

Iowa Utilities Board Fails Public in Municipalization Proceeding

by

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One hundred years ago, private utilities called for the creation of state public utility commissions. At the time, more than 3,000 private electric utilities were competing with one another and with a growing number of municipal utilities. Proponents argued that state regulation would guarantee generous profits, allow consolidation, and discourage municipal ownership. We can only marvel at the foresight of the early industry barons, because the relationship utilities enjoy with regulators continues to serve them. In an order issued July 11, the Iowa Utilities Board (IUB) overturned the decision of voters in five communities to establish municipal electric utilities. In doing so, the IUB failed its obligation to minimize costs to consumers and avoid duplication of facilities in such proceedings, elevated private profit over public will, redefined the democratic process, and set a precedent that virtually precludes the establishment of new municipal electric utilities in Iowa.

The case involved the consolidated petitions of Everly, Kalona, Rolfe, Terril and Wellman to establish municipal electric utilities. All five communities receive electric service from Interstate Power and Light (IPL), a division of Wisconsin-based Alliant Energy. The IUB's responsibility in the municipalization proceeding was to establish service area boundaries for the new municipal utilities and determine the amount of compensation the cities would pay IPL for the distribution poles, lines and related facilities.

In determining the shape of the municipal utility service territories, the IUB accepted IPL's view that the service territory must not extend to customers outside the city limits. (Many rural customers are served by existing municipal utilities and the IUB allows customers to be moved from one utility to another without consent.) To reduce cost and the need for unnecessary duplication of facilities, the cities proposed that several IPL customers outside the cities' corporate boundaries remain connected to distribution lines the city would operate, while continuing to be metered and billed by IPL. The company argued against this approach, claiming that its customers should not have to receive service from utilities that had not proven their ability to provide reliable service. The IUB accepted IPL's reasoning and its claim for compensation for miles of line and new substations that would be needed to reconnect these few customers to the IPL system. By abandoning common sense in its determination of the size and shape of service territory boundaries, the IUB failed its legal obligation to avoid unreasonable duplication of facilities and greatly increased the costs to the cities.

There is great irony in the IUB's agreement with IPL on the question of service boundaries. IPL admitted that it had provided less-than-reliable service to some of the petitioning cities. In an oral presentation of the decision (May 13), one IUB member noted that it was unfortunate that cities had to go to the trouble and expense to establish a municipal utility in order to get better service. In fact, IPL attempted to entice cities to withdraw from the case by promising to improve service and pay legal fees of the cities. A sixth city, Titonka, which had originally filed with the others, took IPL up on the offer. During the lengthy municipalization proceeding, the IUB also considered a case in which IPL asked for approval to sell its Iowa transmission facilities to the International Transmission Company at a hefty premium. In that case, IPL testified that it had failed to make investments needed for reliability because of internal

competition for capital. In both cases, the IUB rewarded IPL for its questionable record of service. In short, the IUB was willing to accept proven unreliability over the unproven record of the proposed utilities whose only purpose was to serve the interests of their respective communities.

Once the service territory issue was resolved to IPL's great benefit, the IUB had to determine the price the cities must pay for the existing distribution facilities. It chose to follow and to expand on a precedent from a case involving the City of Sheldon, which was set by an IUB that was openly and publicly hostile to municipal utilities. That case was not tested in the courts. Following that precedent, the IUB accepted IPL's claims for compensation, which required residents of the five communities to pay a second time for the depreciation the company had collected through its rates. With costs far exceeding those presented by expert witnesses for the cities, tens of millions of dollars of anticipated benefits disappeared.

Citing precedent from the Sheldon case, the IUB claimed the untested right to determine whether municipalization was in the public interest. The inflated cost of acquiring the facilities was the lynch pin of its finding, but there were other departures from the Code used to justify the decision. One of the most radical aspects of the IUB's decision was the establishment of motive as a determining factor in its consideration. In the final order, The IUB postulates that if voters had approved municipalization for the purpose of improving service quality (a factor it chose to ignore) or if the intent had been to develop a model for renewable energy, the finding may have been different, despite the cost. However, the IUB took affront at evidence that a significant motive for municipalization was to generate additional revenue for the city. Beyond the troublesome notion that the IUB has authority to divine and then evaluate voters' motives, there is a greater irony. In the IPL transmission case noted above, the IUB did not challenge the 13.88 percent return on equity that customers would pay in their rates, adding over \$120 million to rates that Iowan's would pay to IPL over the next five years. Apparently, the IUB places private profit of a monopoly service provider above public benefit.

