in a comprehensive way the amount and basis for meeting those needs. Distortions are fostered, fairness suffers, useful standardization and uniformity is not likely.

As a believer in the improvability (though not the perfectability) of independent, quasi-judicial commission regulation of the public utilities, I believe bringing more public power systems under the jurisdiction of state commissions would be a helpful, not hurtful, step for social policy in this important sector. It is not the largest item on the national regulatory agenda, but it is surely worth revisiting every decade or two.

‘Commission regulation has a way of providing a healthy discipline to utility operations.’

NO
by DAVID W. PENN
SUN PRAIRIE, WIS.
TRUSTING THAT THE READER will push all the way through the qualifications and explanations that follow, my short answer to the question, “Should state commissions regulate municipals’ rates?” is no. The four cornerstone arguments supporting this position are:
• the municipal utility’s lack of conflict of interest that would otherwise exist if the utility’s consumers and owners were not the same;
• the open and thorough decision process that legally must be met in conducting municipal business;
• the ultimate cost of leaving municipal utilities crippled and unable to make their own financial decisions as they defer tough decisions to their regulatory bodies; and
• the inefficiency of using extremely scarce regulatory resources for potentially redundant regulation of about one-eighth of the industry—the sector that has consistently and significantly maintained the relatively lower power costs and rates which spur competition and improve performance.

Engineer, environmental, and facilities’ siting regulations, and ensuring compliance thereof, seem to me to be proper subjects of state regulation regardless of the corporate form of any electric utility. In fact, something very similar to the integrated, 10-year advance plan approach used by the public utility commission here in Wisconsin is to be recommended. My negative comments are directed to financial and rate regulation of the retail activities of municipal electric utilities, as currently conducted at the state level in Wisconsin and a few other states.

This excludes the current scheme of wholesale rate regulation carried out by the Federal Energy Regulatory Commission (FERC) at the national level. This exclusion is significant because typically 75 percent to 85 percent of a municipal electric utility’s overall costs go to pay wholesale power costs charged by an investor-owned utility (IOU).

Penn is general manager, Wisconsin Public Power Inc. System, a joint-action agency. Previously he served as an economist with the Department of Energy, the Nuclear Regulatory Commission and the Federal Trade Commission.
Some would argue that the current federal regulation of wholesale electric rates should be transferred to the state level. I believe that would be a serious mistake. The regulated wholesale utilities often serve multistate territories. Even if many do not, they are coordinated, interconnected, and exchanging power across state boundaries on a continual basis.

In our world of instantaneous communications, legal and accounting precedents in one part of the country will immediately be applied somewhere else and need to be monitored by a federal authority. Application of standards that would vary from state to state would lead to the kinds of equity and reliability discrepancies experienced before a national approach was applied to environmental and civil rights issues.

Looking at the state commissions themselves, they would be less able to resist state corporate lobbying efforts by these relative giants than federal regulators would. And they would find it impossible to assemble and keep the additional staff expertise required in each of the states.

In Wisconsin there is full financial, rate, and other regulatory review of municipal electric utilities. For example, to obtain a rate increase or rate restructuring a municipal utility must file with the public utility commission, undergo audit and hearing, and receive approval of the request, or a modified version of it, from the commission.

Ironic as it may seem, my position on municipal regulation should not be taken as critical of individual regulators or decisions here in Wisconsin. I join with most Wisconsin people in being especially proud of the state’s early, progressive, and well-documented role in utility regulation. My biggest fear in this area is that there is a big cost attached to our commission being too successful and too good at its job of regulating municipal utilities.

Four Main Arguments

While I am comfortable being personally identified with the position I argue, no one should assume that my views are or are not shared by the Wisconsin Public Power Inc. System organization or any or all of its members. The following four arguments against financial and rate regulation of municipal electric utilities at the state level seem most important to me, and all-encompassing when taken together:

• First, in a municipal utility there is no conflict of interest between consumers and stockholders. The customers of a municipal electric utility are its owners. This means that all of the frictions are avoided that would otherwise come up in deciding how to allocate between ratepayers and stockholders. Among others, this would include the relevant and interrelated questions on what should be in rate base, the allowable rate of return, debt equity positions, the timing and sequence of investments, the effects of the appearance and reality of financial statements, who pays for plant cancellation and regulatory fines, the issuance of financing instruments, and the form and level of management compensation programs.

• The common interests of public power owner-customers not only greatly reduces the task of regulating a municipal—as opposed to an investor-owned—utility. It also greatly diminishes the need for a state commission to act as a regulatory overseer to protect the consumer.

