



Forming a Public Power Utility

Public power has survived and thrived in America for well over a century. Citizen-owned public power utilities first appeared more than 130 years ago when communities created electric utilities to provide light and power to their citizens. The number of public power utilities has grown from fewer than a dozen in 1890 to more than 2,000 today.

The path to forming a new utility takes grit and determination. The process can be long, complicated and costly, and fraught with legal challenges. But the benefits of public ownership and local control are many, so communities around the country continue to investigate the public power option.

Before launching a campaign to form a new public power utility, it is useful to understand the community's rights and responsibilities in choosing its electric service provider; the steps involved in the process; and how the incumbent utility may respond.

Rights and Responsibilities

It has long been an established principle that communities have the right to form a new public power utility if they are not satisfied with the service they are receiving from a private utility. Nineteen new public power utilities have begun operation so far in the 21st century. Several more communities are waging high-profile campaigns to bring public power to their citizens.

In most states, citizens have the right to determine whether to own and operate their own public power utility or to grant an electric franchise to a private utility. This is a local rights issue. A community is within its rights to determine which public services it will provide to its citizens, whether those services include electric, water, wastewater, gas, sewer, cable or internet services.

It is the responsibility of city officials to examine the performance of the utility providing electric service to the community. An expiring franchise is a prime opportunity for the municipality to evaluate viable electric service options to promote the community's priorities, interests and economic health.



"I therefore lay down the following principle: That where a community—a city or county or district—is not satisfied with the service rendered or the rates charged by the private utility, it has the undeniable basic right, as one of its functions of government, one of its functions of home rule, to set up, after a fair referendum to its voters has been had, its own governmentally owned and operated service."

Franklin D. Roosevelt, September 21, 1932.

Steps in Forming a New Utility

Forming a new public power utility is not a quick and easy process. It takes time and money, and requires the commitment of the community and its elected officials. It requires a long-term view of solving problems, and a commitment to see it through. The process can take several years. But most communities that have gone through the process and have taken control of their electric utility agree it is worth it: they are reaping the benefits of public power every day.

There are many steps in forming a new public power utility; the number of steps and their order vary based on each community's situation, the relationship with the incumbent

private utility, state and local law, and the public's interest in the issue. Several of these steps—like the feasibility and legal analysis—are likely to proceed concurrently. Meanwhile, educating the community is likely to be an ongoing process, starting early and continuing to evolve throughout the process.

The incumbent utility serving the community is likely to feel threatened by any discussion of or attempt at creating a public power utility, and will likely invest substantial resources in a campaign to discredit public power and discourage the community from establishing a public power utility.

1. Start with a Leader

Most campaigns to form a new public power utility start with a leader—an individual or group to spearhead the effort. The leader's first step will be to start building support within the community, since the entire process will be a community-driven effort.

The person or group leading the effort should communicate the benefits of public power, and the reasons why the community should consider public power. Often, this discussion will start by focusing on the reasons the community is dissatisfied with the incumbent utility, as well as how forming a public power utility could improve the situation.

Those leading the public power initiative in your community should also be prepared to fight the misinformation about public power: the incumbent utility may attack the concept of public ownership even before the city begins the feasibility study.

2. Feasibility Study

One of the first steps in forming a new public power utility is to determine if the new utility is likely to be economically viable and has community support. Feasibility studies are designed to answer the initial question: is forming a public power utility economically feasible?

Typically, a city council (or other municipal governing body) will approve funding to hire a qualified firm to conduct the feasibility study. The study will examine the capital and operating costs for the new utility, and will factor in various alternatives for power supply. The study should also identify a range of expected savings, benefits, risks, and recommended next steps.

Often a community may conduct a preliminary feasibility study; if it shows savings, a more detailed study will follow. The second phase may also estimate property value, determine the general condition of the facilities to be acquired, and the costs of separating the new system's facilities from the remaining parts of the incumbent's system. It may also identify legal requirements to be fulfilled, and methods for valuing the utility property to be acquired.

3. Legal Analysis

Early on, there should be a review of state statutes pertaining to the formation of a public power utility to ensure there are no insurmountable legal impediments, such as a statutory ban on municipal buyouts.

State laws may vary broadly on the issue of whether and how municipalities can come to acquire, own and operate an electric utility. For example, Alaska has passed laws making the process known as municipalization easier through the quick condemnation of certain private property; while there is a legal moratorium on condemnation of an electric plant in other states, such as Oklahoma.²² There may also be a requirement to hold a citizen referendum or petition the state public service commission on establishing a public power utility.

State laws may also determine the price that a municipality must pay to acquire an electric plant. Some states have legislated what constitutes "just compensation;" others leave it to the courts, and still others let the local public utilities commission make the determination.

