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THE MUNICIPALLY OWNED ELECTRIC COMPANY'S EXEMPTION FROM UTILITY COMMISSION REGULATION: THE CONSUMER'S PERSPECTIVE

While privately owned utilities are regulated in every state, municipally owned utilities are usually exempt from state supervision. Exemption is supported by the belief that government ownership effectively substitutes for regulation, and that local control is more sensitive to local needs. Critics assert, however, that self-regulation breeds inefficiency, that compliance with self-imposed service standards is unrealistic, and that local control is too susceptible to local political pressures. This Note examines the regulatory discrepancy between privately and municipally owned utilities, and assesses the impact of that discrepancy on residential electric consumers. It concludes that the procedural inadequacies, political disruption, and inefficiency which characterize the operation of self-regulated utilities can be eliminated by placing municipally owned electric utilities under state commission jurisdiction.

INTRODUCTION

MOST ELECTRICITY CONSUMERS in the United States enjoy uniform, adequate service, ensured by state regulation of privately owned utilities.¹ Municipally owned utilities, however, are usually exempt from regulation.² Many cities are becoming or considering becoming producers of electricity to generate income and reduce operating costs.³ These advantages of municipal ownership, coupled with recent economic hardship suffered by investor-owned utilities,⁴ will likely increase the number of municipal

1. See Comment, *Rates Follow Service: The Power of the Public Utility Commission to Regulate Quality of Service*, 28 BAYLOR L. REV. 1137, 1146 (1976).

2. See *id.* (generally describing utility commission jurisdiction state by state); see also NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, 1979 ANNUAL REPORT ON UTILITY AND CARRIER REGULATION (1980) [hereinafter cited as 1979 REPORT] (listing 27 municipal utilities within state regulatory jurisdiction); cf. Osteryoung & Bilenky, *The Cost of Retained Earnings for Government Electric Utilities*, PUB. UTIL. FORT., July 30, 1981, at 44 (29 states regulate government-owned utilities). Few states hold municipal utilities to the same standards as private utilities. See *infra* notes 133-61 and accompanying text. Arkansas, Kansas, New Hampshire, New Jersey, New Mexico, Pennsylvania, South Carolina, South Dakota, Texas, and Wyoming regulate municipal electric utility rates only for service offered several miles beyond the municipality's corporate boundaries. 1979 REPORT, *supra*, at 400.

3. Neuberger, *Two Issues in the Municipal Ownership of Electric Power Distribution Systems*, 8 BELL J. ECON. 303, 303 (1977). Cities such as Berkeley, California; Boulder, Colorado; Madison, Wisconsin; Portland, Oregon; and Massena and Schenectady, New York, recently have considered municipalization for the first time since the 1930's. *Id.*

4. See, e.g., Christy & Christy, *Who Says Utilities are Less Risky?*, PUB. UTIL. FORT.,

electric companies. This development in the electric utility industry, as well as phenomena such as energy shortages,⁵ inflation,⁶ increased public involvement,⁷ and the environmental movement,⁸ call for reevaluating the special treatment given publicly owned utilities.

Historically, municipally operated electric companies were exempt from state regulation.⁹ Recently, however, states have been bringing municipal utilities under supervision, although many still provide varying degrees of immunity.¹⁰ This Note analyzes how differences in state regulatory treatment of privately and municipally owned utilities affect residential electric consumers.

One justification for exempting municipal utilities from regu-

May 8, 1981, at 11; Cohen, *The Changing Nature of Utility Business Management*, PUB. UTIL. FORT., June 19, 1981, at 38; Curtis, *Electric Utilities*, FORBES, Jan. 4, 1982, at 104; Hitch, *Utilities in Trouble*, PUB. UTIL. FORT., Feb. 4, 1982, at 18; Matthews, *Cushioning "Future Shock" by Amending the Utility Mortgage*, PUB. UTIL. FORT., Jan. 21, 1982, at 50.

5. See Thompson, *Preparing for the Future in Electric Power*, PUB. UTIL. FORT., Apr. 12, 1979, at 19, 19-20.

6. Leafner, *Automatic Fuel Adjustment Clauses: Time for a Hearing*, 30 CASE W. RES. L. REV. 228, 228 (1980). From 1973 to 1974, the cost of fuel for electric utilities doubled. Rising fuel costs, tougher safety standards, the OPEC cartel, increased consumer demand, and pollution controls have all contributed to inflated operating costs. Controversy over rate regulation has often kept investor-owned utilities from offsetting these increased costs. *Id.* See generally Swindler, *The Elements of a Sound National Energy Policy*, PUB. UTIL. FORT., Jan. 3, 1980, at 13; Uhler & Zycher, *Energy Forecasting and Its Uncertainties*, PUB. UTIL. FORT., Jan. 17, 1980, at 27.

7. See Alpert, *Consumer Advisory Boards and Investor-Owned Utilities: Rhetoric and Reality*, PUB. UTIL. FORT., Aug. 27, 1981, at 19. Since 1971, citizen participation, consumer involvement, and community control have influenced federal legislation, public policy, and utility management. Some electric utilities are involving consumers in utility management as a result of consumer and regulatory commission pressure to keep rates low despite increasing financing and construction costs. *Id.* at 19; see *infra* notes 45-58 and accompanying text.

8. See generally *Environmental Symposium*, PUB. UTIL. FORT., June 22, 1978 (articles addressing the accommodation of environmental concerns by energy utilities).

9. See *Birmingham Elec. Co. v. City of Bessemer*, 237 Ala. 240, 186 So. 569 (1939), which stated, in comparing the policies for and against exempting municipal electric companies:

[T]here is clearly a sound basis for classification, to include the one [investor-owned utilities] and exclude the other [municipally owned utilities] from the exercise of such power. The defendant municipality, by its nature and elements, is a non-profit producing governmental agency, and engages in proprietary enterprises for the purposes of serving its own inhabitants.

Id. at 244, 186 So. at 572. This conclusion is a representative justification for exempting city-owned electric companies. See *infra* notes 133-47 and accompanying text.

10. The first three states to regulate electric utilities, New York, Massachusetts, and Wisconsin, have given their regulatory agencies authority over municipal producers of electricity, while the newest states to regulate electric utilities, Minnesota and Texas, give the authority to the municipalities. For a comparison of various types of state regulation, see *infra* notes 133-61 and accompanying text.

lation is that local interests are better served when city-owned companies are administered without interference from state regulatory agencies.¹¹ Municipal utilities are frequently nonprofit, charging lower rates than investor-owned producers. Arguably, the increased costs and needless interference caused by state regulation make such supervision undesirable.¹²

Commentators have frequently asserted that self-regulation of electricity production encourages inefficient operation,¹³ and that the absence of outside supervision permits utilities to ignore externalities which are properly part of their production costs.¹⁴ Allowing utilities to police themselves for compliance with service standards has also been attacked as unrealistic.¹⁵ Customers of municipal utilities must frequently tolerate a standard of service inferior to that enjoyed by others in the same state,¹⁶ and must

11. Telly & Grove, *The Municipal Utility and the Liberal Economic Ethic*, 30 CASE W. RES. L. REV. 267, 268 (1980). Defenders of municipal self-determination maintain that "a sound basis for preserving and encouraging freedom and independence of municipal utility operation" is retaining the democratic "grass roots" of home rule. *Id.* at 290; *see infra* notes 162-67 and accompanying text.

12. Lower utility rates charged by nonprofit electric producers are largely attributable to special tax treatment and different accounting methods which are unavailable to private electric suppliers. *See, e.g., Public Power Costs Less*, 14 PUB. POWER (May-June 1981).

13. *See, e.g., Hamilton, Foreword to Public Utility Law Symposium*, 30 CASE W. RES. L. REV. 215, 223 (1980); Jarrell, *The Demand for State Regulation of the Utility Industry*, 21 J.L. & ECON. 269, 269 (1979); Note, *Current Iowa Public Utility Regulation*, 51 IOWA L. REV. 385, 387 (1966) [hereinafter cited as Iowa Note]; *infra* notes 192-217 and accompanying text. *But see* Neuberger, *supra* note 3, at 303.

14. *See* Samuels, *Externalities, Rate Structure, and the Theory of Public Utility Regulation*, in *ESSAYS ON PUBLIC UTILITY PRICING AND REGULATION* 357 (H. Trebing ed. 1971). [E]xternality . . . refers to situations in which one economic actor imposes costs and/or confers benefits upon another without the former including those costs and/or benefits in his cost and benefit (revenue) or operating calculations. In short, the former economic actor is able to operate without bearing all the costs which he creates and/or without accruing to himself all the benefits which he creates.

Id. at 358; *see also* A. CARRON & P. MACAVOY, *THE DECLINE OF SERVICE IN THE REGULATED INDUSTRIES* (1981).

15. *See* PENNSYLVANIA PUBLIC UTILITIES COMMISSION, BUREAU OF CONSUMER SERVICES, COMPLIANCE REPORT (1980) [hereinafter cited as PENNSYLVANIA REPORT] (on file with the *Case Western Reserve Law Review*) (discussing electric companies' problems with customer service regulations); *infra* notes 168-81 and accompanying text.

16. In Ohio, for example, utilities "owned and operated by any municipal corporation" are explicitly excluded from the service standards required of privately owned utilities. OHIO REV. CODE ANN. § 4905.02 (Page 1977 & Supp. 1981). OHIO REV. CODE ANN. § 743.26 (Page 1977) delegates service and rate regulation to local government. Indiana follows a typical approach to exemption, mandating that "[e]very public utility is required to furnish reasonably adequate service and facilities," IND. CODE ANN. § 8-1-2-4 (Burns 1973), while explicitly excluding municipally operated utilities from the definition of regulated public utilities. *Id.* § 8-1-2-1.

also be subject to the capriciousness of local politics.¹⁷

Comparing the characteristics of privately and municipally owned utilities is inherently difficult because of differences in tax treatment, accounting methods, financing options, and philosophical perspectives.¹⁸ However, comparing the two types of utilities as to their impact on customers is possible by contrasting managerial technique, service, and regulatory standards.

This Note reviews the history and policies behind the treatment of municipal utilities,¹⁹ federal supervision of utilities in general,²⁰ and the impact of the consumer movement in the utility area.²¹ It next compares the different types and degrees of state regulation²² and analyzes the problems created by municipal exemption.²³ The Note concludes that the traditional policies supporting regulation²⁴ to ensure "adequate service at reasonable rates"²⁵ outweigh those supporting exemption of nonprofit utili-

17. Some "inherent inadequacies" of local municipal utilities include a lack of experts and investigative powers, an inability to respond to changes in technology, and a preoccupation with vote-getting that compromises sound policy-making. See Blair, *The Politics of Government Pricing: Political Influences on the Rate Structures of Publicly Owned Electric Utilities*, 35 AM. J. ECON. & SOC. 31, 35 (1976) (concluding that "[r]ecent studies of the behavior of government enterprise suggest that political forces are important to understanding [municipal utilities'] pricing policies. The empirical results support the hypothesis that the rate pattern can be viewed as the result of differential political influence among consumer groups."). This suggests that many states regulate city electric service outside of city voting limits to ensure that municipal utilities do not discriminate against consumers without political power. Services and pricing, however, can be compromised by such political decisions as lowering taxes or encouraging different classes of new customers, thus forcing existing customers to subsidize local politics. Moreover, municipal consumers might suffer from inner-city departmental politics or neglect of the system, absent regulation to ensure that minimum state standards are met. See Iowa Note, *supra* note 13, at 388-89; *infra* notes 182-91 and accompanying text.