In the IPL transmission case, it is interesting to note that the Minnesota Public Utility Commission (PUC) also had to approve that sale. Fortunately for Iowa consumers, the Minnesota PUC was not so anxious to give its blessing. Instead, the PUC and municipal utility interveners agreed to a settlement that reduced the 13.88 percent return that the International Transmission Company was to collect to 12.38 percent for five years. That change alone will save Iowa consumers more than \$120,000,000. The settlement also required the buyer to build two high voltage transmission lines in eastern Iowa that will reduce transmission costs and allow deployment of additional wind generators.

The IUB also claimed that, in addition to examining the motive for municipalization, it had the right to examine the size of voter turnout and the margin by which the measures were approved in each community. (In Everly, 89 percent of voters approved the proposal to establish a municipal electric utility.) Turnout or electoral margin might reasonably be considered by a city council in determining whether to proceed with municipalization; it is not a bureaucratic prerogative of the IUB. It is certainly not a standard that has been established by law.

Another unwarranted expansion of authority came in the IUB's reasoning that the cities had not adequately described their plans to promote energy efficiency. The IUB chairman had frequently and publicly stated that many existing municipal utilities are not delivering the same level energy efficiency service as IPL and MidAmerican Energy, whose programs are subject to IUB approval. Though many municipal utilities have exceptional energy efficiency programs, the criticism is not wholly without merit, but municipal utilities are meeting their obligation under the law and expanding their programs to meet new realities in the market. The IUB was wrong to assume that the new municipal utilities would fail to meet the energy efficiency needs of the communities they were established to serve. The Board had no basis to use the less-than-stellar performance of some existing municipal utilities in its expansive approach to determining public interest.

What might account for the IUB's decision in this case? First, it relied on a questionable precedent from Sheldon Iowa's attempt to establish a municipal utility in 1988-89. The IUB at that time was openly hostile to new municipal utilities. Its chairman, Dennis Nagel, had invited New York investment broker Edward Tirello to Iowa to re-state his thesis that of the 150 major investor-owned companies at the time, only 50 would still be in business after five years. In the face of such apparently convincing rhetoric, Mr. Nagel voiced his concern that creating another small utility made no sense. The decision against Sheldon was not challenged in the courts, so it stood for all these years as a barrier to citizens who wished to consider establishment of a municipal electric utility. The recent decision by the IUB to expand on it will raise the barrier even higher.

A second consideration is the relationships between IUB members, their staff, and the utilities they regulate. These relationships may have had little impact on the IUB's decisions, but the Board makes no apparent attempt to avoid the appearance of conflict or to disclose it. With very few exceptions, when members leave the IUB, they do so to work in industries they regulated. At least three former chairs of the IUB and at least four recent IUB members have left office to work for investor-owned utilities. Three others took regulated utilities as clients. Two recent IUB members represented regulated utilities at the time they were appointed. At least five recent and most senior staff members have been hired from regulated utilities. And at least two senior staff members have spouses who work for the companies the IUB regulates. In the IPL transmission case, noted above, the Minnesota Public Utility Commission received testimony from its state Attorney General about conflicts of interest in the Iowa case. The testimony described two conflicts, which if not disclosed, would be illegal under Minnesota law. The Attorney General argued that the presence of such conflicts should diminish the precedential value of the Iowa decision in the case before the PUC. The same staff relationship the Minnesota Attorney General noted in the IPL transmission case was present in the municipalization proceeding.

A third explanation may simply be that the IUB has very limited authority over the operation of municipal electric and gas utilities, generally confined to issues of engineering standards, safety,

and rules pertaining to the disconnection of service for non-payment of bills. By contrast, it regulates most aspects of the operation of private utilities. At a minimum, state regulated utilities enjoy a familiarity with the IUB and its staff that locally-regulated municipal utilities simply do not have. As the barons of industry predicted one hundred years ago, the relationship between state regulators and the utilities they regulate would be a beneficial one.

Whatever the reasons, the decision in the case of the five communities that wished to establish their own utilities is a chilling one. In the end, the IUB gave lip service to the importance of allowing communities to form municipal utilities, but effectively emasculated the law that allows it to be done.