There should also be a review of the city or county's franchise with the incumbent utility, if one exists, to determine if an exclusive long-term franchise agreement exists (legal, valid and enforceable) that may preclude the municipality from forming a new utility, or any specific language pertaining to the acquisition of distribution facilities that serve the community.

4. Valuation

A study must be conducted to estimate the value of the electric distribution system. This valuation may already be included in a thorough feasibility study; if not, a separate follow-up study should be conducted. Any valuation should incorporate legal input as to applicable valuation methods.

As with any type of appraisal, several methodologies may be used to determine the value of the electric distribution

²² "Survey of State Municipalization Laws," Duncan & Allen, May 2012.

system facilities and property that would be acquired. The main approaches to valuing a system are:

- **Original cost less depreciation (OCLD) or “Book value”**—Value of the system is equal to the original cost of building the current system, less the accumulated depreciation of those assets. This is the valuation method used in utility ratemaking.
- **Reproduction cost less depreciation (RCLD)**—Value of the system if it were built today, using the same specifications as when it was originally constructed. Uses the original cost of the system as a base, adjusted up based on increases in the cost of utility facilities, less the accumulated depreciation of those assets. Reproduction costs include both the actual costs of building the infrastructure, as well as related essential costs including legal and engineering fees, executive and management costs and overhead.
- **Replacement cost new less depreciation (RCNLD)**—Similar to RCLD, but this approach assumes that the system were built today, it may be a better, or more efficient, system.
- **Going concern**—This income-based approach attempts to value the electric system based on estimated future earnings that would be lost if the utility were sold. “Going concern” may also be used to refer to assets of a business, such as property records, customer information records, operating records, etc. This approach may be used instead of or in addition to the other valuation methods.²³

A qualified consulting firm performing a valuation study will include a legal assessment to assess the suitability of each method and determine which is most appropriate for your community.

The valuation study will help identify the most economical option for creating a new public power utility: whether to buy or build. The city has the option of purchasing the existing electric distribution system (through voluntary agreement or condemnation), or to construct a new system. The final report should provide a range of values for the system to be acquired.

An incumbent utility will argue for the valuation method that results in the highest possible estimate, which may include not only the value of the system, but also going concern, goodwill and lost future profits (including a share

of its most expensive generating plant). This cost may be higher than the cost of building a new electric system, which is why building duplicate facilities is sometimes considered.

5. Community Education

It is vital to keep citizens informed about the proposed utility, and the benefits of public power, throughout the process. This will help you gauge the support of citizens, local officials and business leaders, and counter strong opposition from the incumbent utility.

The individual or group spearheading the effort should disseminate information about the process of forming the utility, and the benefits the community will realize if the effort is successful. Any misinformation that may be spread by the incumbent utility should not be allowed to go unchallenged.

Local officials should keep citizens involved in the process. Some communities appoint a “blue ribbon” committee of prominent citizens to guide the public power evaluation. This can be very helpful in the process as long as the task force remains public and unbiased. The committee—or any group representing or leading the initiative to form a new utility—should remain mindful of citizen needs and bring their concerns and recommendations back to the local officials.

Because the local business community plays an important role in the success or failure of a municipalization effort, involving businesses early in the process can help build support and avoid misunderstandings.

Similarly, local media should be kept informed of the issues, decisions and the process because of their important role in educating citizens.

Expect public scrutiny of the effort to increase after feasibility and other studies are completed and the campaign begins to gain traction.

6. Referendum

A referendum may be required by law to authorize the establishment of a public power utility.

If there is a preference to establish an independent board to govern the utility instead of the city council (or other local government entity), the ballot issue may be “double-barreled,” asking:

²³ “Legal Issues in Forming a Municipal System: Condemnation, Valuation, and Ouster of Existing System,” Clint Vince, Esq., and Cathy Fogel, Esq., Sullivan & Worcester, LLP, 1993.

1. Should the city (county) be authorized to establish a municipal utility?
2. Should the utility be governed by an independent utility board?

Leading up to the referendum, local officials will present findings and facts on the issue of forming a public power utility. A volunteer community group may be organized to push for the approval of the ballot issue separately.

Depending on the local issues and timing, the city council or county commission may choose to take the initiative to the ballot even if it is not required by law. The council may follow the will of the people, as expressed in the vote, in deciding whether or not to pursue forming a public power utility.

If the community votes favorably to establish a public power utility, it may enhance the marketability and value of revenue bonds.

Some communities may set an early election, after a preliminary study, to test the level of public support based on estimates of costs and benefits, before the community incurs the costs associated with completing a full feasibility study and other studies. If the early referendum passes, the city is not obligated to proceed if the completed study does not warrant it.