18. Letter from Charles E. Teclaw, Manager, Policy Analysis and Research Division, Illinois Commerce Commission (November 10, 1981) (on file with the *Case Western Reserve Law Review*). What Mr. Teclaw referred to as "insurmountable difficulties in data comparability" have resulted rarely, since only the Vermont Public Service Board and the Public Service Commission of Wisconsin have undertaken to compare the service, managerial, and efficiency performances of private and municipal utilities.

19. See *infra* notes 28-44 and accompanying text.

20. See *infra* notes 59-132 and accompanying text.

21. See *infra* notes 45-58 and accompanying text.

22. See *infra* notes 133-61 and accompanying text.

23. See *infra* notes 162-217 and accompanying text.

24. See *infra* notes 76-97 and accompanying text.

25. I. A. PRIEST, PRINCIPLES OF PUBLIC UTILITY REGULATION 3 (1969). "The basic purpose of public utility regulation is 'to assure the furnishing of adequate service to all public utility patrons, without discrimination and at the lowest reasonable rates consistent with the interests both of the public and the utilities.'" *Id.* (footnotes omitted).

ties,²⁶ and that states could regulate municipal utilities and avoid the problems associated with private utility regulation.²⁷

I. HISTORY AND BACKGROUND

The electric utility industry has been regulated since its inception in 1879.²⁸ Local governments granted franchises to early companies. Although franchises were originally granted to competing producers, most markets were eventually monopolized or dominated by large companies.²⁹ As local governments lost the ability to control the developing natural monopolies and prevent inefficient duplication of facilities, many state governments assumed the task of supervising the rates and services of privately owned utilities.³⁰

A. *History and Background of Regulation*

In most states, the commissions which now regulate utility companies originally monitored railroads and canals.³¹ Early electric companies generally were bound only by city franchises until 1907, when New York and Wisconsin became the first states to regulate electric utilities effectively.³² By 1910, six states regu-

26. See *infra* notes 162-217 and accompanying text.

27. See *infra* notes 218-33 and accompanying text.

28. Jarrell, *supra* note 13, at 270.

29. Note, *Regulation, Competition, and Your Local Power Company*, 1974 UTAH L. REV. 785, 787-88 [hereinafter cited as Utah Note]. This Note traces the evolution of the municipal electric market. "Electricity's first commercial use was for limited street lighting in large metropolitan areas. Rather than creating a single electric company, most city governments, in order to stimulate competitive prices, granted licenses to many different companies." *Id.* at 787. The inefficiency that resulted from duplication of generating and transmitting facilities eliminated the competitive market. "Thus, because 'the invisible hand of competition was powerless to check the tendency for economies of scale to lead to monopoly,' the electric power industry went through a period of consolidation and merger." *Id.*

30. Jarrell, *supra* note 13, at 270-71; see also Utah Note, *supra* note 29, at 787.

31. Minnesota, for example, created the Department of Public Service to replace some of the functions of the Railroad and Warehouse Commission, which was renamed the "public utilities commission" in 1980. See MINN. STAT. ANN. § 216A.01 (West Supp. 1983). In New York, gas and electric companies are still regulated in part as "Transportation Corporations." See N.Y. TRANSP. CORP. LAW §§ 10-17 (McKinney 1943 & Supp. 1982).

32. Jarrell, *supra* note 13, at 270; Stigler & Friedland, *What Can Regulators Regulate? The Case of Electricity*, 5 J.L. & ECON. 1, 3 (1962). In New York, powers of electric companies are defined at N.Y. TRANSP. CORP. LAW § 11 (McKinney 1943 & Supp. 1982), standards for municipal electric utilities are found at N.Y. GEN. MUN. LAW §§ 360-66 (McKinney 1974), and Department of Public Service jurisdiction is specified at N.Y. PUB. SERV. LAW § 66 (McKinney 1955 & Supp. 1982). The regulatory authority of the Wiscon-

lated private utilities; by 1917, thirty-five states had electric utility commissions.³³ Currently, all states have commissions regulating privately owned electric utilities,³⁴ yet the degree to which states control municipal electric utilities varies.³⁵

Municipal electric plants were operating as early as 1881,³⁶ usually for street lighting.³⁷ Between 1892 and 1921 the number of municipal electric companies increased more than tenfold.³⁸ Since most of the systems were relatively small,³⁹ many were sold to growing privately owned companies in the 1920's.⁴⁰ Despite a decline of municipal ownership in the late 1920's, factors such as tax advantages, the eminent domain power, lower possible rates, and public demand for utility reform rejuvenated the popularity of municipal ownership during the 1930's.⁴¹

Today, 2200 municipally owned electric companies serve 30 million customers, usually in cities with populations of 10,000 or less.⁴² According to the American Public Power Association, municipal utilities serve 13.7 percent of the population, while investor-owned utilities serve 76.1 percent and rural electric

sin Public Service Commission is set forth at WIS. STAT. ANN. §§ 196.01-97 (jurisdiction over privately and municipally owned electric utilities); 197.01-20 (acquisition of utilities); and 198.01-22 (municipal power districts) (West 1957 & Supp. 1981).

33. Stigler & Friedland, *supra* note 32, at 4.

34. Before 1969, only Texas, Minnesota, and South Dakota did not regulate electric utility service. 1 A. PRIEST, *supra* note 25, at 2. These states subjected privately owned electric companies to state commission jurisdiction in 1975. S.D. CODIFIED LAWS ANN. § 49-34A-5 (Supp. 1982); MINN. STAT. ANN. § 216B.01 (West Supp. 1983); TEX. REV. CIV. STAT. ANN. art. 1446c, § 2 (Vernon 1980).

35. See *infra* notes 133-61 and accompanying text.

36. A. PHILLIPS, *THE ECONOMICS OF REGULATION* 575 (1969).

37. M. GLAESER, *PUBLIC UTILITIES IN AMERICAN CAPITALISM* 447 (1957).

38. *Id.* (the number increased from 235 to 2,581); see also A. PHILLIPS, *supra* note 36, at 575.

39. Municipal electric plants were established because smaller markets were not likely to yield profits needed to attract commercial producers. M. GLAESER, *supra* note 37, at 447. Although municipal suppliers accounted for 41% of all electric systems in 1921, they produced only 4.7% of the nation's total output of electric power. A. PHILLIPS, *supra* note 36, at 575.

40. A. PHILLIPS, *supra* note 36, at 575. Construction of transmission lines which allowed connection of small communities to distant power sources subsequently led to private ownership of the utilities dependent on privately generated electricity. M. GLAESER, *supra* note 37, at 447.

41. M. GLAESER, *supra* note 37, at 447; A. PHILLIPS, *supra* note 36, at 575. For a typical statutory provision authorizing eminent domain acquisitions, see MASS. GEN. LAWS ANN. ch. 164, § 35 (West 1976) (most recently amended in 1914); WIS. STAT. ANN. § 66.065 (West 1965 & Supp. 1982).

42. AMERICAN PUBLIC POWER ASSOCIATION, *THE PUBLIC BENEFITS OF PUBLIC POWER* 5 (1980) [hereinafter cited as *BENEFITS OF PUBLIC POWER*] (available upon request from the American Public Power Association).

cooperatives 10.2 percent.⁴³ In many states, municipally owned utilities and rural electric cooperatives are outside the jurisdiction of agencies which regulate privately owned companies.⁴⁴

B. *The Consumer Movement*

Until the late 1960's and early 1970's, consumer participation in rate hearings and drafting of electric utility regulations was rare.⁴⁵ In the late 1960's consumer activism, disenchantment with government, and environmental concerns combined to establish the consumer as a potent participant in utility lawmaking and hearings.⁴⁶ As organized consumer action affected local and federal legislation, the industry created consumer advisory boards which directly involve customers in utility activities.⁴⁷

Three devices now permit previously excluded consumers to participate in administrative hearings: use of a branch of the state government as a "peoples advocate," individual consumer group intervention at hearings, and the industry's own consumer advisory boards.⁴⁸ The Ohio legislature, for example, created a Consumers' Counsel within the Public Utilities Commission to represent residential consumers,⁴⁹ and municipal corporations in

43. *Id.* at 6; cf. Utah Note, *supra* note 29, at 788 (private companies supply 77.7% of national output).

44. For a discussion of state commission jurisdiction over municipal utilities, see *infra* notes 134-61 and accompanying text. Rural electric cooperatives are excluded from state commission jurisdiction in some states because they are perceived to be "effectively regulated and controlled" by statutes governing cooperative associations, see, e.g., MINN. STAT. ANN. § 216B.01 (West Supp. 1983); other states treat rural electric cooperatives under a separate legislative code, with substantially the same result, see, e.g., N.Y. RURAL ELEC. COOP. LAW §§ 1-70 (McKinney 1948 & Supp. 1982). A few states, notably New Mexico and Wyoming, include rural electric cooperatives under state utility commission jurisdiction. See N.M. STAT. ANN. § 62-3-2 (1978); WYO. STAT. § 37-2-205 (1971). The New Mexico provision stresses the importance of protecting "the interests of consumers" and preventing "unnecessary duplication." N.M. STAT. ANN. § 62-3-2 (1978).

Rural cooperatives affect a proportionately small segment of the population, although signs of increasing demand and production may indicate the need for further study of this type of electric producer. *Energy Input by Rural Electric Systems Continues to Climb*, PUB. UTIL. FORT., Feb. 17, 1977, at 20.

45. Cf. Rosenberg, *Rates, Consumer Pressure and Finance*, PUB. UTIL. FORT., Jan. 31, 1974, at 28 (calling for "innovative, aggressive and fair" representation of the public interest by state regulatory commissions).

46. Alpert, *supra* note 7, at 19.

47. *Id.*

48. Kens, *Public Futility—The Status of Consumers in Light of the Public Utility Regulatory Act*, 28 BAYLOR L. REV. 953, 954 (1976).

49. OHIO REV. CODE ANN. §§ 4911.01-.18 (Page 1977 & Supp. 1983). The Consumers' Counsel Board can only intervene in cases within the Ohio Public Utilities Commission's jurisdiction, and not in proceedings of municipally owned utilities. To encourage

Ohio may intervene on behalf of their residents in state regulatory proceedings.⁵⁰ Pennsylvania protects consumers through a subdivision of its utility commission,⁵¹ while Wisconsin has an independent commission with the exclusive function of representing electricity consumers.⁵² In Minnesota, consumer interests are represented by a division of the Department of Commerce.⁵³ Congress has also acted to assure consumer participation in state hearings. Title I of the Public Utility Regulatory Policies Act of 1978 (PURPA)⁵⁴ encourages special interest groups to intervene as interested parties,⁵⁵ and requires the utility to reimburse intervening groups for legal fees and expenses when their intervention affects the final decision.⁵⁶

The consumer advisory boards established by utility compa-

consumer interaction, the Consumers' Council Board maintains a toll-free number for Ohio utility consumers: 1-800-282-9448. *Id.* at § 4911.01(A).