• But even if municipal ratepayer/owners are free from the effects of allocations to stockholders, are they not still subject to financial frictions among themselves that should be resolved by a state regulatory body? It is clear that frictions could exist between the resident and ratepayer groups, and among types of users, times of use, and the different age, employment, or income status of users. However, my second cornerstone argument against municipal rate regulation is that it is hard to imagine a more thoroughly open and effectively accountable decision-making process than the one legally required of municipal decisions.

• Local council and commission meetings are subject to open meeting laws. Meetings are often telecast. Members jest in only a half-joking way that they must be careful to avoid taking their bathroom breaks all at the same time for fear of constituting a quorum.

Public notice rules must be met. Lead times must be allowed for comment and participation. Files must be open to public inspection, and reproduction of documents must be facilitated. Public power is truly public. This is quite a contrast to the access to information about financial and investment decisions available prior to those same decisions by profit-oriented IOUs.

Beyond these procedural rules, the overall process is one of control by the local community. The municipal utility is either managed directly by a committee of elected city council members, or, as is far more common here in Wisconsin, by a separate electric commission. These commission members are appointed and approved by the city council and mayor. Thus, there are also protections for a free and open decision-making process vested in the ability to elect one’s representatives or throw them out. My experience has been that no major or controversial decision escapes the scrutiny of the local commission, the city council and the local press.

A municipal electric utility is a creature of the local community. It exists because of approval by the community as an entity thatserve the community’s overall objectives. Even in our state, where there is complete municipal regulation by the state commission, there are conflicts about cities extracting payments to general revenues from their utility’s rate revenues.

• I regard my third argument as the most important. From what I can see in a state with full, effective and responsible regulation, municipal utilities are in danger of becoming systematically crippled and unaccountable over the long run as they defer the tough decisions to regulators.

Over time it becomes easier to let state commission staff members advise you as to when to file for a rate increase, what level and structure of rates to file for, what return or reserve to maintain, and what projects and debt to take on. Staff members will assume these responsibilities in good faith and come to be relied on extensively.
‘Freeing state commissions from municipal rate regulation enables them to devote more resources to their larger and more difficult electric utility duties.’

The net effect is that certain municipal utilities may feel protected from the demands of doing their own long-run planning for investment and cash-flow requirements. They will be sacrificing their vigilance and ability to make these decisions should changing events so require.

Perhaps even worse is the loss of accountability. "We had to file for a rate increase (or file for x percent)—the state commission ordered us to." I have heard that phrase many times. Through no personal fault or change, the friendly paternalistic regulator becomes a demanding scapegoat. It would be better if accountability were maintained at the local level and every ratepayer knew that rate increases and investments were necessary because of the dictates of sound business practices. In such an environment, each municipal community would be determining what it wanted to charge itself and what kind of a utility it wanted to put together to support local development requirements. If the community errs, there is no want for rescuers. Municipals have always felt the hot breath of investor-owned buyers ready to take over their financial and service obligations.

- My fourth and final argument against municipal regulation goes to the question of efficient use of scarce regulatory resources. The municipal electric load in most states is only 10 percent to 20 percent of the total. Even so, over the last several decades these municipal utilities have maintained rates 10 percent to 40 percent below those charged for equivalent service by their investor-owned counterparts.

This record has been achieved primarily in an unregulated environment. Costs are comparably lower for public power systems as a whole. Issues that regulators must deal with in regulating Ious are often more complex than those involving municipals. Freeing state commissions from municipal rate regulation enables them to devote more resources to their larger and more difficult electric utility duties.

All of these reasons taken together—the relative lack of size of the municipal load, the past favorable financial performance of municipals, the thorough municipal review process, and the complexity of regulating the larger industry segment of investor-owned utilities—indicate more regulatory bang for the buck is available by concentrating on regulating the private utilities and leaving the municipals to their own public processes of review. There certainly can be little debate that state regulation is constantly operating under the constraint of scarce resources. Judging from the taxpayer mood and the declining federal role, this can only worsen. Directly or indirectly, the size of state commission resources is tied to the state's budget, staffing, and compensation decisions.

On balance, and subject to the qualifications included above, financial and rate regulation of municipal electric utilities over the long run is probably unnecessary, debilitating and inefficient. This is primarily because municipal utilities are owned by their consumers, they are subject to a thorough and open decision-making process, they are in danger of becoming dependent and unaccountable over time if regulated, and the regulatory resources needed could more efficiently be spent elsewhere.

States that are pondering new regulation of municipals should consider these factors, and states with existing municipal regulation such as Wisconsin should evaluate deregulation.