7. Price Negotiation and Condemnation

After the feasibility, legal and valuation studies are conducted, and after any referendum is held, the city or county should develop a negotiating strategy to make a purchase offer to the incumbent utility for the relevant parts of its facilities.

The incumbent utility will often demand an exorbitant price for its facilities, far in excess of the consultant's valuation, and will typically criticize the consultant's study as faulty, overly optimistic or biased. To counter these arguments, some cities hire two independent consulting firms to value the facilities and then compare their results.

For example, in the early 1990s, the city of Las Cruces, New Mexico, commissioned two independent valuation studies when it looked at purchasing its local electric system. The incumbent investor-owned utility was demanding \$176 to \$250 million for the system. Las Cruces commissioned two independent studies; both consulting firms told the city the system was worth about \$38 million.

If the private utility is willing to negotiate, it may be possible to get a more reasonable purchase price, and save the time and expense of a protracted legal fight. In another example, through a negotiation process in the early 1980s, an incumbent investor-owned utility agreed to sell its facilities for \$26 million to the newly formed Emerald People's Utility District. Five years earlier a feasibility study had estimated the value of the system at \$23 million.

If the incumbent refuses to sell, or insists on an unduly inflated price, the city may consider condemnation action under the municipality's right of eminent domain.

8. Public Service Commission Proceedings

In some states, the state public service commission has the authority to determine if the formation of the public power utility is in the public interest, and the price that is to be paid for the incumbent's facilities and for reintegrating the remaining system.

9. Evaluation of Financing Alternatives

As an investment, a new public power utility has tremendous payback potential, but it does take the commitment of considerable funds to acquire or establish the system and begin operations.

Local governments typically issue electric revenue bonds when they buy an electric distribution system. Bonds are repaid from future electric utility revenues over a long period (e.g., 30 years). The bonds are evaluated by a bond rating service, based on the projected net revenues of the electric system.

Unlike general obligation bonds, revenue bonds are not backed by the city or local government's ability to impose property taxes. The new electric revenue bonds should have no impact on other municipal projects and borrowing.

Municipalities are prohibited by federal tax law from using tax-exempt financing to purchase the output facilities of investor-owned utilities, unless they obtain a portion of their state's volume cap for such financing.

However, there is no such limitation on the use of tax-exempt financing for the building of a new system or for improvements to the distribution facilities once they are purchased from the private utility. The public power utility is likely to have a strong credit rating, and new capital

²² "Survey of State Municipalization Laws," Duncan & Allen, May 2012.

expenditures may be funded at a much lower cost of capital than if the system were privately owned.

The debt required for the acquisition of utility assets can be substantial, but that does not mean it is not a good investment, especially considering the benefits the utility will provide the community for many decades to come.

10. Prepare to Begin Operations

The final steps in forming a public power utility include issuing bonds for the purchase and/or construction of facilities; completing power supply and transmission arrangements; planning for the severance of the system from the incumbent utility; developing an organizational plan; setting up the new governing body and recruiting a utility manager; planning for materials, equipment, and supplies; and commencing operations.

The city may decide to contract out some of these functions to a firm experienced in electric utility operations to do the job in the short-run until the new utility is ready to run independently. The contracted electricity provider is accountable to city officials for its performance.

Incumbent Utility Responses

A for-profit electric utility will take extreme measures to stop the formation of a new public power utility, even in very small communities. The incumbent utility fears a domino effect—if one community establishes a public power utility, others may follow. This means a loss of electric load and revenue for the incumbent utility.

When you begin the process of evaluating the public power option for your community, the incumbent utility may offer deals to make the discussion go away quickly. The further you travel down the road toward public power, though, the more you can expect the incumbent utility to spread myths and misinformation, and engage in other anti-municipalization strategies.

Concessions

Faced with the possible loss of the municipal district from their customer base, the incumbent utility often responds to the competitive pressure and offers valuable concessions to the community. These may include lower rates, improved service, performance standards for reliability, investment in the community or a settlement fee.

In many cases, the concessions offered by the incumbent utility are sufficient to persuade the community to abandon efforts to form a public power utility.

Sponsored Studies

Private utilities may offer to pay for the community's feasibility study, or to conduct the study themselves.

The community should be very skeptical if the incumbent private utility offers to provide or conduct a study at little or no cost to the city. Studies sponsored by the private utility will not produce objective results; in fact, their primary purpose is to dissuade a city from forming a new public utility.

When the city, county or municipal district pays for the study, the study will be fair. Unlike the incumbent, the city does not have a vested interest in the study findings. The community is served only by learning the truth, whether or not the study shows that forming a public power utility is economically feasible. Only an unbiased study will determine what is truly in the community's best interest.