50. *Id.* § 4911.15 (Page Supp. 1983).

51. 66 PA. CONS. STAT. ANN. § 308(d) (Purdon 1979) defines the Bureau of Consumer Services, a subdivision of the Public Utilities Commission.

52. WIS. STAT. ANN. § 199.01 (West Supp. 1981). The purpose of the Wisconsin Citizen Utility Board is to "ensur[e] effective and democratic representation of individual farmers and other individual residential utility consumers before regulatory agencies, the legislature and other public bodies and [to provide] for consumer education on utility service costs and on benefits and methods of energy conservation." *Id.* § 199.02.

53. MINN. STAT. ANN. § 45.17 (West Supp. 1981) ensures consumer representation in proceedings of publicly and privately owned utilities.

54. Pub. L. No. 95-617, 92 Stat. 3117 (codified at 16 U.S.C. §§ 2611-45 (Supp. V 1981)).

55. 16 U.S.C. § 2631 (Supp. V 1981). *See also Re* Public Serv. Co., 31 Pub. Util. Rep. 4th (PUR) 351, 354 (N.H. P.U.C. 1979) (an intervenor is a "party" if it has "sufficiently notified] the commission of the desire to actively participate or to state why its interests are affected by the overall proceeding, or that its interests were necessary for a fair evaluation of the issues and that their interests were not represented by other parties to the proceeding."); *cf.* Office of Consumers' Council v. Ohio Pub. Util. Comm'n, 56 Ohio St. 2d 220, 383 N.E.2d 593 (1978) (failure of adequate notice to intervene). *But see* Vermont Pub. Interest Research Group, Inc. v. Central Vt. Pub. Serv. Corp., 39 Pub. Util. Rep. 4th (PUR) 59, 64 (Vt. Pub. Serv. Bd. 1980) (commission has duty to hear any claims of unlawful acts by utility); American Hoechst Corp. v. Department of Pub. Util., 379 Mass. 498, 399 N.E.2d 1 (1980) (industrial customer with standing to appeal as aggrieved party affected by discriminatory rates).

56. 16 U.S.C. § 2632 (Supp. V 1981). Costs are not reimbursed unless intervention substantially contributes to the commission's decision and "persons with the same or similar interests have a common legal representative." *Id.*; *see Re* Costs of Participation in Elec. Rate Making Proceedings, 37 Pub. Util. Rep. 4th (PUR) 259, 273 (Cal. Pub. Util. Comm'n 1980); *Re* Minnesota Power and Light Co., 41 Pub. Util. Rep. 4th (PUR) 554, 616-17 (Minn. Pub. Util. Comm'n 1981) (senior citizen coalition reimbursed although state also intervened on behalf of consumers). *But see Re* Proceedings to Consider Elec. Rate Making Standards, 35 Pub. Util. Rep. 4th (PUR) 339 (Mich. Pub. Serv. Comm'n 1980) (commission without authority to award intervenors' expenses).

nies provide a third forum for consumer participation.⁵⁷ Some electric companies invite participation by consumer advisory boards "as a means of keeping in touch with customers, finding out what they want, softening their attitude toward 'the electric company,'" and "providing [the] participation organized consumerism claims it wants."⁵⁸ But the effectiveness of this forum is limited by the number of companies that decline to initiate such boards.

II. APPROACHES TO THE DUTY TO RENDER ADEQUATE SERVICE

Before the days of electricity, Justice Stone, writing for the Supreme Court, stated, "The primary duty of a public utility is to serve on reasonable terms all those who desire the service it renders."⁵⁹ This obligation applies to both private and municipal utilities. Regardless of statutory requirements, utilities must comply with federal due process requirements. While termination of service by a state-regulated private utility is not considered "state action,"⁶⁰ in *Memphis Light, Gas & Water Division v. Craft*⁶¹ the Supreme Court held that termination of utility service without adequate notice "deprive[s] the customer] of an interest in property without due process of law."⁶²

Prior to the consumer movement, commentators paid little attention to the utility's duty to render adequate service; instead their commentaries focused on rates, valuation of assets, and financing.⁶³ Recently, increased public awareness has forced util-

57. See generally Alpert, *supra* note 7, at 19. But see *Support for Consumer Advisory Boards*, PUB. UTIL. FORT., Dec. 3, 1981, at 65 (representatives of utilities with consumer advisory boards respond to Alpert's views).

58. Alpert, *supra* note 7, at 20.

59. *United Fuel Gas Co. v. Railroad Comm'n*, 278 U.S. 300, 309 (1928).

60. *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345 (1974).

61. 436 U.S. 1 (1978); see *infra* notes 87-98 and accompanying text.

62. 436 U.S. at 22.

63. See Note, *The Duty of a Public Utility to Render Adequate Service: Its Scope and Enforcement*, 62 COLUM. L. REV. 312, 312 (1962). The author noted:

Despite the frequent instances in everyone's life of dissatisfaction with the quality of utility service and the constantly reported complaints of some utilities that they can not afford to fulfill their service obligations, the literature in the field of public utility regulation is singularly devoid of discussion of the extent of a utility's duty to render adequate service.

Id.; cf. Note, *Fourteenth Amendment Due Process in Terminations of Utility Services for Nonpayment*, 86 HARV. L. REV. 1477 (1973) [hereinafter cited as Harvard Note] (written before the appeal of *Jackson v. Metropolitan Edison Co.* to the United States Supreme Court). The author concluded that although increased protection of consumer rights raises

ity companies and legislatures to address adequacy of service,⁶⁴ although commentators have yet to examine this issue. Industry journals, for example, discuss service not in terms of consumer rights but in terms of its cost or impact on the utility.⁶⁵ Many consumers have only vague notions of their rights as utility customers. Their uncertainty is compounded by the differing treatment of private and municipal utilities within the same state. Although some organizations have worked to inform consumers of their rights as utility customers,⁶⁶ many consumers rely solely on information provided by the utility in its billing notices.

The quality of utility service improved from 1958 to 1965, largely in response to low inflation and expansion of the gross national product.⁶⁷ (When inflation is low, investment is strong and demand rises.) While the cost of improvement added to the utility's expenses,⁶⁸ as long as rate increases were granted which reflected these costs, the utility had no difficulty maintaining adequate service levels.⁶⁹ These conditions prevailed in the electric utility market in the early 1960's. When inflation is high, however, growth declines, rates do not offset costs, and the quality of service inevitably deteriorates.⁷⁰ These conditions have characterized the utility market of the 1970's and early 1980's.⁷¹ Economic recession lowered expected revenues by decreasing demand for service, and inflation eroded the utility's resources, curtailing its ability to offset costs. These conditions were exacerbated by "regulatory lag"—the inability of ratemaking procedures to keep pace with the utility's financial needs—which prevents the utility from recouping its operating costs before inflation further erodes its assets.⁷²

the utility's expenses, "such expense . . . is not an exorbitant price to pay for fairness in the distribution of essential services . . ." *Id.* at 1504.

64. *See, e.g., Efficiency of Service and Rate Increases*, PUB. UTIL. FORT., May 24, 1973, at 50.

65. *See, e.g.,* Alpert, *supra* note 7, at 19; Flax, *Will the Utility Service Obligation Become a Victim of Economic Theory?*, PUB. UTIL. FORT., March 27, 1980, at 21.

66. For example, the Duluth (Minn.) Community Action Program sponsored the writing of a booklet discussing utility customers' rights. *See* LEGAL AID SERVICE OF NORTHEASTERN MINNESOTA, MY RIGHTS WITH UTILITIES COMPANIES (1981) (on file with the *Case Western Reserve Law Review*).

67. A. CARRON & P. MACAVOY, *supra* note 14, at 15-32.

68. *See* Flax, *supra* note 65, at 21; Harvard Note, *supra* note 63, at 1404.

69. A. CARRON & P. MACAVOY, *supra* note 14, at 9-10.

70. *Id.* at 11-13.

71. *Id.* at 13.

72. *See* Grigg, *Regulatory Lag Currently*, PUB. UTIL. FORT., June 23, 1977, at 13. "Regulatory lag here refers to delays imposed, due to the legal requirements of regulatory

Economic conditions are as germane to municipally owned utilities as they are to privately held companies. Although many municipal utilities have been relatively immune to these forces due to their freedom from state ratemaking procedures, in periods of extreme inflation even tax-exempt municipal bonds issued to finance city-owned utilities lose their investment appeal. When revenue sources dry up, municipal utility service quality declines.

This potential for harm to customer service is compounded in many states by the grant of immunity from regulatory commission minimum service requirements.⁷³ Before the extent of this problem can be identified, relevant federal standards must be ascertained and compared with typical state standards and policies.

A. Federal Treatment

Congress and the Supreme Court have limited their involvement in utility service to defining minimum standards. The Supreme Court has restricted its consideration to whether termination of service violated constitutionally protected property interests.⁷⁴ PURPA⁷⁵ is the first and only federal statute to address residential utility service. Thus, both Congress and the Court have left much of the responsibility for utility regulation to state legislatures, which must conform to the minimum guidelines established by the Court. PURPA's voluntary guidelines apply only to large electric suppliers, both municipal and investor-owned, and offer a prototype for state legislation consistent with federal energy policy.

1. Constitutional Protections

The first Supreme Court case supporting state regulation of public utility companies was decided in 1876. In *Munn v. Illinois*⁷⁶ the Court held that because certain companies are "affected with a public interest,"⁷⁷ state regulation does not deprive them of property in violation of the fourteenth amendment.⁷⁸ The Court

proceedings, upon utility efforts to make rates and revenues track significant cost changes." *Id.*

73. See *infra* notes 136-52 and accompanying text.

74. See *infra* notes 76-116 and accompanying text.

75. Pub. L. No. 95-617, 92 Stat. 3117 (codified in scattered sections of 15, 16, 26, 30, 42, 43 U.S.C. (Supp. V 1981)).

76. 94 U.S. 113 (1876). The Court also held that the states may exercise their police powers over businesses operating within their boundaries.

77. *Id.* at 130.

78. *Id.* at 125; see generally 1 A. PRIEST, *supra* note 25, at 5-9.

reasoned that when one devotes property to a purpose involving a public interest,⁷⁹ he, in effect, grants the power to regulate that property for the common good, at least to the extent of the public interest involved.⁸⁰ *Munn* preserved the states' right to license public utilities through certificates of convenience and necessity⁸¹ issued by state commissions.⁸² Since the state did not use the certificates to grant a public interest, but merely to declare the property owners' obligations should the property be used for the public benefit, no deprivation of property occurred under the fourteenth amendment.⁸³ In 1952 the Court held in *FCC v. RCA Communications*⁸⁴ that the national policy favoring competition does not outweigh the necessity of regulating utilities.⁸⁵ The Court stressed that the function of regulation is to protect the public interest and prevent needless duplication of facilities.⁸⁶ The right of the consumer to receive electric service was not addressed by the Supreme Court until 1978 in *Memphis Light, Gas & Water Division v. Craft*.⁸⁷

79. "Property does become clothed in a manner to make it of public consequence, and affect the community at large." 94 U.S. at 126.

80. *Id.*

81. See *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 346 (1974). In *Modern Motor Express v. Public Utility Comm'n*, 154 Ohio St. 271, 95 N.E.2d 764 (1950), the Ohio Supreme Court held that the Public Utilities Commission was authorized to license privately owned utilities by granting certificates of public convenience and necessity. The court noted:

It is a fundamental principle that in the matter of the regulation of . . . [utilities and common] carriers the purpose of . . . legislation is to secure to the public necessary and convenient common carrier [or utility] service . . . , but not to surrender any of the rights of the public . . . ; and that such certificates are issued for the benefit of the public rather than for the benefit of the recipients of the certificates.

Id. at 275, 95 N.E.2d at 767; accord *Adams v. Public Utility Comm'n*, 141 Ohio St. 255, 258, 47 N.E.2d 773, 775 (1943). Nevertheless, municipal utilities escape the licensing requirement in states that exempt them from commission jurisdiction, which is a prerequisite to granting certificates. See *infra* notes 136-47 and accompanying text.

82. 94 U.S. 113 *passim* (1876).

83. *Id.*

84. 346 U.S. 86 (1952).

85. *Id.* at 89-96. However, the Court has required certain state-authorized conduct by private utilities to yield to the national policy favoring competition. See *Cantor v. Detroit Edison Co.*, 428 U.S. 579 (1976) (overall state regulation of utility rates does not permit private utility to engage in tying arrangement which violates antitrust laws); *Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973) (private utility's refusal to transport power to municipal systems violated federal antitrust law, although refusal authorized by state agency).

86. 346 U.S. at 92-93.

87. 436 U.S. 1 (1978).

a. Memphis Light

In *Memphis Light* the Court held that termination of utility service without adequate notice deprived customers of a protected property interest in violation of the fourteenth amendment.⁸⁸ The *Memphis* Court found that interests as essential as utility services reach "the stature of 'property'" and "rise to the level of a 'legitimate claim of entitlement' protected by the Due Process Clause."⁸⁹ In *Memphis*, a municipal utility⁹⁰ terminated service to a residential customer due to an error in billing records.⁹¹ In deciding against the utility, the Court of Appeals for the Sixth Circuit had noted that the due process clause requires "(i) notice informing the customer not only of the possibility of termination but also of a procedure for challenging the disputed bill, . . . and (ii) '[an] established [procedure] for resolution of disputes' or some specified avenue of relief for customers who 'dispute the existence of liability.'"⁹² Since individuals had a "property interest" in the utility service, albeit an interest not necessarily involving undisputed ownership, termination must comply with the due process requirements of the fourteenth amendment.⁹³ The Supreme Court found that the termination violated due process because the utility's nominal pretermination notice practices were not reasonably calculated to inform customers of available administrative remedies.⁹⁴

Justice Marshall's opinion for the Court noted that neither injunctions nor actions subsequent to termination or payment effectively substitute for pretermination review.⁹⁵ While an injunction might eventually restore service to the customer, it could result in a "uniquely final deprivation" of an essential service in the in-

88. *Id.* at 7-16.

89. *Id.* at 9. The Court found added support for this conclusion in state regulations allowing public utility customers to enjoin a wrongful threat to terminate service or to bring a wrongful termination action. *Id.* at 11. The Court believed such regulation evidenced the states' recognition of utility service as a protected property interest. *Id.*

90. Memphis Light, Gas & Water Division (MLG&W) is a division of the city of Memphis which provides utility service. It is directed by a Board of Commissioners appointed by the City Council, and is subject to the ultimate control of the municipal government. As a municipal utility, MLG&W enjoys a statutory exemption from regulation by the state public service commission.

Id. at 3-4.

91. *Id.* at 3.

92. *Id.* at 12 (quoting *Craft v. Memphis Light, Gas & Water Div.*, 534 F.2d 684 (6th Cir. 1976)) (bracketed material by the Court).

93. *Id.* at 11-12.

94. *Id.* at 22.

95. *Id.* at 19.

terim.⁹⁶ Justice Marshall expressed this concern: "Utility service is a necessity of modern life. . . . The risk of an erroneous deprivation, given the necessary reliance on computers, is not insubstantial."⁹⁷

The minimum procedural guarantees required by *Memphis Light* are especially important to customers of municipal utilities which, like the Memphis Light, Gas & Water Division, are often exempt from state regulation.⁹⁸ While the *Memphis Light* Court held only that the utility's unsupervised compliance with its own standards failed to ensure minimum constitutionally required protections, state regulation of municipal utilities may be necessary to bring them in line with the fourteenth amendment.

b. *Due Process vs. Equal Protection*

Under a different analysis, courts have examined utility service as a constitutionally protected legitimate claim of entitlement rather than as a fundamental property right.⁹⁹ Claims of entitlement have been based on the nature of the service rendered, the dependence of the consumer, and the availability of alternatives.¹⁰⁰ Although this protection does not extend to all utility service, once the benefit of service is offered by the municipality, it becomes an entitlement.¹⁰¹

Procedural protections based on entitlements to continued utility service have been defined by the courts under both due pro-

96. *Id.* at 20.

97. *Id.* at 18. Citations by the Court include *Davis v. Weir*, 497 F.2d 139 (5th Cir. 1974), discussed *infra* at text accompanying notes 106-10.

98. See *infra* notes 136-47 and accompanying text.

99. "[T]he importance of a service performed by the State does not determine whether it must be regarded as fundamental" for equal protection purposes. *San Antonio Indep. School Dist. v. Rodriguez*, 411 U.S. 1, 30 (1973). For a discussion of the distinction between a fundamental right and an entitlement, see *Dawes v. Philadelphia Gas Comm'n*, 421 F. Supp. 806, 815-16 (E.D. Pa. 1976); *accord*, *Koger v. Guarino*, 412 F. Supp. 1375, 1383-87 (E.D. Pa. 1976), *aff'd mem.* 549 F.2d 795 (3d Cir. 1977) (if municipal utility is sole supplier, user has legitimate claim of entitlement to continued use); *cf. Memphis Light*, 436 U.S. at 9-12 (entitlement based on state statutory requirement not to terminate at will). *But see Jackson v. Metropolitan Edison Co.*, 419 U.S. 345 (1974) (water is the only utility service that is fundamental, i.e., essential to life).

100. See *supra* note 99.

101. *Cf. Goss v. Lopez*, 419 U.S. 565 (1975) (no fundamental right to education but once offered by state, continued benefit becomes entitlement); *Koger v. Guarino*, 412 F. Supp. 1375, 1383-87 (E.D. Pa. 1976), *aff'd mem.*, 549 F.2d 795 (3d Cir. 1977) (once municipality establishes water system, user has legitimate claim of entitlement); *see also Bradford v. Edelstein*, 467 F. Supp. 1361, 1368-69 (S.D. Tex. 1979) (electricity and water); *Donnelly v. City of Eureka*, 399 F. Supp. 64, 67-68 (D. Kan. 1975) (sole source of water); *Bronson v. Consolidated Edison*, 350 F. Supp. 443 (S.D.N.Y. 1972) (electricity).

cess¹⁰² and equal protection¹⁰³ theories. On the surface, analyses based on either theory appear to employ similar levels of judicial scrutiny, analogous tests, and identical policy rationales. Nevertheless, there are significant distinctions between due process and equal protection applications.

Due process analysis focuses on pretermination procedures prior to the elimination of utility service.¹⁰⁴ Equal protection analysis, on the other hand, focuses on how pretermination procedures affect the customer after termination.¹⁰⁵ The equal protection-due process dichotomy is exemplified by comparing *Memphis Light* with *Davis v. Weir*,¹⁰⁶ which was decided on equal protection grounds.

In *Davis*, a municipal utility terminated water service to a tenant user whose landlord neglected to pay the utility bills.¹⁰⁷ Since the due process violation arising from termination without adequate notice was not contested by the utility, the Fifth Circuit addressed the utility's refusal to restore service until the tenant made the delinquent payment.¹⁰⁸ The court found that holding tenants responsible for the debts of the customer of record "divided those who *apply* for utility service into two categories: applicants whose contemplated service address is encumbered with a pre-existing debt [for which they are not liable] and applicants whose residence lacks the stigma of such charges."¹⁰⁹ The court held that this classification bore no rational relation to the legitimate gov-

102. 436 U.S. at 9-22.

103. See *Davis v. Weir*, 497 F.2d 139 (5th Cir. 1974); see also *Koger v. Guarino*, 412 F. Supp. 1375 (E.D. Pa. 1976), *aff'd mem.*, 549 F.2d 795 (3d Cir. 1977) (utilizing both due process and equal protection analyses).

The *Davis* court noted that the utility conceded that due process required pre-termination notice to the user, citing *Bell v. Burson*, 402 U.S. 535 (1971) (suspension of driver's license without hearing violated procedural due process) and *Goldberg v. Kelly*, 397 U.S. 254 (1970) (procedural due process requires hearing before termination of welfare benefits). 497 F.2d at 143. While neither case involved utilities, *Bell* and *Goldberg* illustrate the Supreme Court's concern that benefactors of a significant state-provided service receive a pretermination hearing.

104. See *Memphis Light*, 436 U.S. at 12.

105. See *Davis v. Weir*, 497 F.2d 139 (5th Cir. 1974); *Koger v. Guarino*, 412 F. Supp. 1375 (E.D. Pa. 1976), *aff'd mem.*, 549 F.2d 795 (3d Cir. 1977). For a discussion of these cases and the equal protection/due process distinction in the municipal utility service context, see Note, *Municipal Utility Service as a Property Right: Pre-Termination Notice to Tenant Not Required*: *Sterling v. Village of Maywood*, 28 DEPAUL L. REV. 885, 896-99 (1979) [hereinafter cited as DePaul Note].

106. 497 F.2d 139 (5th Cir. 1974).

107. *Id.* at 141-42.

108. *Id.* at 173.