Lawsuits

You should expect the incumbent utility to take the city to court. There will be a cost in time, money and perhaps political will.

When a private utility talks about a costly legal challenge to forming a public power utility, it is really part of a public relations battle to stop the initiative. The incumbent's goal is not necessarily to win, but to exhaust city funds or intimidate city officials and civic leaders into abandoning the idea of municipalization.

If the feasibility study has been thorough and actions have been based on legal authority, the city will probably prevail. Cities often win the lawsuits, either because there is no merit to the incumbent's claim or because the utility decides to settle at the last minute rather than risk a result that sets an undesirable precedent.

Political Challenges

Once a community begins to evaluate the public power option, politics almost certainly will play a role. The pros and cons of municipalization may become the focus of political campaigns.

The incumbent utility may thrust the issue into elections by putting up candidates to run against local policymakers who support evaluating or pursuing the public power option.

Private utilities may also try to thwart the democratic process by lobbying for state or local laws or sponsoring ballot initiatives designed to stop the formation of a new public power utility.

For example, Pacific Gas & Electric Co. (PG&E) sponsored a California ballot initiative in 2010 that would have required a two-thirds majority vote before a local government could establish or expand electric delivery service or establish a Community Choice Aggregation program. The *Los Angeles Times* endorsed a “no” vote on the initiative:

“The so-called Taxpayers Right to Vote Act is really a ploy by [PG&E] to block ratepayers from forming cooperatives to purchase and distribute electricity at reduced rates. PG&E is spending its customers’ money to tell those same customers that they have to protect themselves against an imaginary power grab by local government. It is PG&E, in fact, that is trying to protect its market share by requiring a two-thirds vote to establish a new local power system.”²⁴

The initiative was defeated, with the largest percentage of “no” votes occurring in areas served by PG&E.

Public Relations Attacks

The incumbent utility will wage a major public relations battle to stop the community from forming a public power utility. The utility will use its considerable economic and political clout to sway public opinion against the formation of the new public power utility.

The incumbent may use mailers, bill stuffers, newspaper editorials, television, radio, internet ads and videos, and presentations by company officials filled with messages aimed at confusing the issues, creating fear, and spreading misinformation. They may hire a professional PR firm and give it a large budget. Incumbent utilities will strive to create doubt about the formation of a public power utility—whether it can be done and how successful it will be.

Responding to attacks

To respond effectively to these tactics, local officials, citizens, and business leaders who support public power need a well-coordinated public education campaign to set the record straight.

Local officials are most successful when they pay attention to citizens’ concerns, document the legal and economic feasibility, and explain the advantages clearly and succinctly.

The educational campaign is strengthened by encouraging support from community groups, speaking at community events, and keeping the local media well informed.

Citizen education is vital throughout the process of establishing a public power utility. Local leaders should start early and explain why the city is considering public power in a way that has meaning for local residents and businesses.

Although there will be times when it is necessary to respond to the incumbent’s attacks on the public power proposal, it is best to stay with positive messages about the formation of the new utility. In other words, do not let the private utility take the fight to its hill. Stay on message.

City officials, rather than outside hired guns, have more credibility with citizens because they have the community’s best interest at heart. Local elected and appointed officials, as well as local business leaders, should be prepared to respond to false charges against public power.

Citizen support groups can help, particularly if the city is prohibited from doing more than presenting findings and facts. Local citizens may form a committee to actively promote a ballot initiative and help educate the community on the benefits of public power. Citizen groups like “Pull the Plug” in Las Cruces, New Mexico, “CLUB” (Coalition for Lower Utility Bills) in San Francisco and “Citizens for Power Options,” in Casselberry, Florida, made sure fellow citizens were well informed about the public power option.

Keep the media informed on your goals and the process. Sit down with editorial boards of local newspapers to explain what you are trying to do and answer questions. The private utility is likely to step up its advertising in the local newspaper. If allowed by state and local law, the city should counter by placing educational ads in local newspapers. Social media can also be a powerful tool for countering attacks by well-heeled investor-owned utility seeking to derail an effort to form a public power utility.



“PG&E [Pacific Gas & Electric] spent more than \$10 million to defeat the ballot initiative [to allow the Sacramento Municipal Utility District to serve customers in Yolo County]. The utility had estimated that it could lose about \$43 million annually in gross profit margin if the measure succeeded.”

“Voters Nix SMUD Takeover of Yolo County Customers,”
Dow Jones Newswires, November 8, 2006.

²⁴ “On June 8,” Editorial, *Los Angeles Times*, June 6, 2010.