109. *Id.* at 144 (emphasis in original).

ernment interest in supplying utility service: "The City has no valid governmental interest in securing revenues from innocent applicants who are forced to honor the obligations of another or face constructive eviction from their homes. . . ." ¹¹⁰

Due process analysis, unlike the rational basis test used in equal protection analysis, involves balancing the government's interest against "the risk of erroneous deprivation" of a protected entitlement. ¹¹¹ The timing of the complaint against the utility determines whether a due process or an equal protection inquiry is most appropriate. When the user of municipally supplied utility service is denied pretermination notice and opportunity to be heard, due process treatment is appropriate. ¹¹² Classifications drawn by the utility after termination may be challenged on either ground. ¹¹³ The appropriate analysis, however, depends not on wooden applications of traditional due process or equal protection concerns, ¹¹⁴ but on the common policy motivating these decisions, ¹¹⁵ which goes beyond the need for equal treatment and adequate notice. Quite simply, as the Supreme Court stated in *Memphis Light*, "'A public utility should not be able to coerce a customer to pay a disputed claim.'" ¹¹⁶

2. PURPA

The only congressional act addressing consumer rights to utility service is Title I of the Public Utility Regulatory Policies Act of 1978 (PURPA). ¹¹⁷ PURPA applies to both regulated and nonreg-

110. *Id.* at 145. *Cf.* *Chatham v. Jackson*, 613 F.2d 73 (5th Cir. 1981). The *Chatham* court read *Davis* as permitting termination of utility service to a landlord's residence because of delinquent payment for service to an apartment building he owned. Unlike the tenant in *Davis*, the landlord had contracted for the utility service and benefited from its improvement of his property.

111. *See Memphis Light*, 436 U.S. at 17.

112. *Id.* at 9-22. "This Court consistently has held that 'some kind of hearing is required at some time before a person is finally deprived of his property interests.'" *Id.* at 16 (quoting *Wolf v. McDonnell*, 418 U.S. 539, 557-58 (1974)) (emphasis added).

113. *See, e.g., Davis v. Weir*, 497 F.2d 139 (5th Cir. 1974); *Bradford v. Edelstein*, 467 F. Supp. 1361 (S.D. Tex. 1979).

114. *See DePaul Note, supra* note 105, at 899 (criticizing *Sterling v. Village of Maywood*, 579 F.2d 1350 (7th Cir. 1978), *cert. denied*, 440 U.S. 914 (1979), for exaggerating this analytical difference to reach a decision that "runs counter to the current trend of public policy concerning the rights of utility users to receive notice prior to termination of utility service.").

115. *See supra* notes 86, 99-103, 114 and accompanying text.

116. 436 U.S. at 10 (quoting *Trigg v. Middle Tenn. Elec. Membership Corp.*, 533 S.W. 2d 730, 733 (Tenn. Ct. App. 1975)).

117. 16 U.S.C. §§ 2611-45 (Supp. V 1981). *See generally* *Flax, supra* note 65, at 21;

ulated utilities which sell over 500 million kilowatt hours of power a year.¹¹⁸ The Act invites utilities to increase information to consumers,¹¹⁹ establishes standards for uniform termination of service procedures,¹²⁰ and encourages the use of "lifeline rates."¹²¹ PURPA gives consumers the right to intervene in utility proceedings and requires that the utility compensate successful consumer participants.¹²²

Lifeline rates, typically defined as "rates for essential needs of electric customers," allow a rate preference for elderly, disabled, or low-income utility customers.¹²³ The primary purpose of lifeline rates is preventing service termination during the winter months.¹²⁴ Supporters of lifeline rates reason that since low-income households use less power than higher income households, the former spend a larger percentage of their income for electricity and thus pay a higher average rate.¹²⁵ Moreover, rate increases are felt more by low-income users than by wealthier users.¹²⁶ On the other hand, lifeline rates are criticized as social engineering that inhibits the utility's operating efficiency.¹²⁷ State commis-

Jones, *The National Energy Act and State Commission Regulation*, 30 CASE W. RES. L. REV. 324 (1980); Journey, *PURPA Rate Studies: Much Ado About Technical Analysis*, PUB. UTIL. FORT., July 16, 1981, at 23; Richardson, *Why PURPA's Title I Should Be Repealed*, PUB. UTIL. FORT., Feb. 12, 1981, at 13.

118. 16 U.S.C. § 2612 (Supp. V 1981).

119. *Id.* § 2625(f).

120. *Id.* § 2625(g).

121. *Id.* § 2624.

122. *Id.* §§ 2631-32; see *supra* notes 55-56 and accompanying text.

123. See Investigation into Rate Structures of Elec. Util., 38 Pub. Util. Rep. 4th (PUR) 409 (Or. P.U.C. 1980) (lifeline rates rejected because they impose inequitable and burdensome effects on low-income customers). Lifeline rates are authorized by statute in some jurisdictions. See, e.g., CAL. PUB. UTIL. CODE § 739 (West Supp. 1981); MICH. COMP. LAWS ANN. § 460.6f (Supp. 1981), construed in *Consumers Power Co.*, 25 Pub. Util. Rep. 4th (PUR) 167 (Mich. Pub. Serv. Comm'n 1978) (rate relief to senior citizens not discriminatory). Without statutory authorization, state commission establishment of lifeline rates has been held to violate statutes forbidding rate discrimination. See *Mountain States Legal Found. v. Colorado Pub. Util. Comm'n*, 197 Colo. 56, 590 P.2d 495 (1979); see also Note, *Conservation, Lifeline Rates and Public Utility Regulatory Commissions*, 19 NAT. RESOURCES J. 411 (1979) (lifeline rates violate New Mexico statutes).

124. See, e.g., Francfort & Woo, *Lifeline and Incremental Cost Residential Electric Rates*, PUB. UTIL. FORT., Feb. 17, 1977, at 15; see also Frank, *Lifeline Proposals and Economic Efficiency Requirements*, PUB. UTIL. FORT., May 26, 1977, at 11 (lifeline rates can be administered consistent with efficiency standards).

125. Francfort & Woo, *supra* note 124, at 15.

126. *Id.*

127. Flax, *supra* note 65, at 24; see also *Lifeline Rates: An Update*, PUB. UTIL. FORT., Aug. 13, 1981, at 48 (recent state treatment); *The Lifeline Rate Issue*, PUB. UTIL. FORT., Oct. 11, 1979, at 42 (analyzing conflicting state approaches). Since lifeline rates are available only to customers of regulated utilities, municipal utility customers are denied lifeline

sions and municipalities are under no obligation to adopt the standards recommended by PURPA, but need only consider them.¹²⁸ PURPA only compels states to permit and compensate consumer intervention.¹²⁹

Although PURPA indicates that Congress intended to encourage uniform and adequate utility service, the Act assures only that consumer information and intervention opportunities will be provided. Utility customers may thus find the Equal Credit Opportunity Act¹³⁰ to be useful federal legislative protection. The Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age, and receipt of public assistance.¹³¹ Since Congress did not exempt utilities from the Act, utility companies must comply because they extend credit to residential customers.¹³² However, absent coverage by PURPA or the Equal Credit Opportunity Act, customer protection from overreaching utilities remains with the states. And in states which prohibit their commissions from intervening in municipal affairs, local governments provide the only regulatory supervision of municipally owned utilities.

B. *State Regulatory Treatment*

While no two states regulate electric utilities identically, common characteristics permit categorization. State utility commission treatment of municipal electric companies falls into three general classifications. The first includes states that exempt municipal electric utilities from commission jurisdiction or allow

rate protection in jurisdictions which exempt municipal utilities from state commission regulation.

128. 16 U.S.C. §§ 2621-23 (Supp. V 1981). Since Title I of PURPA does not mandate compliance with its provisions, it has been criticized as "unnecessary, theoretically unattainable and practically capricious." Richardson, *supra* note 117, at 13. Given the limited power of the Act to require improved and uniform utility standards, Title I is more a policy statement than a legislative mandate.

129. 16 U.S.C. §§ 2631-32 (Supp. V 1981); *see also* Jones, *supra* note 117, at 330-32.

130. 15 U.S.C. §§ 1691-91f (1976 & Supp. V 1981).

131. *See* Donoghue, *The Equal Credit Opportunity Act and Public Utilities*, PUB. UTIL. FORT., June 5, 1980, at 28 (except for three limited exemptions, *see* Equal Credit Opportunity, 12 C.F.R. § 202 (1983), public utilities are governed by the Act). The Act has influenced state utility service regulations. In Pennsylvania, for example, regulated utilities must comply with the Act's credit standards. PENNSYLVANIA REPORT, *supra* note 15, at 7 (discussing origin of 52 PA. ADMIN. CODE §§ 56.01-56.99).

132. Donoghue, *supra* note 130, at 31. "What utilities must not do is rely on the erroneous assumption that the broad exemption from the Truth-in-Lending Act for public utilities also exempts utilities from the Equal Credit Opportunity Act." *Id.*

commission intervention only with the municipality's consent.¹³³ The second includes states that regulate municipal utility operations beyond city borders.¹³⁴ The third includes states that regulate the service or rate components of municipally owned electric companies or treat them like privately owned utilities.¹³⁵

1. Total Exemption

Half of the states statutorily exempt all municipal electric utility operations from commission jurisdiction.¹³⁶ The typical policy behind exclusion is that "municipal utilities are presently effectively regulated by the residents of the municipalities which own and operate them. . . ."¹³⁷ Generally, the statutory scheme for exemption involves limiting commission jurisdiction to "public utilities" and then excluding municipally owned companies from that definition.¹³⁸ Some states constitutionally prohibit "special commissions," including state public utility commissions, from interfering with the power of local governments to regulate municipally owned electric companies.¹³⁹ Moreover, constitutional

133. See *infra* notes 136-47 and accompanying text.

134. See *infra* notes 148-52 and accompanying text.

135. See *infra* notes 153-61 and accompanying text.

136. The following states exempt all municipal utility operations: Alabama, Arizona, California, Connecticut, Delaware, Georgia, Hawaii, Idaho, Illinois, Kentucky, Louisiana, Michigan, Minnesota, Missouri, Nevada, North Carolina, North Dakota, Ohio, Oklahoma, South Dakota, Tennessee, Texas, Utah, and Virginia. 1979 REPORT, *supra* note 2, at Table 4.

137. MINN. STAT. ANN. § 216B.01 (West Supp. 1981). *But see* Taylor v. Beltrami Elec. Coop., 319 N.W.2d 52 (Minn. 1982) (municipal and cooperative electric companies must comply with commission service regulations).

138. See MICH. COMP. LAWS ANN. § 460.6 (West 1967) ("The Michigan public service commission is hereby vested with complete power and jurisdiction to regulate all public utilities in the state except any municipally owned utility."); N.C. GEN. STAT. § 62-3(23)(d) (Supp. 1981) ("The term 'public utility'. . . shall not include a municipality."); OHIO REV. CODE ANN. § 4905.02 (Page Supp. 1981) (municipally operated corporations excluded from definition of "public utility"); *id.* § 4905.03 (Page Supp. 1981) (municipally operated corporations excluded from Public Utility Commission jurisdiction); S.D. CODIFIED LAWS ANN. § 49-34A-1(12) (Supp. 1981) (commission jurisdiction extends to "public" utilities; definition of public utility does not embrace "an electric or gas utility owned by a municipality"); TEX. REV. CIV. STAT. ANN. art. 1446c, § 3(c) (Vernon 1980) ("The term 'public utility' or 'utility,' when used in this Act, includes any person, corporation, river authority, cooperative corporation, or any combination thereof, other than a municipal corporation.").

139. *E.g.*, UTAH CONST. art. VI, § 28 ("The legislature shall not delegate to any special commission . . . any power to make, supervise or interfere with any municipal improvement, money, property or effects . . . or to perform any municipal functions."); *see* Logan City v. Public Util. Comm'n, 72 Utah 536, 271 P. 961 (1928) (constitution forbids state legislature from delegating authority to commission to fix rates of municipal utility).

home rule¹⁴⁰ states may supervise their charter cities' electric utilities¹⁴¹ only by supplementing or superseding municipal regulation with "general laws,"¹⁴² legislation uniformly applicable statewide.¹⁴³

States immunizing municipally owned utilities from commission regulation usually adopt separate statutory guidelines for exempted utilities. Ohio, for example, has enacted legislation empowering municipal corporations to regulate their own utilities;¹⁴⁴ Michigan has adopted statutes governing city lighting.¹⁴⁵ Some states allow a municipality to "avail itself of all the benefits . . . of the regulatory services of the commission."¹⁴⁶ Others provide that municipalities may seek the aid of the commission when making single rate determinations without becoming subject to commission jurisdiction in subsequent matters.¹⁴⁷

2. *Service Beyond Municipal Boundaries*

Many states allow their utility commissions to regulate only municipal electric operations outside of the municipality's corporate limits.¹⁴⁸ The policy behind this restriction is to preserve lo-

140. Home rule denotes a grant of power by a state to its local governments to frame and adopt a charter of government. Over half the states have adopted home rule provisions; of these, half have done so by statute and the rest by direct constitutional grant of legislative power to local governments. F. MICHELMAN & T. SANDALOW, *MATERIALS ON GOVERNMENT IN URBAN AREAS* 302 (1970). Courts have construed constitutional home rule provisions as restricting the state's power to areas of exclusive statewide concern and areas of joint state and local concern. A state may not legislate in areas of exclusive local concern; if it does, inconsistent local law prevails. *Id.* at 352-53. Courts, noting the extra-territorial aspects of municipal utility operation, have placed them within the joint concern area to permit state commission regulation. *See, e.g., Vaubel, Of Concern to Painesville—Or Only to the State: Home Rule in the Context of Utilities Regulation*, 33 OHIO ST. L.J. 257, 284, 328 (1972).

141. Vaubel, *supra* note 140, at 312.

142. *See, e.g., OHIO CONST.* art. XVIII, § 3: "Municipalities shall have authority to exercise all powers of local self-government and to adopt and enforce within their limits such local police, sanitary and other similar regulations, as are not in conflict with general laws."

143. *See* F. MICHELMAN & T. SANDALOW, *supra* note 140, at 336-37.

144. OHIO REV. CODE ANN. § 743.26 (Page 1976).

145. MICH. COMP. LAWS ANN. §§ 107.1-10, 123.91-101 (1967).

146. *See, e.g., N.M. STAT. ANN.* § 62-6-5 (1978).

147. *See, e.g., OHIO REV. CODE ANN.* § 743.45 (Page 1976).

148. Alaska, Arkansas, Colorado, Kansas, Maine, Mississippi, New Hampshire, New Jersey, New Mexico, Pennsylvania, South Carolina, West Virginia, and Wyoming only regulate municipal electric companies that operate beyond municipal boundaries. 1979 REPORT, *supra* note 2, at 3. In New Jersey, for example, "[e]very municipality in supplying electricity, gas, steam or other products beyond its corporate limits is . . . declared a public utility." N.J. REV. STAT. ANN. § 40:62-24 (West 1967). The public utility commission has

cal control while protecting the interests of consumers who exert no influence in the city's political process.¹⁴⁹ The Wyoming Public Service Commission, for example, has jurisdiction only over municipal utility operations outside city boundaries and the sale of excess electricity,¹⁵⁰ even though Wyoming has no municipally owned electric utilities.¹⁵¹ Pennsylvania, on the other hand, requires a certificate of public convenience and necessity for utility service beyond a city's corporate limits.¹⁵²

3. *State Regulation of Municipal Electric Utilities*

The final category includes states which subject all municipal utility operations to commission jurisdiction. Notably, the states most experienced in utility regulation—Wisconsin, New York and Massachusetts—fall within this category, while those least experienced—Minnesota, South Dakota and Texas—exempt municipal utilities from commission regulation.¹⁵³

The degree of permissible supervision varies from state to state. Some commissions regulate only utility service or rates, while others subject publicly owned utilities to the same standards as investor-owned companies. Iowa, for example, authorizes commission supervision solely over utility service.¹⁵⁴ In contrast, the Indiana Public Service Commission has jurisdiction only over ratemaking procedures:¹⁵⁵ municipal utility rates may be neither excessive nor too low to permit "adequate and efficient service."¹⁵⁶ New York,¹⁵⁷ Wisconsin,¹⁵⁸ and Vermont¹⁵⁹ apply equal stan-

jurisdiction to regulate its "service, accounts, property rights, equipment, franchises, extensions, reports, rates [and] issuance of bonds . . ." *Id.*

149. See, e.g., Blair, *supra* note 17, at 31.

150. WYO. STAT. § 37-1-101(a)(vi)(H) (1977).

151. 1979 REPORT, *supra* note 2, at 3-4.

152. 66 PA. CONS. STAT. ANN. § 1102(a)(5) (Purdon 1979).

153. Municipally owned electric utilities are regulated by utility commissions in Florida (only basic rate structure regulation), Indiana, Iowa, Massachusetts, Maryland, Montana, New York, Oregon, Rhode Island, and Vermont. 1979 REPORT, *supra* note 2.

154. See IOWA CODE ANN. § 476.1-2 (West Supp. 1983) ("The Iowa state commerce commission shall regulate rates and services of public utilities. . . . Nothing in this paragraph subjects the *rates* of municipal utilities to the regulatory authority of the commission." (emphasis added)).

155. IND. CODE ANN. § 8-1.5-3-8 (Burns 1982).

156. *Id.*

157. N.Y. GEN. MUN. LAW § 364 (McKinney 1974) (includes municipal electric service as a public utility regulated within N.Y. PUB. SERV. LAW §§ 64-74 (McKinney 1955 & Supp. 1981)).

158. WIS. STAT. ANN. § 196.01 (West 1957) ("Public utility means and embraces every corporation . . . town, village or city that may own, operate, manage or control . . . any

dards to municipally and investor-owned electric utilities. And in Massachusetts, municipal power companies are included within utility commission jurisdiction, although some provisions of its public utilities laws apply selectively to private or municipal utilities.¹⁶⁰ State supervision has not, however, eliminated local input into the regulatory process.¹⁶¹

In states which regulate municipal utilities, policies supporting the regulation of natural monopolies prevail over policies favoring local autonomy. To determine the impact of this preference on the electricity consumer, this Note next explores the problems created by immunizing municipal utilities from state control.

III. PROBLEMS WITH IMMUNITY FROM STATE CONTROL

States exempting municipally owned utilities from utility commission regulation view local government ownership as an adequate substitute for state regulation to protect the public interest.¹⁶² This rationale, however, is undercut by the practice of the states most experienced in regulating municipally owned power companies.¹⁶³ The experienced states, which treat public and private utilities alike, appear to have rejected the notion that

plant or equipment or any part of a plant or equipment, within the state, for . . . the production, transmission, delivery or furnishing of heat, light . . . or power either directly or indirectly to or for the public”)

159. VT. STAT. ANN. tit. 30, § 2902 (1970). In discussing the “powers of municipalities,” the statute states:

[I]n all such respects such municipality shall have the same privileges and be subject to the same restrictions as are provided for public service corporations Such municipality may change, enlarge and extend the same from time to time and maintain the same, having due regard for the safety and welfare of its citizens and security of the public travel.

Vermont and Wisconsin are the only states which have compared the performances of investor-owned and municipally owned utilities. See *infra* notes 197-99, 209-10 and accompanying text.

160. MASS. GEN. LAWS ANN. ch. 164, §§ 34-69F, 129-32 (West 1976 & Supp. 1983) (apply exclusively to municipal regulation); *id.* §§ 3-33A (apply exclusively to corporate regulation). But see *id.* §§ 1-2, 69G-75A, 76-128 (West 1976) (both corporate and municipal regulation).

161. See, e.g., MASS. GEN. LAWS ANN. ch. 164, § 75 (West 1976) (local aldermen to regulate utility operations affecting “health, safety, convenience or property of the inhabitants of their towns”); WIS. STAT. ANN. § 196.58 (West 1957) (preserving a degree of concurrent jurisdiction).

162. See Peltzman, *Pricing in Public and Private Enterprises: Electric Utilities in the United States*, 14 J.L. & ECON. 109 (1971). “Specifically, it is unlikely that the management of a government firm will be permitted complete discretion in the setting of prices. Rather, it will be constrained by formal pricing rules or by supervening organizations representing other parts of the government.” *Id.* at 121.

163. See *supra* note 153 and accompanying text.

local ownership protects local consumers. Other states, by regulating service or rates, have recognized the municipality's inability to maintain acceptable standards at least in those areas.¹⁶⁴

Municipally controlled utilities are vulnerable to three central problems. The first is the failure to achieve necessary levels of economic efficiency.¹⁶⁵ The second is disruption caused by political pressures,¹⁶⁶ and the third is administrative inefficiency and inadequacy.¹⁶⁷ This Note contends that unregulated utilities are more susceptible to these problems than regulated utilities.

A. *Procedural Inadequacy*

When a state exempts municipally owned utilities from commission regulation, it puts the burden of regulation and compliance on the utility itself.¹⁶⁸ City-owned utilities consequently become self-policing industries. One serious problem with a self-policing industry is that even where standards are predetermined by the state, as in Ohio and Michigan, they are likely to be interpreted in the light most favorable to the utility.¹⁶⁹

Most municipally owned electric companies are found in small or medium-sized communities¹⁷⁰ where local governing boards lack the technical and administrative expertise of the state commissions.¹⁷¹ The lack of investigative powers and viable administrative structures hampers efficient handling of complaints and

164. See *supra* notes 154-56 and accompanying text.

165. Cf. R. SCHMALENSSEE, *THE CONTROL OF NATURAL MONOPOLIES* 11-12 (1979). Although this treatise is primarily concerned with failures of regulation of privately owned utilities, its observations apply equally where government ownership is substituted for regulation.

166. Cf. *id.* at 11-12.

167. *Id.* at 12-13.

168. See *supra* notes 11-17 and accompanying text.

169. M. GLAESER, *supra* note 37, at 71-78; see also Iowa Note, *supra* note 13, at 388-89 (local regulation in Iowa has failed, so state regulation recommended).

170. Three-fourths of all municipal electric systems are in communities of 10,000 or less. See *BENEFITS OF PUBLIC POWER*, *supra* note 42, at 5.

171. While state utility commissions are concerned only with utilities, city governments must address all facets of the city's operation. City officials not only lack the specialized expertise of state utility commissioners, but also the funds with which to procure outside technical advice. Consequently, they are often forced to rely on the utility's own management for evaluation of its performance. The only detailed management study comparing publicly and privately owned utilities found a lack of technical and managerial expertise among Vermont's 22 smallest municipal power companies, and suggested that the largest municipally owned company should "share its resources and experience with smaller municipal utilities" throughout the state. VERMONT PUBLIC SERVICE BOARD, *IV MANAGEMENT AUDIT OF ELECTRIC UTILITIES IN VERMONT XI-4 (1977)* [hereinafter cited as *VERMONT AUDIT*] (on file with the *Case Western Reserve Law Review*); see *supra* note 17.

enforcement of regulatory standards.¹⁷² The prohibitive cost of effective regulatory agencies at the local level¹⁷³ results in denial of representation and intervention rights to most municipal utility consumers.¹⁷⁴

In a study of compliance by Pennsylvania's privately owned utilities with service and notice requirements, the state's Public Utility Commission's Bureau of Consumer Services identified 806 instances where utilities misapplied commission regulations.¹⁷⁵ The study examined the efficacy of voluntary compliance with regulations governing access to utility service,¹⁷⁶ termination of service,¹⁷⁷ and billing procedures.¹⁷⁸ The Bureau of Consumer Services noted that the most frequent violations were committed by the less efficient utilities, and that customer complaints provided accurate indicia of problems with the utility.¹⁷⁹ The Bureau concluded that utilities often view regulations "as an obstruction placed in the path of company management."¹⁸⁰

The Pennsylvania study indicates that similar problems occur with unregulated utilities, and are likely to go unremedied. A municipal utility which views consumer service regulations as an obstruction is unlikely to protect the rights of consumers as zealously as a disinterested state commission. Smaller utilities frequently lack the manpower or resources to analyze and process consumer

172. See Iowa Note, *supra* note 13, at 388; see also M. GLAESER, *supra* note 37, at 71-78.

173. See Iowa Note, *supra* note 13, at 388.

174. Since many municipal utilities are too small to invoke PURPA jurisdiction, municipal consumers are not guaranteed intervention rights. See *supra* note 118 and accompanying text.

175. PENNSYLVANIA REPORT, *supra* note 15, at 4 (evaluating utilities' implementation of the Pennsylvania Public Utility Commission's *Standards and Billing Practices for Residential Utility Service* [codified at 52 PA. ADMIN. CODE §§ 56.1-231 (Shepard's 1981)]).

The purpose of this chapter is to establish and enforce uniform, fair, and equitable residential utility service standards governing eligibility criteria, credit and deposit practices, and account billing, termination, and customer complaint procedures. The policy of this chapter is to assure adequate provision of residential utility service, to restrict unreasonable termination of or refusal to provide that service, and to provide functional alternatives to termination or refusal to provide that service.

52 PA. ADMIN. CODE § 56.1 (Shepard's 1981).

176. PENNSYLVANIA REPORT, *supra* note 15, at 7-11; see 52 PA. ADMIN. CODE §§ 56.71-56.192 (Shepard's 1981).

177. PENNSYLVANIA REPORT, *supra* note 15, at 13-37; see 52 PA. ADMIN. CODE §§ 56.11-56.65 (Shepard's 1981).

178. PENNSYLVANIA REPORT, *supra* note 15, at 37-46; see 52 PA. ADMIN. CODE §§ 56.11-56.65 (Shepard's 1981).

179. PENNSYLVANIA REPORT, *supra* note 15, at 2-5; see *infra* note 195.

180. PENNSYLVANIA REPORT, *supra* note 15, at 53.

complaints.¹⁸¹ Where a municipal utility is unwilling or unable to monitor service standards, it denies the residential customer the minimum protections guaranteed to customers of regulated utilities.

B. *Political Susceptibility*

One of the strongest policy arguments for exemption is that freedom from state regulation allows municipally owned electric companies to be responsive to local needs.¹⁸² Nevertheless, leaving municipal utilities under local control exposes them to greater political pressures than utilities regulated by state commission.¹⁸³ Local politics often results in a government-run enterprise which places the needs of special interest groups before those of the general public.¹⁸⁴ As one commentator notes, "government-firm management will use prices to confer benefits on voters in return for effective political support for the enterprise and its management."¹⁸⁵ Since "[t]he government manager who tries to buy political support through the price structure . . . cannot benefit every voter," a manager must concentrate on benefiting customer classes which will "extend the base of his political support."¹⁸⁶ As a result, local decisionmaking often is dictated by special interest groups, which subverts the goal of regulation—furthering the public interest.¹⁸⁷

An understanding of the impact of politics on a municipal utility is essential to an evaluation of its pricing structures. Managers of municipally owned electric companies usually take directions from the mayor's office, city council, or a local utility commission.¹⁸⁸ States which subject government-owned utilities to state commission regulation recognize the deleterious impact of local political pressures on municipal utility management. Wisconsin supervises rates charged by municipal electric companies to pre-

181. See M. GLAESER, *supra* note 37, at 71-78; Iowa Note, *supra* note 13, at 388-89.

182. The city's governing body, acting in a political capacity, expresses the value preferences to which the utility management must aspire. It becomes the pulse of public approval. To a degree, then, the public gets the utility service it is willing to demand, though it assumes the risk of mediocre performance should it fail to insist upon responsible management of its utility enterprise.

Telly & Grove, *supra* note 11, at 285.

183. R. SCHMALENSEE, *supra* note 165, at 12.

184. Blair, *supra* note 17, at 31.

185. Peltzman, *supra* note 162, at 112 (footnotes omitted).

186. *Id.* at 112-13.

187. See Blair, *supra* note 17, at 31; R. SCHMALENSEE, *supra* note 165, at 12.

188. Blair, *supra* note 17, at 31.

vent the use of excessive charges to increase city revenues.¹⁸⁹ The Indiana Legislature, on the other hand, has declared that “[r]ates and charges too low to meet . . . requirements [of operation] are unlawful.”¹⁹⁰ Politically motivated reluctance to increase rates is as harmful to consumers as excessive charges. An insufficient rate base inevitably jeopardizes quality of service, especially if inflation makes utility operation more costly.¹⁹¹

C. *Inefficient Operation*

Municipally owned utilities are commonly defended for their sensitivity to “social principles”¹⁹² and their relative imperviousness to the necessities of efficient operation which constrain investor-owned utilities.¹⁹³ Municipal utilities often place greater emphasis on social goals than on efficiency, and approach these goals with more commitment than investor-owned utilities.¹⁹⁴ However, failure to pursue operational efficiency may endanger local ownership, creating the threat of takeover by a large investor-owned utility less sensitive to local needs. To determine the level of efficiency necessary for acceptable operation, and whether regulation is required, two kinds of efficiencies—managerial and economic—must be defined and distinguished.

1. *Managerial Efficiency*

Managerial efficiency measures management’s competence in utility operation, and is eventually reflected in service quality. The Pennsylvania study indicates that less efficient utilities failed to meet service standards more frequently than well-run utilities.¹⁹⁵

189. See E. CLEMENS, *ECONOMICS AND PUBLIC UTILITIES* 575–76 (1950). See *infra* note 216.

190. IND. CODE ANN. § 8–1.5–3–8 (Burns Supp. 1982).

Reluctance to increase rates is a problem unique to municipally owned utilities. The Cleveland City Council, for example, did not grant the city-owned municipal light plant a rate increase for over five and one-half years, despite high inflation and increasing costs. Plain Dealer, Mar. 9, 1982, at 10-A, col. 4.

191. A. CARRON & P. MACAVOY, *supra* note 14, at 6–14.

192. See J. BONBRIGHT, *PRINCIPLES OF UTILITY REGULATION* 109–20 (1961); Telly & Grove, *supra* note 11, at 275–82.

193. See R. SCHMALENSEE, *supra* note 165, at 13–20; Telly & Grove, *supra* note 11, at 282–84.

194. See *BENEFITS OF PUBLIC POWER*, *supra* note 42, at 12–13; Telly & Grove, *supra* note 11, at 282–87.

195. PENNSYLVANIA REPORT, *supra* note 15, at 5. The Bureau of Consumer Services noted that consistent patterns of noncompliance with service regulations indicate problems

Government ownership does not guarantee efficient operation of a utility,¹⁹⁶ especially if it shares funding, administration, and technical personnel with other government departments so that it has insufficient resources for self-policing. An audit by the Vermont Public Service Board compared operating efficiency of all publicly and privately owned utilities in Vermont and found that the "smaller municipal utilities have been excessively fragmented and insular, and their services and operations tend to be uneven in quantity and quality. . . ." ¹⁹⁷ The Vermont audit also noted that the status of the state's largest municipal electric utility as a city department impeded its financial planning.¹⁹⁸ Vermont's jurisdiction over municipal electric utilities enabled it to correct the budgeting deficiencies.¹⁹⁹

Municipally owned utilities charge lower rates than investor-owned utilities.²⁰⁰ The lower rates are made possible by advantages unique to municipal utilities—exemption from income and property taxes, availability of tax-exempt bond financing,²⁰¹ and access to cheaper fuels or wholesale electricity²⁰²—rather than by efficient management.²⁰³

The city's dual role as manager and regulator presents a seri-

in utility management. Some management shortcomings may prove equally damaging to the utility and its customers. For example, the Bureau concluded that a routine analysis of customer credit histories could have reduced "customer fraud or material misrepresentation." *Id.* at 11. One Pennsylvania utility's practice of failing to screen termination notices and place holds on accounts "reveal[ed] the possibility of ineffectual collection practices," and another utility's failure to adhere to stay procedures evidenced "a lack of coordination between customer services and the collection department." *Id.* at 22-23.

196. See R. SCHMALENSEE, *supra* note 165, at 96-97.

197. VERMONT AUDIT, *supra* note 171, at XI-3.

198. *Id.* at VIII-6, 7. The Vermont Public Service Board also found the utility's budgeting performance unacceptable by industry standards. *Id.* at 6.

199. See VT. STAT. ANN. tit. 30, § 2902 (1970).

200. BENEFITS OF PUBLIC POWER, *supra* note 42, at 8; Hamilton, *supra* note 13, at 223; see also A. PHILLIPS, *supra* note 36, at 575.

201. Richardson, *On Government Takeovers of Investor-Owned Electric Utilities*, PUB. UTIL. FORT., Nov. 4, 1976, at 19, 21, 24.

202. See Niagara Power Project, Pub. L. No. 85-159, 71 Stat. 401 (1957) (codified at 16 U.S.C. § 836(a)(1) (1976)) (giving power purchasing preference to public bodies and non-profit cooperatives in half the power generated by Niagara facility).

203. J. BONBRIGHT, *supra* note 192, at 405-06; M. GLAESER, *supra* note 37, at 582; R. SCHMALENSEE, *supra* note 165, at 94; Hamilton, *supra* note 13, at 223; Peltzman, *supra* note 162, at 135-36; Richardson, *supra* note 201, at 19.

There are "marked differences between the high taxes imposed upon the private utilities of this country and the relative freedom from taxes or tax equivalents enjoyed by the electric plants operating under Federal, state or local ownership. [This] tax situation [makes difficult] any fair comparison between private-plant and public-plant performance." J. BONBRIGHT, *supra* note 192, at 405. This tax advantage has been labeled illusory because

ous managerial dilemma from the consumer's perspective.²⁰⁴ The city as management is expected to remain impartial, yet it represents potential adversaries—the utility and its customers. Thus, the city as regulator has less incentive to apply the level of scrutiny of a disinterested state commission. When political pressure is added, the city's conflicting roles are further unbalanced.

2. *Economic Efficiency*

To provide public benefits consistently, a utility's operation and management should reflect externalities.²⁰⁵ Additional customer service costs arising from inadequate service by inefficient utilities exemplify an externality: the customer bears a cost which rightfully should be borne by the utility. State supervision of service by investor-owned utilities indicates that legislators believe utilities should bear the costs of their own inefficiencies. Exempting municipally owned utilities from state regulation should not be construed as legislative intent to excuse them from inter-

"[a]ny 'savings' [to the public] . . . would still have to be recouped by imposing higher . . . taxes on utility customers and other property owners." Richardson, *supra* note 201, at 22.

204. R. SCHMALENSEE, *supra* note 165, at 88:

[M]anagers of government enterprises, along with their controllers, are expected to serve as the agents of both equity capital and of buyers. This dual role is clearest in the case of those with oversight responsibilities, and it stems at least in part from their association with the equity-holding government. . . . [I]n the absence of effective control, the management of public corporations is called upon to be both "actor and judge." If one accepts the controller-manager dichotomy, at least in the abstract, it becomes clear that at least some of the questions that one might ask about regulated industries can also be asked about government enterprises. One might wonder, for instance, what goals controllers and managers are likely to pursue, and what the performance implications of alternative control structures are.

205. See Samuels, *supra* note 14, at 358–59. "Externalities" are costs or benefits which are not reflected in the price of a good or service. In this Note, "externality" refers to external costs imposed by one economic actor upon another, without inclusion by the former in his operating calculations. These external costs pose potential problems:

If [external costs are] . . . included in a utility's rates, the rates will generate revenues in excess of a reasonable revenue requirement. If external costs are ignored, a misallocation of resources will result because the *full* cost to society is not reflected in the price, and consequently, more energy is consumed than would be otherwise.

Note, *Reform of Electricity Pricing in the United States*, 25 BUFFALO L. REV. 183, 200 (1975) (emphasis in original, footnotes omitted).

An Environmental Protection Agency study of Kentucky, Illinois, Ohio, Pennsylvania, and West Virginia determined that "[s]tricter environmental controls on electric power plants could prevent 54,000 pollution-related deaths and avert billions of dollars in crop losses in the Ohio River Valley by the year 2000." N.Y. Times, Mar. 2, 1981, at A-12, col. 1. The environmental damage to farmers and other individuals residing outside the utility's service area represents an external cost of electricity production which should rightfully be borne by the producer as pollution control expenses.

nalizing service costs; rather, it may evidence a naive belief by legislators that municipalities will adequately account for externalities.

Municipal utilities assert that they are well-equipped to internalize social externalities,²⁰⁶ since they are generally nonprofit.²⁰⁷ Yet municipally owned utilities often have difficulty meeting operating costs because they are relatively small and run at less than optimal economies of scale²⁰⁸—factors which reduce their overall efficiency. The Public Service Commission of Wisconsin analyzed the operations of municipally owned electric companies and found that “operating revenue and expense ratios vary inversely with plant size.”²⁰⁹ This analysis also noted that large utilities have lower expense ratios than smaller utilities.²¹⁰ The Vermont Public Service Board found similar characteristics in its smaller municipal utilities.²¹¹ Without commission supervision to ensure that municipal utilities charge rates sufficient to cover costs and maintain service quality, customers are likely to bear the costs of inefficiency.

Because state regulatory bodies confront the same procedural,

206. See J. BONBRIGHT, *supra* note 192, at 109–20 (discussing social principles of ratemaking); Telly & Grove, *supra* note 11, at 276; see generally R. SCHMALENSEE, *supra* note 165, at 19 (social goals are best served by pursuing economic efficiency). Charging lower rates to charitable institutions is one “social principle of ratemaking” sometimes used by municipal electric utilities. J. BONBRIGHT, *supra* note 192, at 111.

207. Supporters of city ownership contend that municipal utilities are accountable to the local public rather than to shareholders. See, e.g., BENEFITS OF PUBLIC POWER, *supra* note 42. The lack of accountability to shareholders, however, may encourage self-defeating strategies such as lowering rates below cost needs, which could thwart social goals or disrupt managerial efficiency. See Richardson, *supra* note 201, at 25.

208. Economies of scale cause long-run average costs to decline as output is increased. Since electric utilities are natural monopolies, direct competition creates diseconomies which appear as ruinous competition and unnecessary duplication of resources. Optimal economies of scale in such a market are reached by large scale producers which benefit from declining average production costs. Average production costs generally bear an inverse relationship to utility size. See J. BONBRIGHT, *supra* note 192, at 11–17; R. SCHMALENSEE, *supra* note 165, at 3–5.

While one commentator assumes that tax advantages, freedom from regulation, and superior management ensure more efficient operation of municipal utilities, see Neuberg, *supra* note 3, at 320–21, another asserts that municipal utilities are inherently less efficient because of size, political impact, and the absence (in most cases) of the profit motive that characterizes investor-owned utilities, see Peltzman, *supra* note 162, at 145–46.

209. PUBLIC SERVICE COMMISSION OF WISCONSIN, ANALYSIS OF 1980 OPERATIONS—MUNICIPAL ELECTRIC UTILITIES IN WISCONSIN ii (1981) (on file with the *Case Western Reserve Law Review*).

210. *Id.* at ii-iii. Distribution expenses are raised by a greater concentration of customers per mile. *Id.*

211. VERMONT AUDIT, *supra* note 171, *passim*.

political, and efficiency problems in the context of regulating private utilities, they have the expertise to treat these problems in the context of municipal utility regulation. State regulation ensures utility compliance with and accountability for service standards, obviating court intervention to impose procedural fairness.²¹² State commission regulation offers greater objectivity than municipal supervision by virtue of its relative insulation from local politics and interest groups.²¹³ Local control tends to place political expediency above the public interest. As one commentator observed, "The more numerous consumers were not found to be consistently favored by government-owned utilities."²¹⁴

In terms of managerial efficiency, public utility commissions provide objective decisionmaking, in contrast to the often self-serving decisionmaking by city-owned and regulated utilities. State commissions recommend improvements, as in Vermont;²¹⁵ protect consumers from overcharges, as in Wisconsin;²¹⁶ and police for rates set too low to provide adequate service, as in Indiana.²¹⁷

IV. CONCLUSION

The problems arising from exempting municipal electric utilities from state commission supervision²¹⁸ suggest that regulation would better serve the public interest. State commission regulation offers consumers more coherent, meaningful complaint and service procedures,²¹⁹ and holds municipal utilities accountable for minimum service standards.²²⁰ Nor are state proceedings as susceptible to conflicts of interest and political manipulation.²²¹

212. See, e.g., *Memphis Light*, 436 U.S. 1 (1978); *supra* notes 99-116 and accompanying text.

213. Peltzman, *supra* note 162, at 145; see *supra* notes 182-91 and accompanying text.

214. Peltzman, *supra* note 162, at 145.

215. See *supra* note 171.

216. Municipally owned utilities were brought within commission jurisdiction in Wisconsin to prevent them from charging excessive rates to enhance city revenues. See E. CLEMENS, *supra* note 189, at 575-76; WIS. STAT. ANN. § 196.01 (West Supp. 1982).

217. IND. CODE ANN. § 8-1.5-3-8 (Burns Supp. 1982).

218. See *supra* notes 162-217 and accompanying text.

219. See *supra* notes 168-81 and accompanying text.

220. The PENNSYLVANIA REPORT, *supra* note 15, at 13, indicates that prior to the establishment of service standards for regulated utilities, service was often terminated in a "callous and cavalier fashion," usually with little or no notice. Although the Report addressed only investor-owned utilities, unregulated municipal utilities show similar disregard for procedural fairness, as indicated by the facts of *Memphis Light*. See *supra* notes 90-94 and accompanying text.

221. See *supra* notes 182-91 and accompanying text.

Commission ratemaking procedures protect consumers from overcharge²²² and permit municipally owned utilities to earn adequate revenues.²²³

States which regulate municipal utility rates have decided that commission supervision better protects the public interest than local self-determination. Wisconsin initiated commission regulation of municipal utilities to protect customers from excessive pricing by city government.²²⁴ Regulation in Indiana ensures that timid municipal governments will not provide inadequate funding for utility operations.²²⁵ A Vermont audit offered insightful suggestions as to how the state's municipal utilities could improve operations.²²⁶ Adopting innovative ratemaking procedures which minimize regulatory lag²²⁷ has increased the profitability of municipal utilities in New Mexico.²²⁸

The decision to regulate municipally owned utilities requires weighing the policies supporting regulation against the traditional justifications for exemption. In short, natural monopolies are regulated in the public interest to protect consumers in a captive market;²²⁹ exemption is supported by the belief that government ownership preserves local autonomy and effectively substitutes for regulation.²³⁰ Because the utility industry is constantly changing, legislatures must frequently balance these competing policies and decide which approach best serves the needs of their citizens. In-

222. See *supra* note 189 and accompanying text.

223. See Peltzman, *supra* note 162, at 109; Richardson, *supra* note 201, at 26; *supra* notes 182-89 and accompanying text.

224. See *supra* note 189 and accompanying text.

225. See *supra* note 217 and accompanying text.

226. VERMONT AUDIT, *supra* note 171, *passim*.

227. Regulatory lag occurs when "constraints of government management by operating rules introduce lags in the response of government firm prices to their economic determinants . . ." Peltzman, *supra* note 162, at 140. New ratemaking techniques reduce the effect of the lag between requests for and receipt of new rates. See Catalano, *Customer Costs*, PUB. UTIL. FORT., Dec. 17, 1981, at 59.

228. New Mexico adopted rate price indexing for municipally owned as well as privately owned utilities. Price indexing

provides for automatic, quarterly adjustments in base service rates in response to net increases and decreases in the company's actual book costs for furnishing jurisdictional service. It is hoped and anticipated that the method will promote incentives to serve the public and achieve equality between unit service rates and unit service costs and, thus, the conditions which competition in the furnishing of such services would achieve if permitted to do so.

In re Public Serv. Co., 8 Pub. Util. Rep. 4th (PUR) 113, 136-37 (N.M. Pub. Serv. Comm'n, 1975) (emphasis in original).

229. See *supra* notes 25, 29-30.

230. See *supra* notes 11-12 and accompanying text.

clusion of municipally owned electric utilities in state public utility commission jurisdiction provides a practical solution to procedural inadequacies,²³¹ political disruption,²³² and inefficiency.²³³

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231. *See supra* notes 168-81 and accompanying text.

232. *See supra* notes 182-91 and accompanying text.

233. *See supra* notes 192-211 and accompanying text.

